Pabrai Investment Funds
2011 Annual Meeting Transcript

Note: This is the transcript of the September 10, 2011 meeting held in Rosemont, Illinois and September 17, 2011 meeting held in Huntington Beach, California. Mohnish's presentation style is extemporaneous; hence, there were some differences in the two presentations. Transcripts of both meetings were merged to produce this single document. The transcript has been edited for readability.

The transcript should be read in conjunction with the Annual Meeting presentation slides handy. They can be accessed at: http://www.pabraifunds.com/website/2011_PIF_AM_Slides.pdf.

Slides 1-2:

Thank you for coming. It's always wonderful to see the turnout on a Saturday afternoon because there are so many other ways to spend your time. I always enjoy the annual meetings because I learn a lot in the process. Our format is pretty much the same each year. I'll go through a presentation and try to move along as quickly as I can. The part that I enjoy more, and probably most of you might enjoy more, is the Q&A.

Slides 3-6:

We have three funds, and PIF2 is our oldest fund. It started as PIF1 in 1999 and then it rolled into PIF2. It is more than 12 years old now. Since 2000, it's averaged about a 17% return annualized, after fees, and has done quite well. $100,000 invested in 2000 would be worth $554,000. If you invested $100,000 right at the beginning (and there are a few folks in the room who did that) then it would be worth about $777,000 today.

PIF2 has done vastly better than the Dow - 15 points/year better. I always like to look at how we've done over one year, three years, five years, and since the funds have been around. I focus on the numbers towards the right. Of course, for the life of the fund we've done very well, 18.5% versus 3%, and for the five year number we've beaten two out of three indices. NASDAQ is slightly ahead, which is something I don't like, but I hope that will get fixed.

Slides 7-10:

PIF 3 is our offshore fund for non-US investors. It's also the fund where we have all our IRAs, foundations and endowments. If it were up to me, I would have one pool of capital in one fund, but the laws require us to segregate these different pools. PIF3 has been around since 2002. It's averaged about 13% a year and it's also done much better than the indices. The best index, which is the Dow, has performed a little below 5% over that same period. For PIF3, if you look at the numbers for the one year, three years and the life of the fund,

our numbers are much better than the index. The five year numbers are trailing one of the indices very slightly.

Slides 11-14:

Fund 4 is a fund for US qualified investors, and Fund 2 is for US accredited investors. PIF4 has been around since 2003, so there is about eight years of history and it's averaged about 9%. PIF4 has also done better than the index, about 9% vs. the index at 7%. Again, the one year, three year, and life of the fund for our numbers are better than the indices. The five year numbers are slightly below one of the indices.

Slide 15:

We have about $580 million under management. This is looking at a snapshot of all the published numbers of the fund which is PIF2 and PIF4 until June 30th and PIF3 until July 31st. If you look at it towards the end of August, it would be around 5% or so less than that.

Slide 16:

Folks are always interested in getting a little bit of update on what the funds have done since the end of June. If you look at the end of June year-to-date performance numbers, the funds have done between 0.6 and 2.4/1.9%.

Fund 3, which is our offshore fund, reports performance every month. The other two funds report performance every quarter and their holdings are very similar. Fund 3, for the year through the end of August, is down about 5.3% and if you look at the indices through the end of August, they are down between 2% to plus 2%. We are lagging the indices by somewhere between 3% and 7% for year-to-date. I don't fixate on the year-to-date numbers. I try to focus on longer term numbers. The good news is that with all the gyrations of volatility in the market generally, that's good for us, because we can put money to work.

Slide 17:

The other side of the coin about funds doing better than an index is they have to have very low expenses. Pabrai Funds probably has the lowest expense ratio of any mutual fund or hedge fund I'm aware of. PIF2's expenses are nine basis points which is less than 1/10 of 1%. PIF3 is six basis points and PIF4 is five basis points which is 1/20th of 1%. These are even lower than last year's, so they've gone even lower than where they were. They're probably the lowest expense ratios we've ever had.

Slide 18:

These are a couple of slides I always put on every year. It is an anomaly to be able to beat the index. John Bogel will say that 85% of money that's managed underperforms the index. Of the 15% that outperform the index there is a very small sliver of it, only 0.5%, 1 in 200 managers that outperforms the index by more than 3% a year consistently. Long term outperformance is a very small sliver and our goal is to beat the indices because if we don't beat the indices, you are better off just putting your money in an index fund. We want to beat the indices by a small margin and, for the most part, we've achieved that so far. I'm confident we'll continue to keep doing that.

Slide 19:

Pabrai Funds are closed, and at this time we are not taking any new money from existing investors or new investors. So this is not a sales pitch, but we don't charge any management fees. If we had a traditional hedge fund structure, a 2 and 20 structure, I would take in $10 million a year in fees, regardless of whatever happened to the performance.

My family is the largest investor in the funds, so we eat our own cooking. Our interests are fully aligned and we only get paid if we produce at least 6% a year, subject to high water marks. Our last high watermark was June 30th, 2007. We have to get 6% annualized above that before we collect a fee. We haven't collected a fee for the last four years or so which is, from my point of view, perfectly fine, because that's fair. We have no leverage, the funds have no derivatives, and we have no short positions. There are no loans or any kind of leverage on the funds, and it's a very stable group of investors. There are about 400 families around the world that have invested and it's a high IQ group of investors with many entrepreneurs and family offices. We also have some endowments and foundations in the fund and it's a long-term group. Generally, it's a group that "gets it" so we're happy to have a great set of investors.

Slide 20:

I always go through post mortems on past investments we've made. This time I'm going to talk about three companies. These are all companies that we no longer have a position in. I have to clarify this because in the past, I was asked if that's a stock tip and if people should go trade it, so, it's not a stock tip. We are already done, exited and have sold these positions off (though one of them might be getting interesting again).

The first one I want to talk about is International Coal Group (ICG), the second one is London Mining and the third one is a company called Terex, which is a competitor to Caterpillar and Komatsu.

Slides 21-22:

We held ICG for a little over a year. We first invested in it in the first quarter of 2010 and we were out of it by April 2011. We bought it at about $4.50 a share, and we sold it at about $10 and change. About two weeks after we sold the last of our shares, they announced that they were being bought out. We would have made another 30% on it if we had just held on with some kind of magical foresight for another two weeks, which we didn't do. We invested about $11 million in all 3 funds in ICG and we collected nearly $26 million. That's a 138% gain over a year. You can see towards the far right that ICG was bought by Arch Coal.

Slide 23:

ICG is a very interesting business because it was formed by Wilbur Ross. Wilbur is a dyed-in-the-wool value investor and he is an active value investor. He manages his companies and he had done a consolidation in the steel industry called International Steel Group many years ago. He bought mothballed, bankrupt US Steel Mills. Since he bought them out of bankruptcy, he was able to renegotiate all the labor contracts. They were all new, re-negotiated labor contracts and there were no legacy liabilities - those all went to the US government.

He was able to get those companies back to being profitable and stable. He injected some good management practices and some streamlining of their product lines and finally sold all of it to Mittal, which is now Arcelor Mittal. It was a nice home run for Wilbur, and was very good for the communities where those mills operated, because it brought employment back and revitalized those areas. It was, across the board, a win-win. He did the same thing with other industries. First he set up the International Steel Group, and then he set up the International Coal Group. He also set up something that I was never too fond of, the International Textile Group. I left the Textile group alone because it has some serious headwinds.

International Coal Group was interesting because they bought coal mines, mostly in Appalachia and some in the Illinois Basin. No legacy liabilities again, because they were bought out of bankruptcy. All the pension liabilities, everything, went away. He was good at forming very good relations with the labor pool that came back to work for him, and pushed innovated labor practices and compensation plans.

What got me excited about International Coal Group was that, traditionally, it was a thermal coal producer which is primarily used to generate power. They had long term contracts to deliver coal for power plants all over. They were beginning to mine and expand their metallurgical coal operations. There is a big difference between met coal and thermal coal. Metallurgical coal is used to produce steel and it is a choke point for industrial development. You can't build cities without steel. You can't create steel without having metallurgical coal. It is a choke point because about 70% or 80% of the seaborne metallurgical coal trade is controlled by four countries. Those countries have very solid lock on the industry. Canada, Brazil, Australia and, to a small extent, India have large metallurgical coal reserves. As a result, they do quite well with it and met coal has done well.

There is a huge divergence in the pricing between met coal and thermal coal, but there is not that much of a divergence once you have the resource to produce it. The fact that Wilbur Ross was going to be expanding into met coal put a very different spin on the kind of business it would be in a few years because met coal production has massively higher margins. Then in 2007, I noticed that a company in Canada, Fairfax, which we've owned for many years and are very astute value investors, had started to buy into ICG. They built up a substantial position at around $6 a share. The price collapsed for not very good reasons. We had a very good entry price and I liked the fact that Wilbur Ross was in there and I liked the fact that Prem Watsa of Fairfax was in there. We thought we would do well with that combo together.

Slide 24:

We had also invested in Teck Cominco which later became Teck. Teck had taught me a lot of things about coal and steel production. We had exited our Teck position in the first quarter of 2010, so it was fun to have an ability to play back into that sphere and make some more hay. Since all knowledge is cumulative, if we hadn't made the investment in Teck Cominco I may not have had the interest or even the understanding of what ICG was going to become.

One of the things about Pabrai Funds (and that's the reason I put up two of these ideas) is that we lifted these ideas from other investors. We lifted the International Coal idea from the Fairfax filings. We looked at the Fairfax financial 13F filings every quarter and noticed that they had the International Coal position. I looked at International Coal and saw that Wilbur Ross was in there and, of course, I was very familiar with Wilbur Ross and his adventures with International Steel Group. This led us to do a deep dive and reverse engineer. Why would Wilbur Ross be in the coal business? Why would Fairfax be so interested in investing in the coal business?

This whole notion of following other great investors and what they are doing is very fertile ground where we can do well. In fact there have been studies done where, for example, you buy what Warren Buffett buys after it is public that he's bought it, on the last day of the month that it is public and at a high price on the last day of the month. And then you sell it on the last day of the month when it is public that he no longer owns it, at the low price at the last day of the month that he doesn't own it. If you did this, you would end up beating the S&P by seven percentage points on average, long term.

So, if you just index, you are better than 85% of humanity, and then if you do what Warren does you can probably even fire me. The concept of following what the great investors do, just blindly doing what they are doing, reverse engineering it and then trying to take advantage of it is quite powerful. The US government helps you quite a bit because the SEC rules require filings. It requires us at Pabrai funds to file all our positions over a certain size every quarter, and the size threshold is pretty low on a 13F filing.

If you own over 5% you have to file. If you own over 10% you also have to file and these rules are global. Many other countries have filing thresholds that are even lower, so generally you can get a good sense of what folks are doing in various markets around the world. All you need to do is basically just sit there and reverse engineer whatever you can. If you can't reverse engineer, you can still leave it alone. That notion is quite powerful. Another reason why that approach works so well, from what I have found in my life so far, is that there is a quirk, some kind of a bug in the way human brains are configured after all these years of evolution, where humans don't like to copy. So, if you tell humans a good idea, they often don't follow it, which is quite bizarre. That's just the way we are. What I have learned to do is train myself to fight those natural urges and do what other smart humans are doing and it works out just fine.

The second company was an original one that I didn't lift from another investor. Once in a while we can do things on our own.

Slide 25:

Terex is a company that we bought in April 2009. The April 2009 time frame is interesting because the whole world was going to hell at that time. The Dow went to a multi-year low. We bought Terex at about $12 a share, and we sold it a couple of years later for about $37. We had invested about $6 million with a basket bet. We put about 2% of the portfolio in it because it correlated with a lot of other positions like Teck, as well as International Coal. We realized about $20 million over two years, which was a 206% return.

Slides 26-29:

What prompted me to get interested in Terex was simply the long term chart. Terex went from close to $100 a share to about $12 a share in a very short time frame. I had never heard of Terex before, I'd never even looked at it before. I thought if something has lost 85% of its value and it's got $7 billion in sales, it's worth looking at why that might be happening. I started to probe into what Terex did. It was an $8.7 billion market value company with sales of over $5 or $6 billion, and the market value got reduced to $700 million. It's a heavy equipment manufacturer for construction and surface mining. You're probably familiar with some of their brands. One of their brands is Genie. They make aerial lifts that people use to fix electric poles or clean office building windows. They compete with all kinds of companies like Caterpillar, Komatsu, etc.

Terex used to be part of GM and was spun out. It went through a whole bunch of different spin-ins and spin-outs and different types of acquisitions. This is a small player in a pretty large market. The reason why we made the investment in Teck Cominco, why we made the investment in International Coal and why we made the investment in Terex, is that there is a huge movement taking place in humanity from rural to urban. This will continue going on for several more decades and we will end up in the next two or three decades with more than 100 New Yorks getting built out around the world, mostly in Asia and Latin America. When you start thinking about building out 100 New Yorks, or even one New York, the critical components of doing that is you can't do it without iron and steel. When you have huge migrations of humans from rural areas to urban areas, generally, their caloric intake goes up, the protein consumption goes up, they eat better and are consuming a much wider range of commodities. It puts pressure on various things that the earth's crust has to provide and some of these things that it has put pressure on are choke points. So, in a world of gold miners, it is great to be the one selling pick axes. In a world where you have to build out all these cities, if you are the guy selling the shovels you are likely to do okay.

The notion was that it's not a bad idea to own a shovel maker. I liked the business because they were increasing their footprint in Asia, and they were very cheap from a number of different perspectives. The company had a very conservative balance sheet. They didn't have much debt, they had a solid cash position, and in a few months, they sold just their mining business, which is a very small part of the Terex portfolio, to a company called Bucyrus for $1.3 billion. When we bought it, the market cap was $700 million. By early 2011 they had nearly a billion in cash. We had in two years, more than a 200% return. Now it didn't look like such a no-brainer to be invested in it because the business was starting to get overvalued. So we decided to exit and the

interesting thing is that in this case, we were right on because right after we exited, Terex came down, all the way to $13 recently.

Now it's time to take another look at Terex and maybe see if we want to do a round trip on it again. I'm digging into it because it's a little bit of a different business. They've done a large acquisition in Europe. They've diversified their mining business so I just have to see what the pieces look like now versus before. That's our journey with Terex.

Slides 30-33:

The last business I wanted to talk about today is this very obscure company called London Mining. Of course, we'd never heard of London Mining, so we were lifting ideas from other portfolios. (It's a good idea to lift ideas from other portfolios.) We bought London Mining for the first time in December 2008 for $1.26 share. We sold it just recently, all of it for about $6.30 on average. We had invested about $5 million at the peak of the financial crisis. My problem was everyone was pulling cash from Pabrai Funds and we had a huge basket of great ideas to invest, and London Mining was one of them. We made a basket bet because it was in the metallurgical coal space and in the iron ore space - mainly in the iron ore space which was interesting for us. There was a 360% return over about two and a half years.

If you look at the chart for London mining, you see a big drop. That drop happened because they issued a large dividend to shareholders. It wasn't the stock price dropping for any kind of distress reason. They had a very successful exit of one of their projects and they had a huge amount of cash in the balance sheet so they decided to push it out to shareholders. When they pushed that cash out, the stock price dropped to reflect the fact that the cash had left and that's when we got interested in investing.

We got interested in investing because one of the investors I looked at (like we had looked at Wilbur Ross) was the portfolio of a guy in San Francisco called John Burbank. He runs Passport Capital. They have about $5 billion under management and John is an interesting guy. He used to teach English in China right after college and then he bounced around doing a few other things. He finally ended up at Passport Capital and he has a very interesting take on the world. He does what I would call thematic investing. He comes up with broad-based macro themes and after he has high conviction of those themes, he will invest in a wide range of ideas based on that theme. One of his big themes is to go long what China is short. For example if you look at our Teck Cominco investment that's what we did. Basically China wants to build out all these cities, and you cannot build cities without iron and steel. Iron and steel have choke points because they need to import it from Australia, Brazil and Canada. Those

three countries pretty much control the build out of Chinese cities. If you can find the right asset at the right price in those countries you do well.

When I was looking at Passport's portfolio, which is a fun exercise to look at, I noticed that there was a company which I'd never heard of before called London Mining. They owned about 13% of the company, which was pretty sizable. I started to drill down on London Mining and what I found is that this was a company with $146 million dollar market cap, no debt and $300 million of cash. We didn't need more than a 50 IQ to make the investment. They were purely focused on metallurgical coal and iron ore which are two words that I happen to love.

The seaborne trade is controlled and the weird thing about London Mining is that they had these very early stage mining projects in what I would call very difficult geographies and places that most of us are unlikely to visit, like Columbia, Sierra Leone and Greenland. They're mining iron ore in Greenland, they're getting these tailwinds from old iron ore projects in Sierra Leone and they have a lot of issues with the politics and the permitting. But when I looked at the whole equation of their balance sheet, the excess cash and also what they were going to commit into the projects, it looked like there was a low probability of having a loss of capital. In many ways, London Mining was a black box because I could not get a lot of detail on how those specific projects would play out. In fact, after nearly three years of owning the stock, I still have the same obscurity that I had when we made the investment. I still don't have a lot of details of those projects and nuances but now what had happened is the stock had gone up about four or five times and it was no longer net-net.

They had made progress on some of these projects, and they had had some issues on some other projects, but overall the company was doing fairly well. We said okay now we can take our chips off the table. It may well be that we sold too early which is fine, I have no issues with that, I've done that many times before. A lot of these projects are pretty early stage but they have massive production growth coming in the future, if you believe everything that they're telling you. I have no margin of safety if I believe everything they're telling me, so we decided to just move on. The business was a black box and still is a black box. I liked the net-net nature of the business where you could liquidate the business that you've invested in and double your money. We made a basket bet and made a decent return on the business.

Slide 34:

I'd like to talk a little bit about our current portfolio composition. I normally don't talk much about what we own presently but there are some interesting nuances. I won't go into names, we're not in the stock tip business, but I've

found that markets are unlikely to be inefficient as you go into larger cap businesses because there are just more analysts and more people focused on them. For example, you're not going to find IBM as a net-net anytime soon, trading below cash.

But what I find interesting is at Pabrai Funds more than 45% of our assets are in six companies, each of which have a market cap of over $5 billion and four of those six companies have a market cap over $45 billion. They're large and that's very unusual because that has not been the case in the past. It's not the case that we decided that we want to invest in large caps. What happened is we found that those were some of the cheapest businesses that I could find to invest in. One of the unusual things is that there's plenty of value in these large cap businesses today. We haven't had this sort of mix of businesses in any of the last 12 years we've run the fund.

Also, the second thing about the portfolio today is we've always had some non-US exposure. I would say we're in a pretty healthy amount but this must be an all time high in terms of the amount of either revenues or assets. Either the entire companies are overseas or a large portion of their revenues are overseas. I'll give you one example - we own a stake in a Canadian company called Brookfield Properties. It shows up in our 13F filings. Brookfield Properties is based in Toronto. They're into owning class A office buildings in major cities. Historically, the business was focused on Canada and the US, and they went into these core geographies. What I like about Brookfield Property's philosophy is they very much believe in being right at the center.

The classic notion of "location, location, location" for Brookfield is absolutely sacrosanct. They want to own real estate, for example, in Manhattan in the most prime areas. Or in areas they think are being overlooked. For example, they have huge investments in downtown Manhattan which will come up in the next few years, and pretty decent investments in midtown. They've done it at times when people weren't that interested in those areas, so they typically want to have absolutely prime properties bought at times when they're available at a good price. Historically, the company had properties in Canada and the US and invested in two types of cities. They were either in what I would call resource centered cities, like Houston for example, which is driven by oil, or Calgary, again driven by the natural resources. But recently, they expanded quite significantly into Australia. They own very prime office space in Perth and if you look at their Australian investment or even their Western Canada investments, those might appear to be in Australia or in Canada but they're driven by China.

Brookfield has no assets in China but it is a beneficiary of what goes on there. Brookfield is a big company where there were a significant amount of assets in the US in places like New York and Washington. When I look at the whole

portfolio now, Brookfield has only 40% now in the US and about 60% outside the US. That number is going to get more and more attenuated over time. When you look at these companies in a portfolio, I'm estimating about 55% to 60% of either the revenues, assets or both are sitting outside the US, or they're being driven by things that are outside the US. Again, that is not by design, it just happens to be where we found our value.

Slides 35-36:

These are a couple of nuances about the portfolio. We also were happy to have about 25% of our total portfolio in cash as the market started to get tumultuous. It was nice to have plenty of dry powder to do a few things. We don't have 25% cash today, it's less than that, but we still have plenty of dry powder. Another change for us, is that until a year ago I had never in my life invested in a Japanese company. Now we have more than 10% of the portfolio invested in Japan. I'm quite excited about our Japanese investment. It is the cheapest market in the world.

It is quite interesting to look at this Japanese basket. We have invested about $58 million so far into Japan. We are still buying everyday and the Nikkei has dropped about 15% since we started buying. Our basket is up about 11 or 12%. Over the last year, that $60 million was an average of about $30 million invested because it took time. We were able to put about $5 million a month into Japan. On our $30 million investment, we've already had a return, mostly unrealized, of about 20% odd percent or $6 or $7 million. And that's in the face of an index that's gone down significantly. These are businesses that are trading at a pretty wide discount and we expect to do well with this. But it is different than what we had in the past and I just want to throw this chart out for you about Japan which I find extremely interesting.

If you look at the Nikkei, currently it's under 8,700 and it was at this level about 30 years ago. Of course, it went from 8,700 to about 40,000 and then proceeded to come down to 8,700 with a lot of gyrations up and down over that period. But to think about an index that is at the same level it was 30 years ago is quite stunning. We've seen that happen in the past in the US. The Dow used to be at about 850 in 1965 and it was at about 850 in 1982. We went through a 17 year period in the US where the Dow did not move even though the US economy over that period did okay. Then from 1982 to 1999 the Dow went from about 850 to 14,000. It did extremely well and it over shot. You had companies like Coca-Cola and GE trading at 30-40 times earnings and of course it's done nothing since then. If you look at the Dow from 1999 to 2011 it's flat or down. It will probably stay there until 2016 because there is poetry in markets. The next 17 years from 1999 takes us to 2016. Now it may not be exactly that but, 17 years is kind of interesting. The human brain has all kinds of bugs in it and

one of those bugs is that we have kind of limited memories. Usually about 17 years is what it takes for the last kind of major hits in the market to be washed out from people's memories and they walk back in.

The Nikkei is sitting right now at the same point as it was sitting in April of 2009. April of 2009 was when the Dow was at about 7,000 and we've come back from there, but the Nikkei hasn't. It is sitting right where it was. Even in the last two and half years, even though Japan is nowhere near the precipice it was in 2009 like the way the world was, it hasn't moved. One of the things that comes up with these 17 year cycles and why these 17 year cycles exist is, let's say you have a company that trades at 15 times earnings. They make a $100 million a year, have a market cap of one and a half billion. Let's say that market cap doesn't move for the next 15 years but they keep producing $100 million a year after tax. They would have one and a half billion in cash after 15 years. The market capital would be one and a half billion and they would still be producing $100 million a year and that type of equation suddenly makes people look at it. They start investing in it and of course that would make the price go up. That's why you see that these cycles don't last as long. If you go for 30 years on a company that was trading at 15 times earnings and you don't move at all for 30 years, what's going to happen is that you will have a business which has a market cap of one and a half billion. And it has three billion of cash because they will be producing, assuming they didn't blow it up in crazy ways. So they've got three billion of cash, one and a half billion market cap and 100 million in earnings. That is the situation we find in these Japanese companies.

Our basket contains a lot of Japanese net-nets which means the companies have more cash. They can be liquidated today and you don't even care about the going concern value of the business or a greater value than the marketed price for the whole business, and there are quite a few of those.

We started investing in Japan before the tsunami. We've invested right through the day before the tsunami, and the day after the tsunami we just continued. Our investing just continued unabated and the index has dropped about 15% from about a year ago when we started investing. As I look at it today, we are up a little over 10% on the Japanese positions, so the delta versus the index is almost 25%. It's a pretty significant delta which I would expect because we are pretty much scraping this bottom.

Because I'm in such a generous mood, I decided I might as well give the great good folks here a stock tip. This is a company that I have buy orders out to execute on Monday and on Tuesday and Wednesday unless you guys drive it crazy. In that case there will be unfilled buy orders on Monday. I want to give a real example of what we're doing. Taisei Oncho which is a regular household name, was founded in 1941 and is a designer and manufacturer of air

conditioning and plumbing equipment. It has a $59 million dollar market cap, in US dollar numbers.

It has about a 4% dividend yield. If you take all the cash, short term, and long term bonds they have, subtract out unearned revenue (because they get some stuff in advance from customers), then subtract all the debt (they have hardly any debt), you end up with $114 million. I'm not even including accounts receivable. If you take accounts receivable minus accounts payable, that will give you another few million dollars. If you take inventory, that will give some more money. If you start looking at all the things they have, what you end up with is the stock price at $4 and change and the tangible book value is about $17.

Slide 37:

Okay so mirror, mirror on the wall… The last 12 months revenue is $536 million, the last 12 months net income is $6.1 million. The $6.1 million is not it, basically their depreciation is about $2 million and their cap-x is $0.8 million, so it's producing about, say about $7 million. Since 2006 they have been profitable. In fact since 1992, they've produced between $400 and $700 million in revenues. The revenues are very stable and we've been buying every share available. I'd love to meet the guy on the other end selling us the shares. We've been buying every share being offered to us since December of last year and we own 1.4% of the company. You own some part of it as well which is good. That's an example and we have about 30 or 40 of these which comprises our $60 million dollar Japanese portfolio. I'm continuing to buy because I don't find too many other things that are more interesting than this.

This is just an example of kind of what we're doing in Japan. The reason I wanted to share this is that we have 45% in the large cap space, we have 10% and growing in Japan, and we have 55 to 65% outside the US. We have dry powder in cash, and we have plenty of things in the portfolio. We have one investment in China but we have a lot of things that benefit from what happens in India, China and Latin America, even though we don't have direct investments in those places and we have very little exposure now.

Slide 38:

That's the snapshot of where we're at and the cross-section of the weird things we've invested in in the past. We've gone into a number of different industries, a number of different kinds of countries, market caps and different types of businesses sometimes even bought debt and so on. Some of them have not worked, we've lost money on plenty of businesses, but overall, it's been a good batting average and it's worked out well.

Slide 39:

We have a few folks here so I'd like to just recognize them. Conyers Dill & Pearman is our general council in the British Virgin Island and they just like to hang out on the islands so they're not here. Michael Liccar - Bob Sempsey is here and Tony is here. Bob and Tony do our accounting and tax work. We have got quite a few folks from Morgan Stanley. Ajay is here, and some other members from your team.

Can you stand up? All the Morgan Stanley folks? Okay, well thank you and are our Japan trades in for Monday? Alright just checking. Mike Froy from SNR Denton which used to be Sonnenschein is here. Nadim isn't here because Sonnenschein just merged the large law firm in the UK and now he spends a lot of time in Asia. They've got a lot of stuff going in all kinds of interesting geographies - Uzbekistan and Kazakhstan and so on.

Pricewaterhouse does our audits and Folio Group is our administrator in the BVI for the offshore group.

Slide 40:

This is the Irvine team all in blue so we're color coordinated. From left to right, is our Office Manager, Julie, then Nikki, most of you've probably spoken or emailed with and then Jeneva is in the center, Lynn and then me. We have a rough life hanging out in Southern California.

Slide 41:

We're ready for questions and we have a couple of microphones so we'll just go back and forth.

Q&A

Q: In the annual report I noticed that there were two investments that parallel Buffetts Berkshire Hathaway and I'm not sure if you mentioned these or not - BYD and Goldman.

A: They are in the annual report right?

Q: In the annual report.

A: Like we mentioned, we have no original ideas.

Q: Okay, but those two ideas have not being doing well recently. Are they still in the portfolio or …?

A: Well, we can't talk about whether it's in the portfolio or not, but the next filing will come out and the next group of annual reports will come out at the end of the year so you can take a look at that. Goldman, whether we own it or not will be visible to you in the mid November timeframe. BYD will be visible to you in the February-March timeframe when our audit report comes out.

Q: My name is Cathy, I'm from St. Petersburg, Florida and I swear I'm only asking one question but I'm going to explain while I'm asking. Why wouldn't you invest in Bank of America, specifically the warrants and the leads. The reason why I'm asking is because in one of Joel Greenblatt's books, he mentioned a Wells Fargo investment back in the 90's and he got the idea from Bruce Berkowitz. Subsequently Warren Buffett made a purchase of Wells Fargo and they made a lot of money off of that investment. Recently Berkowitz had said that his investment in Bank of America reminded him of his Wells Fargo investment and after Buffett disclosed his Bank of America investment he said it reminded him of his American Express investment so…?

A: That's a good question; do you own Bank of America?

Q: I most certainly do.

A: Now do you own the warrants or the stock?

Q: I have the warrants.

A: Alright, that is pretty smart.

Q: Thank you.

A: We have no original ideas. We are constantly scavenging so maybe we have bought it maybe we are going to buy it, but we are certainly tuned in.

Q: I am Sean Riley from Indianapolis, Indiana and I had a question relating to what is going on now related to an investment you made in the last decade. Given your investment in Frontline in 2003, 2004, is there any reason you would be tempted to invest in just the overall shipping industry? What are you thinking right now? What is going on?

A: That is a good question and yes, the shipping industry has been going through some distressed times recently and we made a decent amount of money in the industry in the past. We now have some level of competence and an understanding of the industry. We looked at it a few times in the last couple of years and more recently as well. We haven't invested anything in that space and I will give some reasons (if I can turn to professor for about five minutes on shipping). Let me just talk about real estate and then I will tie it to shipping.

If you talk to people who construct these big office towers, typically those projects take three to four years from the time they are conceived to the time there are tenants moving in. Sometimes it takes longer, like ground zero, Freedom Tower - 10 years and it is still under construction. So it takes a long time. These guys in real estate are either eternal pessimists or eternal optimists. When occupancy gets tight, all of them at the same time tend to start building a bunch of towers. Then all those towers come on the market in the four years (at the same time) and rents collapse. All of them go bankrupt and the banks end up holding all these towers and other people buy them and so on.

The same cycle repeats after a few years and again the occupancy gets used up, and it gets tight, and again they overbuild. You have this boom and bust cycle that happens in these large office towers because of the 3 or 4 year time scale for building them.

If you look at the warehouse market in the US, there are big square blocks all over that Wal-Mart and Costco and other businesses use for distribution. Those tend to take six to nine months to put up from the time you start to finish. You tend to not have as attenuated boom and bust cycles on those as you have in the office towers because the time frames are very tightly shrunk.

In the shipping business, the analogy is that when you look at the VLCC (the Very Large Crude Carriers) those have a three or four year production time window and so they are like the office towers. The only difference is that the highly exuberant Greeks who operate in that market are just like the real estate

guys on steroids. What the real estate guys do, the Greek guys do to the power of 10. They are way more exuberant and way more depressed than the real estate guys are.

You tend to have a more extreme kind of behavior take place. Also, the Korean ship yards or the Japanese ship yards have this very bizarre habit of taking in orders with hardly any deposits when times are good. The Greek guys get boat loads of orders flooding into the ship yards with very little money put up. Then they decide to renege on them. Now the shipyards are getting a little smarter about taking more cash up front. Basically what happens is that VLCC market tends to have this boom and bust like real estate but it happens more intensely because of all the Greek players involved.

The dry bulk carriers, which are the ships that are used for transporting coal, iron ore and corn, tend to have a much shorter time frame for construction - six to nine or ten month time frames. Those order books tend to be like the warehouses and you don't see as much of a boom or bust. You still see it quite a bit because again you've got the Greek guys operating there as well. The VLCC market is of more interest for me than the dry bulk market because of this nuance. You will tend to get more crazy behavior, but nothing that I have seen so far comes anywhere close to the dynamics that we had in 2003 with Frontline.

Frontline is a Norwegian company which had a large number of VLCC's. They had almost the entire fleet on sport charter. You want a company which has a large fleet which is almost all on sport charters. This means that their revenues can gyrate quite extremely based on what's happening in the market. Frontline had the sport charter fleet, and extra space rates had collapsed way below break even on these ships so they were not making any money on the ships. At that time there was another nuance between single hull and double hull carriers. After the Exxon Valdes, the shipping laws were changed where they eventually required all the ships that carried oil to be double hull. Over time the single hull ships were being phased out. This was happening in the 2002, 2003 time frame and the single hull ships that existed were mainly used to carry crude to places like India and China where if there is a spill, nobody cares. All the double hulled ships would come to Europe and the US. That is how they segregated those markets out.

But what happened in 2003 when rates collapsed is the single hulled ships stopped being rented. Even the Indian importers of oil and the Chinese importers all switched to double hull because the delta was so tiny. The single hulled ships stopped being rented and they all started on an accelerated basis to be scrapped. The dynamic we had at that time was that Frontline was a situation where the value of the ship was about $70 million in normal times. They had very smartly financed all their ships with non-recourse financing. With

Frontline you could look at a liquidation of the company, and I could see the value of the ships.

The value of the ships had not dropped much. It had gone from $70 million to $60 million or so. But when I looked at the Frontline stock price, and translated it into value of the ships, it was pricing the ships at about $15 million apiece. There was a massive difference from the public market's pricing of the ships because the public markets were pricing the stock based on cash flow which was non-existent. They were not looking at the assets. There was a gap where the company was conservatively financed. They could sell one ship after another because they were all non-recourse ships. Each time they sold a ship they would generate a whole bunch of cash. That dynamic is very interesting to me but I have not found it in this cycle. We looked quite a bit for the last 2 years. I looked to try and replicate because then I don't have to think much. But we couldn't replicate.

Q: Michael Rosenbaum from Arlington Heights. As I was looking at the examples you were giving of the investments you had made, they seem to be relatively small dollar investments relative to the total amount of the funds in total. I was wondering how big an investment has to be to move the needle or are you really making very relatively small investments in the recent market environment?

A: Many of those investments were made at a point where the funds were down more than 60%. We have $500 million under management now. When those investments were being made, the total investments under management was under $200 million - about $180, $190 million. All three of the investments were in one way or another related to a commodity space. I made a whole bunch of investments in the commodity space in the fourth quarter of 2009, and the first quarter of 2010. Even though they were separate investments, I thought of them as a pool because they would all act the same way. For example, if China stopped building cities they would all have an issue.

We maxed the position size for each one of those at two percent of the portfolio. 2% of the portfolio at that time was less than $4 million. If you look at London Mining, that's approximately what we invested, about $4 million. Then things started to get a little bit better. We started to get to $300 and $400 and $500 million under management. Now if we were to make a basket bet, for example the same bets, they would be at about $10 million - $10-12 million each which is about 2%. What we have done to position sizing is if a normal position for us is 5% and I'm managing over $600 million, it will be about a $30 million position.

Our Japanese bet is an unusual bet, because we haven't done this type of bet before. I think of that entire group as a single block because we know very little

about the businesses, but we know they are all very cheap. I initially allocated 10% to that block and I'm probably going to be willing to take it up to about 20% if those valuations persist and we can buy. I'm not sure we can ever even get it up to 20%, we'll see. We may end up with $100 million or $120 million eventually in Japan on a cost basis. Typically the companies we were buying in October, November, December last year are no longer at prices that we can buy them at. They were cheap at that time. Many of these things have gone up 50%, 70% or 80%. We are no longer buying them. It shifts - even though we buy Japanese stocks every day, almost every week the names we are buying tend to move around.

Typically, for a normal bet we would be putting 5% of assets. If we were bullish and saw limited downside, we would take some positions up to 10%. Originally, we used to be 10 positions at 10% so now a 10% position becomes an anomaly. A 5% position becomes typical and then if we have these correlated type bets going on, then they become smaller.

Q: I see you have a large amount of capital in Potash. In particular I wanted to know, 1) how you value that equity, and 2) what do you think about the risk at Potash … the fertilizer prices being up 25% this year and up significantly from their lows?

A: I would suggest you defer that question until Potash is no longer in the portfolio because we don't discuss current portfolio positions. Do you want to ask another one?

Q: Can I ask another question?

A: Yes, go ahead.

Q: Is there a concern that more commodity will come on the market when you make investments in commodity businesses, and prices for commodities are increasing? And what's the barrier to entry in that investment?

A: My take is that commodity businesses are not always what the name implies. They are not always commodities in the sense that each one has its own nuance. The key thing when investing in commodities is where they are on the cost curve. I don't have a slide but if you think about iron ore being sold at $100 a ton, there will be some mines, maybe in the first quartile, that are producing it at $10 a ton. 25% of all popular production may be at $10 or $15 a ton, and then the next 25% at $30, $40 a ton and the third quartile may be at $60, $70 a ton and the fourth quartile may just be $80, $90 a ton making just a little bit of money.

If a company is in the first or even second quartile and prices drop, the higher price stuff will be mothballed. Those mines will close. In fact, we saw that in 2008, when a lot of the high priced mines were shut down. But the low priced mines have no impact on production and they want to continue producing because they are still very profitable. The key thing in commodity is 1) to look at the cost curve and where the company is on the cost curve. Which quartile is it in? 2) look at what would be the valuation or the multiple of that business if the price came down and how much it would drop as it came down. You can tell all of that by looking at the cost curves. This is the same way that you would look at, for example an oil company or natural gas companies. It's all about the cross curves. If there is a natural gas company producing at $5 in MCF and there is another one producing at $3 in MCF, those are two very different businesses. A $3 MCF natural gas company can be an incredible business if it's trading at a multiple that would make sense if natural gas is at $4 for example.

Q: Alan Parsow from Elkhorn, Nebraska. Let's say tomorrow you find an investment that you want to put 5% of your portfolio in and you are lucky enough to have that quadrupled. At the same time your fund assets may be up 20%, so the percentage of that single investment goes up. At what point do you limit the size or position in your portfolio?

A: So far, in the last twelve years, we've never trimmed a position for that reason alone - because it got too large. In fact, for most of the first nine or ten years, we were running very concentrated, typically ten positions, each one at 10%. Now, we are less concentrated, so it's less of an issue. For example, let's say we are managing $100 million, and we invested $5 million. If that position goes to $20 million and the portfolio has gone up by 20%, we are now at one sixth of the portfolio. We would not be trimming if something is at one sixth of the portfolio just for that reason alone.

Q: So when you got to 20%, what did you say?

A: That wouldn't be the reason alone to trim. What I would be more interested in looking at is, what is the discount to intrinsic value? What are the coalitions of other parts of the portfolio and do I have a concern? For example, you get two different types of companies. There are some companies like in our Japanese positions, where they'd be long gone before a 4x because what we know about them is every limited. But let's take a company that we know very well, Fairfax. Fairfax is a company that we can evaluate on a number of metrics. We can evaluate on book value; we can evaluate a number of different ways. We'd be looking at some of those metrics to see how or where it sits relative to intrinsic value, and if it looks in any way faulty, we'll be done. We'd be trimming and even exiting.

Q: Inaudible.

A: Let's say typically we want to sell when we are at 90% of intrinsic value. Let's say we are able to calculate it's at 80% of intrinsic value and it's at that 20% size. One of the things that would be going through my mind is, do I have stuff to buy that is at 40-50%? And I'd be looking at doing a swap. In fact, that's a question we are going through right now in the portfolio where I don't have an issue with position size. We don't have the 20% issue, but we have an issue where we have positions that are nearly fully priced but not fully where we want them to be. And we've got other stuff that's a lot cheaper. So we may make the swap.

Q: Alex Bossert from Minneapolis, Minnesota. Mohnish, when you were buying Japanese companies, how did you account for the lack of information - financials in Japanese, the annual reports in Japanese? Did you hire a translator or …do you secretly speak Japanese?

A: The financials are in English, and the numbers are in English. Beyond that, the only other thing that's in English is about a paragraph, maybe five sentences of what they do, and that's the end of our sum total of knowledge of the business. It would not be useful to hire a translator because by the time they were done trying to translate what someone was trying to tell me, it would not be coming from someone who's running the business but maybe some investor relations person. I didn't think it was worthwhile to look at each business traditionally, the way I would look at businesses in the States. Part of the reason I wasn't that worried or concerned about it is because we have a basket.

We don't have a lot of exposure to any one particular name. I would not be willing to do this basket with a large number of other countries. For example, I would not have an interest in a Chinese basket, and I would not have an interest in an Indian basket. I was specifically interested in Japan because the notion that to lose money on a Japanese investment because of dishonesty in the management team is extremely low. In India and China, the probability would rise considerably. In many other countries it would rise a lot, so we couldn't do what we were doing in Japan in many other countries.

To some extent, we lucked out that we have an extremely high quality culture and extremely compelling valuations, both converging together in a manner that makes us very comfortable. That's why we went about it that way. We didn't have to do a whole lot of work.

Q: Arthur Dzaghgouni from the Cayman Islands. Mohnish you mentioned a few of your investments in the past where you've bought low and sold high.

Would you be able to mention one where you bought high and sold low. I want to understand your logic of how you decided you had made a mistake.

A: We have many that we bought high and sold low. If I miss some, some of the people in the audience can correct me. Some of those are the bloopers which are all on the screen. We lost money on Sears. We had bought Exide bonds, and we lost money on that. We lost money on CompuCredit, we lost a lot of money in Delta Financial. We talked about that a couple of years ago. We lost money on the Budget bonds too.

So we've lost money a few times. I always try to put up losers. I try to mix it up between the losers and I try to put up a disproportionable amount of losers. As it turns out since the fourth quarter of 2008 till now, the best I can tell, we don't have a single investment where we'll end up with a loss. As for our Japanese basket, within the basket we'll have some losers. But the basket as a whole will be quite profitable and that's because of the checklist.

We haven't talked about the checklist here, but we've talked about it plenty in the past. We have a checklist process which has done vastly better than I thought, and our error rate has gone down in the last couple of years. I would suggest, if you want to get into the losers, is to go on our website. All of our presentations are on the website and all the transcripts are on the website too. They are there since 1999 and pretty much anyone that you pull up other than the last couple years will have plenty of discussion on losers.

For example, I'll talk a little bit about one. We made an investment in Sears, Sears Holdings, and we exited. We lost maybe somewhere between a third and a half of the money we had put in. There are many smart people invested in Sears. It's run by a very smart guy, Eddie Lampert, who cares a lot about shareholder value. I missed a very simple thing in Sears.

If you do any kind of liquidation analysis on Sears, you would end up with a situation where you would say that the stock at present prices is cheap because they have so much in assets in terms of their real estate. It is not cheap from a going concern cash flow perspective, because the business is in a very severe decline and it will just accelerate in its decline. Just to take a show of hands, how many of you have visited a Sears store in the last three months? We have a few guys, like four or five guys out of 100. If I had asked the same question five years ago it would have been quite different, and 10 years ago it would have been very different. We're seeing a pretty precipitous decline in folks who are regular Sears shoppers. You'll also notice that the ones who raised their hands have mostly a lot of white hair. It's not as if Sears can bury their old shoppers, and get new ones in. That's not happening.

What I missed with Sears is that between the assets and monetizing the assets through a liquidation, which is where you would make the money, sits some 200,000 employees. I don't see any way that you can ever go from A to B in a manner that would be profitable for the shareholders.

Eddie is a very smart guy, and I drank the Kool Aid and bought the stock. But we finally decided that we were wrong about that investment and we added that to a checklist. That is, just because something has a liquidation value that's more, you need other things. Sears has basic problems such as competitive advantage, basic problems with a moat, basic problems with the whole Target, Amazon, Wal-Mart, the other big box guys eating into their space in every which way. Coupled with all that is high unemployment and the economy going down. That's an example of one where we lost money and we learned a few things and hopefully we won't repeat that again.

Q: My name is Ray from Chicago. You have so much respect for your guru, Warren Buffett. Why did you dump him, and why are they doing so bad with all their talent?

A: I'm sorry I didn't get it, why I sold Berkshire?

Q: Yes.

A: Okay so you're concerned why…

Q: Obviously they're not doing well.

A: Okay so you're concern is why we sold Berkshire and what was the second question?

Q: And why they're doing so badly?

A: Why Berkshire is doing so badly … I would venture to disagree. I don't think Berkshire is doing badly at all. Their stock is doing badly. Here's the thing. Taisei Oncho is doing badly - the stock is doing badly but I completely disagree with the statement. They're running a good business, and they're making good money. There's nothing wrong with the business. What is wrong with the business is the price people are ascribing to it. My guess is that it may be a good time to invest in Berkshire, if you think they're doing badly. The reason we don't have a large Berkshire position is because we think we can find things that are at a greater discount. Let me put it this way - you would do fairly well to just buy an index fund which would give you better than 85%. Plan B, is to buy Berkshire which would be doing better than an index fund, and plan C is to just buy and sell what Warren is buying and selling and you may do even better than

Berkshire. Like what you suggested about Bank of America. What a great money making idea that is.

And so there's plan A, B and C. You can do all of those. I have a huge amount of respect for Warren and if I knew nothing about nothing, I would just put it all in Berkshire at present price. I would do just fine with that.

Q: Mohnish thank you for this meeting; there's really nothing like this that I've had the opportunity to participate in. A few years back, you would talk about putting placeholders in the portfolio when there was a lack of ideas or things that would compel you to put money to work, but there was an investment that you thought was attractive enough to generate a return above and beyond let's say a million dollars. Are you still using placeholders?

A: We were totally wrong on placeholders and we've completely given up on placeholders. I discovered the problem in the fall of 2008. The placeholders go down right at the time when everything else is going down and you need that cash. The single greatest lesson I learned from the fourth quarter of 2008 was when the funds dropped 67% in value from top to bottom during the financial crisis. Of course, we made it back, but that 67% drop from top to bottom came because we were fully invested, including our wonderful placeholders which also dropped. Take an example where you had the same two thirds drop in the fund, but the fund is 25% cash. You have 75 cents invested and it loses two thirds of its value so now that 75 cents is down to 25 cents but the second 25 cents is just sitting there. The maximum the fund goes down when you have that cash cushion in a two thirds drop is 50% which is a big difference from 67%. The second important thing is keeping that last 25% of cash. We had to sell Peter to buy Paul. That last 25% of cash at those times would probably get invested in things that are straight away at 3X or 4X in a few years. That last 25% can make you a tremendous amount of money. It also takes away any pressure to sell anything that has collapsed for no reason.

The cash cushion serves multiple purposes. One of those purposes is it tempers your drop and we saw it this time when markets were turbulent, we were sitting on a heavy cash cushion. We didn't have anywhere near the drop we had earlier. We were very comfortably able to put that money out as we saw opportunity without having to touch the rest of the portfolio. So we are done with placeholders, we're not going there again.

Q: Stuart Lucas from Chicago. In the annual report it shows that you have a significant investment in alternative energy. When most people think of alternative energy they think of things like solar or wind which tend to be very difficult to figure out what the intrinsic value is, and also tend to be high cost producers, ethanol, rather than the kind of analysis that you gave a few minutes

ago. So you probably have something else going on in your logic and I was just wondering if you could tell us a little bit about why you have that piece.

A: That's a good question except that we don't like to talk about what we own.

Q: I'm not asking to talk of specifically about the companies just…

A: It would hard for me to go into any kind of detail without opening the kimono if you will.

Q: Fair enough.

A: So we'll…

Q: Keep your kimono closed.

A: Do you have another question?

Q: 2008/2009 was not the world's most comfortable experience. How did you think about structuring the portfolio, other than the cash piece which you've already described, to try to mitigate the likelihood that even the equity portion goes down by two thirds?

A: We've done a couple of things. We changed the concentration levels, so we are much more spread out. Charlie Munger has said that if you're not prepared to handle 50% drops a few times in your investing lifetime, you shouldn't be investing. If you think of a company like Berkshire Hathaway and its stock price, very stable, robust, high quality businesses, they have gone to 50% drops multiple times. They've lived through that and they've been comfortable with it. So to some extent we can't avoid it. I mean we are not going to short things, we are not to hedge things in an artificial way. Pabrai Funds is going to be affected if the broad markets go through severe declines, but the counter balancing point would be our cash and, hopefully the way we spread things out. I don't expect our Japanese basket to act like most of the rest of the stuff we own. That's going to act quite differently on its own. In fact it already has. Other things in the portfolio had gone down and this had gone up. It's acting in a different manner. Beyond that, we could very well see a significant drop in the market. It's just the nature of the beast.

Q: I'm Ken Hart from Chicago. Do you take into consideration the currency when you make foreign investments and if so how? And what percentage of the returns do you expect in the Japanese basket to be due to currency fluctuation as opposed to intrinsic changes?

A: I have no great insight into the way currencies are going to move, so we're not going to take any kind of position one way or another based on currencies. When we made our investments in Japan, we did not hedge the yen in any way. What has happened is the index has dropped about 15% or so since we started, and the yen has become about 7 or 8% stronger on average. On average it was in the low 80s and now it's in the high 70's so there's some advantage we've gotten because of the yen.

On balance what we are buying today in Japan, including the stronger yen is cheaper than what we were buying a year ago, because the drop in the Nikkei is a lot more than the rise in the yen. I'm more excited about it today, than I was a year back.

Q: Obviously for a price to decline from value, there's got to be some kind of problem normally or people aren't looking at the stock, or they hate the markets and whatever may be. How do you distinguish for that company if it's a legitimate problem it's going through? How do you distinguish if it's a temporary and solvable problem, or a permanent problem that they can't work through. Can you provide an example of a case in the past where you've seen a company work through that and come to the other side okay?

A: Sometimes we made mistakes in the sense that we've thought it was temporary and it turns out to be permanent, and sometimes we've just been off on our judgment. Where we're going to spend our time on, for the most part, are things that are distressed.

When things are distressed, they can be one of the advantages you have in the equity markets. It's an auction driven market and it's subject to a huge amount of human emotion. In an auction driven market you are likely to see more mispricing than in a private kind of negotiated transaction environment. Buffett gives an example where can you look at any stock. Let's say you look at IBM for example. You look at the 52 week range on it, and it might be 80 to 120. I don't know if IBM's are those levels right now but that's a typical range. But a typical business doesn't go through that much of a range in its valuation in a year. The business doesn't fluctuate by 50% in a year but a typical stock easily fluctuates by 50% in a year. That auction driven market obviously gives you an advantage if you can figure out why it's distressed. That's where we spend our time - we try to figure out whether the distress is justified or not justified.

For example when we made our investment in London Mining, a business with $300 million of cash and $150 million market cap, that business would not sell for $150 million in a private transaction. It would not even get to a five minute discussion if someone made that offer. But in the public markets at that time,

people were just dumping anything and everything, they didn't care. We could make some judgments about whether the mispricing is due to long term business fundamentals or due to investor sentiment at the time. Sometimes we're wrong in the sense that sometimes we think that these are temporary issues and they turn out not to be temporary like Sears. We thought that Sears was a turnaround and Eddie is a smart guy. We thought that things would move and we were wrong on that. It didn't move and isn't going to move.

Q: It's Parag Patel from Indianapolis, Indiana. When you interview corporate management and you talk about how they allocate capital, not historically but on a perspective basis, how do you feel comfortable with somebody? That's one of the areas where I've made a lot of mistakes before. It's so critical in terms of value creation. I think of the relationship with Warren Buffett and Kraft for example, in terms of what they were thinking about doing. I don't know the details about it but I think it's the first time that he was involved in one of the investments that he's had a public sort of tiff with the board and the management team.

A: We don't interview management. We are in fact too lazy to even go meet them and we never call them for sure. Once in a while if they call me I tell them never to call me again. We don't interact with management and the reason we don't is very specific. The typical public company CEO has tremendous sales skills. They couldn't have gotten to that position if they weren't in one way or another a great salesman. There's nothing wrong with that, that's perfectly fine. Also, they are optimists, which is also fine because you cannot lead unless you always see the glass as half full or overflowing. Even with a little bit of water you see it as overflowing. You have to have that dynamic, otherwise you cannot lead because the troops won't follow you. If you go to meet this super salesman-eternal-optimist and you talk to him or her about a subject that they know everything about and you know nothing about, what's going to end up happening when you leave that meeting? You're going to think, "my God this is the best possible investment I could ever make." I'll just put it all in there.

That's a problem. What you're better off doing is sitting in a room and reading the last 10 years of what they said what happened, and then form your own conclusion of where you think the business is going to go in the future, rather than having them tell you about it. So the first thing is to avoid having management tell you what the business is going to do. What you ought to do is have your own assessment of what you think the business is going to do.

To give you an example, Terex is a company where if you go on their website and look at their presentations, they have projections saying that they will make $6 dollars a share in cash flow in the next two or three years. If you buy based on that forecast, it should be a $90 stock and it's at $14. You want to buy the

stock. But just because they think they're going to make $6 a share doesn't mean that's going to happen. It's not that they're being deceitful. It may well happen and they may well have all kinds of plans to make that happen, but you ought to do your own homework. Public company CEOs work pretty hard, they're pretty honorable people. Like Buffett says, you'd be happy to have your daughter marry one of them. The average public company CEO is a fine person but you just cannot take what they say at face value. There are all these other dynamics going on that'll affect it. I would suggest you form your own opinions based on just sitting in a room and reading. Like Pascal says, all man's miseries stem from his inability to sit quietly alone in a room and do nothing. So if you just sit in a room, it's all fine.

Q: Jim Abercrombie from Chicago. Going back to what you mentioned about cost curves, you use that for commodity based businesses. Are there any other metrics you seem to use as much in other types of businesses that you want to share with us about evaluating good opportunities?

A: The cost curve stuff carries across all businesses. For example, I don't typically invest in retail but you could look at the same thing in retail. You could look at a retailer's gross margins and how much it cost them to run the business and you could compare the cost retailers on that metric, because that metric tells you how good or poor they are at running the business. You could look at for example, the shrinkage and other things.

So each business and type of business is going to be different. In banking you could look at the spread between the interest margin and what they put at the bottom line because again that tells you how efficient they are. The cost curve idea can be transferred across. It would just change the nuance that you're looking at. But when you're looking at valuation and businesses and comparative modes, the industry is going to determine which factors you want to be zooming in on. In commodities, generally, cost curves are a good way to go.

Q: My question is that you were just talking about the CEOs who are being optimistic and they should be as leaders, but I'm more talking about capital allocation decisions.

A: Yeah most CEOs are terrible at capital allocation…

Q: Buffett has mentioned that in his report.

A: One of the issues we have as passive equity investors is we don't have much of a say in how capital gets allocated. For the most part there is a significant frictional cost from that. Even in Japan, the history of allocating capital well is pathetic. One of the things I added to my screen was I wanted to

see significant increases in tangible book value over time. That's not perfect but there were companies that were producing lots of income but the book value wasn't changing. We try to adjust for that, but this is one of those kinds of evils you live with. You try hard to gravitate over time to managers that are good capital allocators. One of the things that you brought up about position sizing is if I own a great capital allocator, I'm less interested in selling those positions. I look more at the ones who have either no clue about capital allocation, or they have a tailwind that even they know they have and that's fine.

Most of our commodity businesses we invested in were tailwinds that they had no control over and they didn't even know they had those tailwinds. We knew they had the tailwinds, so we could take advantage of that.

Q: Back to Frontline for a second because you talked a lot about that industry. In the 1990's that was an industry that did not earn its cost of capital. I was just curious of what you thought about the industry and do you think it's a classic commodity business? Do you think it's a business that can earn an excess of their cost of capital?

A: No.

Q: No. So you're just buying it cheap as an asset?

A: Exactly.

Q: When it's trading at 15 cents or 30 cents versus a dollar?

A: Exactly. My take on shipping is that it's purely opportunistic at a point in time when it's depressed and the factors work in your favor.

Q: One last question relative to capital. If you were in a buy position and you felt management was grossly misallocating capital, would you voice your opinions? Write a letter? Is there some type of show to activism privately that you would do, not sort of the Dan Loeb where he goes and yells at them. He holds CEO's responsible for the share price. They shouldn't be responsible for the share price according to your opinion, and I agree with what you said - they're responsible for performance and the market should value the shares.

A: I'll give you a real example. We had a situation where we owned a significant block of a company and every year I get the proxies to vote on, and I take those seriously. I always vote against the option plans. Generally speaking, I vote against any comp plan without even bothering to read them because there's no point reading them. They're all useless, they've got their consultants, they've got all the stock options and restricted stock and all of that. Of course I

expect no impact from those actions but in one case, we had enough of a block and there were some other people who had other issues (not the issue I had) and their plan failed to pass. I got a call from the CEO and he said, hey you don't understand, I can't hire the people I want and we need to do this and that. I said, no you don't need to do this. I told him that I'm not changing my vote. I'm going to send you a book and I want you to read just six pages from the book. And I'll send it to your entire board, and I want you to have them read the six pages. I don't expect them to make any change to their behavior after reading the six pages but I'll feel better. I sent them Cunningham's "Essays of Warren Buffett" and I highlighted the sections on stock options and then I added a quote. I said this quote is not in the book. It was a Charlie Munger quote which says that I'd rather put a viper down my shirt than hire a comp consultant. The first thing you do is fire the comp consultant, then we'll go through the other pieces.

They suggested to me that I come and meet them so we could discuss this more face to face. Of course I shouldn't have done it, but I said okay one time, I'll make an exception and go to meet management. So I went and met the entire board which was the only time I had done this. But I'm never going to do it again. I told them when I came in to give me about 20 minutes to give a monologue and I just unloaded for 20 minutes as intensely as I could. I quoted from the bible of investing all over the place and all that stuff. I did all of it and of course there was no change in behavior.

Q: Satijid from University of Chicago. My question is regarding copying and pasting ideas from different investors. You mentioned that you tend to follow Fairfax, Prem Watsa - he's from the insurance industry, and John Burbank he is our macro guy. I'm sure you must be following Seth Klarman and a couple of other investors. Don't you feel sometimes everybody goes wrong at the same time and how you do you…

A: I'm sorry don't you feel what?

Q: All of them go wrong at the same time?

A: I would go so far to say that if there was a fund which was limited to only making investments which were made by a predominant list of investors who in the long term had beaten the indices by some significant margin, and you looked only through that list, you did your research, did your reverse engineering and only picked the ones that you could fully understand why the investments were made, I would argue that that type of a fund would do very well, long term.

You will not make money in every position that you reverse engineer, but overall, you would do much better with that approach than just sitting there and looking

at a bunch of screens or trying to run screens or trying to go through some cheap stocks and pick them. The fact that it went through a vetting process where someone like Seth Klarman, put it in the portfolio is a pretty significant filter because Seth is very, very thorough and very anal. It doesn't mean that he doesn't make mistakes; and most of the time, with someone like Seth Klarman, I can't even figure out why he did something so I just leave it alone. We have one stock in our portfolio which came from Seth. We haven't exited yet, we still own it. We were able to figure why he did it and we'll do quite well with it. There was no way we would have made that investment or even known about it unless we went through that process. So I'm a big proponent of doing that. We've not done it in every case but I should do more of it.

Q: Hi Mohnish, this is Bishar from New York. I was wondering if there's an update on the checklist. My specific question is - you spoke about Sears where you said there were 200,000 employees sitting between the liquidation value and the stock price. Similarly there is a Japanese culture of safeguarding the employees and everything which may not lead you to get to the liquation - what do you think about that?

A: I don't think we're going to have any type of influence on the Japanese businesses to suddenly return a bunch of cash to shareholders or do other things. I don't think that we will have behavior change - we're not counting on that. But if you look at our Japanese screens for example, Taisei the one I put up, is one of the absolute cheapest stocks out there. It's trading, if you do a simple calculation at less than one fourth of its intrinsic value, which is somewhere in the 23 to 27 cent range.

There are no Japanese stocks that I've been able to find that trade below 20 cents, so even in a market like Japan, nothing trades at less than one fifth of intrinsic value. You seem to hit some type of a floor where they don't. The second thing we notice is the ones that we were buying which were cheap six, eight months ago, are no longer that cheap - they moved up. Plenty of people have done studies. Ben Graham did a whole bunch of work on this. You do not need activism or liquidations or any kind of unusual items to make money on net-nets. By themselves because they're so cheap, they'll work out. I don't think we are going to make 4X on something with Taisei Oncho but the fact that we would lose money on it is quite unlikely. The fact that we do better than the index is quite likely, so on balance it will work out fine.

Q: Inaudible.

A: I would not be doing this with large amounts of money with a portfolio into it. It may end up providing very nice returns. One of the things about the Nikkei, if you pull up their chart for 30 years, is that it was at about 8,000 or

9,000 30 years ago, and then goes to 40,000. Now, it's at 8,000 or 9,000. The journey from 40,000 to 9,000 is not a straight line - there were massive rallies. There were rallies of 80%, 90%. It would go down to 12,000 then go up to 17,000 and so on. If we happen to catch one of those waves from the 8,000 or 9,000 level to even a 13,000 or 14,000 level, we would make money coming and going. We would just clean up because these things will just take off. It's not out of the question because the whole index is so cheap.

Q: Obviously cheap is not always good, sometimes it's just cheap. You mentioned the lack of visibility with Japanese stocks and you also mentioned this with London Mining. At what point does creating a basket of things that seem to be cheap antithetical to the concept of value investing based on individual companies that are studied in the Ben Graham model?

A: Ben Graham was very heavily overdosed on quantitative investing. His perspective was that if you bought a basket of net-nets like the Japanese basket and you didn't know much about the business and you let them alone for a while, sit, you would do just fine. Historically net-net investing has always paid off just because they're so cheap. The net-nets disappeared from the radar by the time the mid-60s came and they never came back after that. The US hasn't had net-nets in any kind of great quantities, except the very early days after the depression and in the 40's and 50's. After that they pretty much went away. So, Graham found that there wasn't a whole lot of this ultra-cheap stuff to do. He would be amused and intrigued if he were looking at these Japanese companies because he would find that it had many similar characteristics to what existed in the 40's and 50's in the US.

Having said that, my biases are not towards pure quantitative investing. The Japanese basket is interesting. We'll do okay with it but it's not going to dominate the portfolio. Also, it's a point in time. If you look at a 20 year period that we run the fund, we might have three years where 10% or 15% of the portfolio went into this quantitative stuff and then the remaining 17 years we didn't have that. It's just making hay while the sun shines.

Q: Stephane Fitch from Chicago. You've been doing this for a long time and you mentioned earlier you hadn't received a fee since 2007 and it struck me you were very patient. I was wondering if you had any tips for some of us who fail to be patient sometimes and we're not able to wait four years for our next paycheck. I'm not talking about financial advice here, I'm just talking about how do you, just keep your head together for that long? Is there something you … what are you eating, brother?

A: People lose sight of some basic reality. My father–in-law jokes - he says when he comes to the US that this is the only country I see where the poor

people are fat. He's right. In India, you would hardly ever find a fat poor person. If you are fat, in India by definition, you are prosperous. So the US is kind of unusual in the sense that on average there are more obese people at the lower end of the income scale than the upper end. You could try to calculate the number of people who truly have real painful experiences in life where they are truly starving or they don't have shelter. My perspective is that with a lot of the homeless people in the US, they have other issues which are driving the homelessness. Homelessness is not the primary issue, other factors have caused the homelessness.

The way that US defines hunger is "sometime during the year you went hungry". That's the US definition of hunger. Recently there were some reports of how many are hungry. It's not like sometime during the day you went hungry. Over the year you maybe had a few meals where you wanted to eat, but you couldn't get the nutritional benefits. The reality is that the US is a great country with tremendous safety nets of all kinds for private and public. The number of people who end up starving or end up homeless is a rounding error. But the number of people who get worried about that is extremely high. Someone for example loses their job and they're freaked out, "I'm going to go hungry, I'm going to starve." But there are so many safety nets in the country. And if you think about what you need to be happy and what you need to have a decent basic happy life, it's not much. Most things in life are free. The best thing to do is what Charlie Munger says, "The best way to be happy is to get your expectations down". Or Warren asks, "What's the best way to have a long lasting marriage?" And then he says, "not necessarily a happy marriage just a long lasting one". He says to just marry a spouse with low expectations. The whole point is that most of the problems we face are in our head, they're not physical problems. The head is something you can control and as long you keep a basic balance, most people are going to go to the grave without ever going hungry for a day or ever being homeless for a day.

Things will be provided. There are plenty of safety nets and money is not going to drive happiness. You can find happiness in plenty of other places.

Q: My name is Joe Brown from Orange County. I'd like to know what types of reading material you utilize for your foreign investments.

A: The Japanese investments are simple because I don't speak Japanese. There's very little to read. We bought a basket of Japanese stocks for that reason. We know very little about these businesses other than the fact that the financials are in English, which is helpful. Second is that it's a very high quality culture. I expect losses in some of our positions, but I don't expect losses due to fraud. For other businesses it depends. We've got a lot of Canadian businesses, and in Canada the SEDAR filings are very similar to the SEC filings. Depending

on what we are looking at, if it's Anglo-American type culture then we can do fine. We are worried with some geographies - we don't do much in China. Partially because we have a question about whether we are even looking at the right financials, and also whether they are authentic or not. But it just depends on what pops up. I read a few different newspapers and publications. They tend to have coverage of things around the world and if something looks interesting, then we'll dive into it and take it from there.

Q: Kurt Hoffmann, Sacramento, California. Mohnish, you've said in the past that you like to focus most of your time on individual companies and you don't try to focus on the economy. Even Peter Lynch said something about, if you spend 12 minutes on the economy you've wasted 10 minutes. With that in mind, obviously in 2008, the economy hit portfolios hard to the tune of 40% on the S&P. Do you have any thoughts on the European debt crisis in Greece and how that's playing out and does that impact your investment methodology? Thanks.

A: I have no insight that would be better than yours. It's hard to tell how that plays out. It's worth paying some attention to the macro, but you should also weigh heavily towards the micro. To take a very extreme example, let's say we have an investment that we used to have in Stewart Enterprises which is in the funeral services business in the U.S. Whatever happens in Greece has absolutely no impact on Stewart Enterprises. We still have to take care of the dead and we have to do it in a respectable manner. We won't see a business like that having its revenues affected. Then you start looking at a business like McDonald's versus another business like Tiffany's. Tiffany's is likely to get somewhat more affected and Tiffany's could possibly take a bigger hit than McDonald's would. You look at the macro picture but you should fixate more on the micro.

We have this company in Japan, Taisei Oncho, based in Osaka doing commercial air conditioning and plumbing. If there is a big slowdown that would impact their revenues and would impact their cash flows, we still have such a big margin of safety there because they are trading at half of cash. We could go through a couple of years of grief in that business and it would still work out okay. I would not look at what is happening in Europe and decide I want to just stay in cash, for example. I wouldn't make that decision. Some things are easy to figure out. And if you can't figure it out, then you are better off not wasting too many cycles on it. We don't have any meaningful exposures as far as I know directly to Greece.

Q: Thank you very much Mr. Pabrai for throwing this meeting. It's a delight to hear your thoughts. My name is Daniel Osowski. I am from Santa Monica, California. My question pertains to two investments or past investments that you mentioned, Teck Resources and Terex. You were able to buy them at great

prices when there was a significant amount of fear in both situations. As you touched upon, due to leverage in the situation, people were very concerned about potential bankruptcy. For Terex, I think that people were worried about the financial covenants and potential breaches due to losing profits and their cranes in AWP business whilst Teck Cominco had a huge refinancing risk. How did you get around that, or what sort of checklist did you to use to feel a little bit better about being able to buy at those cheap prices? Thank you.

A: Teck was relatively straight-forward in the sense that there was another business which I didn't invest in because I wasn't smart enough. It's General Growth Properties. They run shopping malls. General Growth went bankrupt and when it re-emerged from bankruptcy, the debt got paid fully and the equity had plenty of value. In some cases you can have a bankruptcy where the equity survives and the reason why it survived in the case of General Growth and Teck is the same reason. In both cases, the companies had a liquidity mismatch. They had vastly more assets than liabilities, but they didn't have liquidity to service liabilities immediately.

General Growth had huge amounts of real estate but they had debt payments and principal payments coming due which they couldn't meet. They couldn't sell assets quickly enough to meet those payments so they filed for bankruptcy protection. Under the protection of the courts they restructured, streamlined, paid off the debt, re-financed and they came out and they were fine.

Teck has the same situation. If you looked at their assets, their balance sheet, and you look at the liabilities, there was a massive liquidity mismatch. If they went bankrupt, that would not be such a good scenario because once you take a company to the bankruptcy you have lots of other costs that kick in and they have a loss of business reputation that has impact as well. We would not have had as much of a recovery if they went bankrupt but we still would have had a pretty significant gain. If they did not go bankrupt it was going to be a home run. The question was, was it going to be a small home run or a large home run? I felt that the odds were pretty high that they wouldn't even have to file bankruptcy. They had many levers - they could sell some properties, they could advance sell production, or there might be a recovery in commodity prices. All of the above is what ended up happening. Commodity prices recovered a little bit, they were able to get financing from China Investment Corp and they were able to ride it out. The Canadian banks that held their debt didn't want to run a mining company. They were most likely to do an "extend and pretend." They extracted their pound of flesh, collected their fees and pushed the maturities out.

There are a large number of questions on leverage on the checklist. In Teck's case clearly, there were questions on leverage. Terex did not have the same issues. Terex had a much more conservative balance sheet. Their main issue

that the market was concerned about was the dropping sales and the subsequent losses. So in the case of Teck, we didn't have too much of a concern when you just looked at the assets and liabilities and put it together. General Growth was exactly the same situation. I just wasn't smart enough and Blackman had a 30x return on that so it was nice home run for them.

Q: I am Vipul Patel from Brentwood, California. My question is how do you prevent sites like GuruFocus.com from copying a portfolio and putting it out there as soon as you buy the stocks?

A: Since I am copying everyone, they should be allowed to copy me, right? And of course copying me can be injurious to your health as some folks have found. GuruFocus is not able to put up things on a real time basis. We have laws we have to follow. We have to do quarterly 13F filings which come out 45 days after the end of the quarter. They can look at that and put that up. Typically, for the most part they put up the 13Fs which come out once a quarter and they are 6 weeks delayed. It's not in real time.

There are a couple of professors who had done a study of copying Buffett's position. If you buy the stocks that Warren Buffett bought after it is public that he owned the stock; and you buy it on the last day of that month when it was public; and you buy it at the high price of the last day which means you did the worst trade on the last day to buy the stock. Then if you sold when it became public that he had sold and again, you sold on the last day of the month, and you sold at the low price of that day, you would beat the index by about 8% points a year over 30 or 40 years. What could be simpler than that? You don't even need me. You could do that on your own. It's a powerful construct to look at what other good investors are doing. It has not bothered me in any way that these sites like GuruFocus do that, because I am on GuruFocus as well extracting everything I can. More power to them.

Q: Hi Mohnish, Jefferson Lilly from San Francisco. What new mistakes have you made over the last year?

A: Welcome Jefferson. We've been using the checklist since around the fourth quarter 2008. Joe Benevento helped me on the checklist. Joe is here. Joe can you just raise your hand where you are, right there in the corner. Joe used to be a student at Harvard Business School and he spent one summer and did some terrific work for me on the checklist at zero pay. He did a great job and so we are very grateful for the work - it was quite useful. Since he put the checklist in place, our error rate has dropped considerably. In fact, from then until now we can't point to a single investment that we made in almost 3 years, that we think we'll have a permanent loss of capital. So far I can't name one. Now we have stocks right now that are below what we bought them at, but we

don't have a view that we will have a permanent loss of capital on those - maybe it's the triumph of the optimist.

I had expected the checklist to help, just not that much. We will have an error rate but it is surprising to me that the simple ideas sometimes are the most powerful. I just ran the checklist on a new position that I have been looking at. I ran it on Friday because I have been looking at this company for a while. I said, "Well let me just run the checklist and see what comes out." And it came out pretty clean. There were a few issues that came out where I didn't know the answers, so I went back and looked at the data and got those answers. I will probably, maybe by tomorrow, place my first buy orders on that company. We have about 98 questions on the checklist. When I ran it for that company, it took less than 20 to 25 minutes. Then I had to do some research and come back because of some questions where I didn't know the answer. The checklist brought up maybe six or seven questions where there's a red flag and it always does that. There is no company we have invested in where there are no red flags. When I look at the red flags, the odds are pretty high for that business that the investment will work out fine. It is not 100% probability, but it is very high probability.

We have comfort in that. So far, so good, we'll keep our fingers crossed. I only wish I had done it a few years back. It would have been great to have had it in 2005. Then it would have been a different trajectory. But it is an incredibly powerful tool and it works well. Just to give you an example, before I ran the checklist for that business I said, "I don't know even why I am running it. I have talked through all the issues I know." When I ran the checklist, it brought up issues that I hadn't thought about and it forced me to get those answers which is the value it adds. So it's been wonderful.

Q: My name is Warren from Beverly Hills. I am just wondering how you realized that you are a value investor and what's your take on growth investing which seems to be what Wall Street is always concerned about, top line growth?

A: There is no difference. There is no such thing as growth investing or value investing. There are only two buckets - you are either investing or you are speculating. The term "value investing" is redundant. All intelligent investing is value investing. Ben Graham would say that. In my mind, it is the only logical way to allocate capital. An example is a stock like Google, which people have put into a growth bucket. If we have clarity on the cash flows Google will generate over the next 10 or 20 years and we could discount those back today, Google may well be a value stock. Just because it is growing doesn't mean it's a growth stock and not a value buy. The best investments are ones that have high growth and are trading at a significant discount to what cash they are going to generate for you on a present value basis over time.

Another thing about investing is that Buffett says that the whole concept of value investing is either it makes sense to you in the first two minutes when you encounter it, or it will never make sense to you. In fact, that's the way the world operates. When you look at the trillions of dollars that are managed in the markets and the way they are managed, a very small sliver is managed intelligently using value principles. This is good because it means we can make some money. That has not changed over decades. It has always been a sliver - it may have become a little fatter sliver. In the year 2000, that sliver became very thin and then it became bigger. It is always the small minority that practices it which is good and there is no difference between value and growth. It's all the same and you can look at it from the same lens.

Q: I am Santosh Garg from West Covina. I just wanted to know, is it likely that you are going to open to the new investors? And, can you make your comments about your charity please?

A: The reason we closed the funds is because we had significantly more capital than ideas and that is still the case. But we also have some investments that are getting close to maturity. We will be exiting those and we will have significant amounts of cash generated from those. In the current situation, I don't see a need for us to bring in capital. I also wrote in the annual report that at the point in time when I am going to be asking for capital, you may not be that excited about sending it to me. At that time when I call you, I will remind you of this conversation and hopefully, you will overcome your hesitations and sign that check even though it will be hard to do it.

When I go out for capital, it will be in a fairly stressed time. I hope we don't have that, but if we do, then it also means that subsequent to that we will probably do quite well. Another thing I just want to mention about the portfolio and all the composition stuff is that I feel good about the portfolio and allocations we have today. It is hard to tell where this goes, but it wouldn't surprise me if we did very well in the next two or three years. It might be a nice few years even with some of the noise we have in Europe.

You had a question about Dakshana. We had started a family foundation called The Dakshana Foundation about five years ago. We basically went through a process where we focused on doing the most good with the least dollars spent. The greatest leverage you get when giving money away is an education. Education has this huge payback. Give a man a fish you feed him for a day, teach him how to fish and you feed him for a lifetime. When I was looking at forming the Foundation, we wanted to create fishermen, not give fish and then question what kind of fishermen.

Again, cloning is such a great tool. I read an article in Business Week about this guy in Bihar in India who was running this specific program where he was taking very poor kids and prepping them to go to the IITs. The ROI on that activity is off the charts. I visited him and I asked if we could fund him to scale and he wasn't interested. He said, "I am happy to help you in any way, but I don't want any funding from anyone." We decided to do what we do in the investing world - we decided to clone what he was doing. We just took his model and cloned it.

Warren Buffett says a great business can withstand lots of shoddy management for long periods of time. And I would say in many ways that will be Dakshana's story. We were able to pick up a tremendous model and that model is so resilient and so powerful even though we've had plenty shortcomings. We got a lot of tailwinds - we had the government of India willing to work with us and just a set of characters that came together and even now some donors. It's worked out very well. These are very early days. We will see how it goes, but it's fun.

In many ways, I wish more entrepreneurs and investors would focus on giving back earlier in their lives, because the skill set they have can be quite useful and we are seeing that now - the likes of the Gates Foundation or Pierre Omidyar, and all these guys at Google who have come to wealth very early in their lives. It's great to see some very interesting, innovative things happening on the philanthropic side.

Q: I am just very curious - how do you compute your free cash flow? Do you use Buffett's method of owner's earnings?

A: Free cash flow is pretty straightforward. I normally don't give the business any credit for cap-ex. Some businesses like to split out growth cap-ex and maintenance cap-ex. All cap-ex is money leaving the drawer and so it is gone. What I would do is I would take net income, I would subtract all cap-ex and would add all depreciation and that will get a pretty good proxy. Over long periods, you can look at the receivables and be able to make sure they're all coming through, and also look at those kinds of gains when the earnings are increasing in book value.

For example, in our Japanese screens that we ran, we didn't buy the cheapest stocks in Japan. I'm buying the ones that are very good consistent earners and they are able to translate earnings into real growth in book value on a consistent basis. They're cheap in the sense they have huge amounts of cash versus the markets caps, but they have a decent underlying business. The way that they run that underlying business looks good. In the case of Taisei Oncho, they are pushing out 40% of earnings every year into dividends. What we hear about Japan is that they don't do that, but Taisei Oncho is doing that. They are taking the cash pile and pushing it out.

Q: Ray from San Diego. Three quick questions for you. Throughout your conversation you are using the word "we". I assume you're the one making your investment decisions, or do you bounce your ideas off someone else on a team type of basis? That's number one. Number two, last year at this time you said you're a net seller. Are you still a net seller or net buyer, last quarter, let's say? My third question is a hypothetical question. If one of your bigger positions dropped, let's say went from about 150 down to the 103, 104 level, would you buy more of it at that time if it was approaching the 10% limit or do you just never go over 10% in any of your investments?

A: Let me answer the third one first. I don't want to allocate more than 10% on a cost basis. 10% is enough because one of the things that came out of the checklist is that there are no sure bets. Warren and Charlie would both disagree with that statement, but we have to do what we are comfortable with. The "we'" versus "I" - it is just me. But I do talk to humans. It's good to talk to some humans. And the good news is that they are not on payroll, they are free and they have no vested interest other than to be aligned, which is great. That has been quite useful. In fact one of the reasons we haven't had an error rate is that besides the checklist change, before 2008 I didn't talk to folks. So there are two changes, one is the checklist and the other is I have a conversation with a few folks. Most of it is just one person and it is interesting because there are always things that come out that I miss, have a blind spot, etcetera; or sometimes things that he'll miss, so that's been useful. And for the third question - our cash positions have gone down, so obviously, we are a net buyer now. We used to have about $140 million in cash a few months ago and it is much lower than that today. Absolutely we are a net buyer, and happy to be a net buyer.

Q: I'm from Diamond Bar. Do you do any due diligence to foreign companies like England, Japan? Before you invest, do you go and visit them or talk to somebody higher up on the phone?

A: I never talk to management. Rather, I would say it would be an exception for me to talk to management. Sometimes I might bump into them and be forced to have a conversation. I might kick the tires on businesses, depending on the nature of the business. For example, we had an investment in Sunrise Senior Living which is a retirement home set up. We've never gone to headquarters, but we might go and just visit one of the facilities on an anonymous basis.

Q: The steel stocks like Mittal, USX are so low and have gone down. Why are they selling so cheap?

A: A lot of things have gone down, but the steel makers have a particular nuance. Steel makers are basically a processing facility. They are taking raw material ingredients, running it through their furnace black box and creating steel. To the extent that their black boxes are like everyone else's black box, that conversion fee is going to be fairly competitive across the board unless they have some type of a competitive or process advantage. But if you look at some steel makers let's say, Tata Steel, or if you look at one we used to own in Latin America, they own some of their own mines. Tata has huge amounts of their own mines. That gives them an advantage because the chokepoint is not so much in processing the steel, it's in the control of the raw material resource.

The steel makers are trying to go integrate backwards. They realize that they don't have significance now. You have some advantages. Geography gives you an advantage because steel is very heavy and difficult to transport. If you're close to the natural resource base, that gives you an advantage which is why the US has huge amounts of iron and steel around the Great Lakes. Some of those things give you an advantage which can give you a buffer versus other players and other geographies. But there very few steel makers. Posco is one. They are a Korean steel maker with a process advantage. Posco has FINEX technology which allows them to take lower grade iron ore, lower grade coal and make high grade steel. That is proprietary technology that Posco has. They have had some problems with executing on that. They were trying to build a plant in India to get access to those incredible resources, but they are having trouble.

The steel business, in general, is a conversion business. Unless you have some type of a moat or advantage on that conversion you may not get anywhere. When ArcelorMittal had done some of the roll ups, there was hope that the steel industry would get consolidated, and with a few large players they would be able to fatten their margins. But the reality has been that the slowdowns have hit them hard. In fact, a lot of them are trading at a fourth or fifth of where they were trading.

Q: Joy Global is also a mining company - will that be a good buy out or?

A: I am not familiar with the financials of Joy Global. A lot of the metals mining space is not that interesting to me right now. It was of interest a couple of years ago. There are still are pockets of opportunity, but I would say that of late we haven't found much to do in that space.

Q: Samir Patel from Seattle. Going off the last question, I was wondering to what extent do insider holdings of officers or directors influence your thought process especially about the companies you talked about today?

A: It's on the checklist, and that's one of the questions we look at. We look at what type of ownership insiders have. It's always good to see that, but we've had plenty of investments where there hasn't been high ownership and they've done fairly well. It's not a black and white showstopper issue where we will not invest if there are not high stakes. Take a business like IBM, for example. It's unlikely that insiders and IBM are going to have large stakes. In that case, if I can get to the net worth I look at what portion they have which fits that. It's a factor I do look at, but it's not the only factor and we've made investments and done well where there has not been a large stake.

Q: I have two questions, one is just kind of a funny one. Were you disappointed that your lunch with Warren Buffett didn't result in you being chosen to be part of his team?

A: Yeah I didn't pay enough. You know that was the problem. I should have bumped up the bid!

Q: The second question is going back to one of your investments a couple of years ago on the Level 3 convertible debt that you bought, along with reverse engineering from Southeastern Asset Management. What are your thoughts today in terms of deleveraging the transaction with global crossing?

A: I haven't looked at Level 3 lately. I have never focused that heavily on their business so we've never owned the stock. What we've always looked at was on the debt side and we've looked at it from our vantage point of the probabilities that we would buy it when it is in a fairly distressed situation. We typically have bought the debt in the 40, 50, 60 cent range. We've done it twice and this worked out well both times. Level 3 has always been a company that believes bandwidth demand would increase and they would be a chokepoint, and that theory probably comes to pass at some point. I don't know when.

Q: I just want to follow up on Southeastern. They have had a tough couple of years. What are your thoughts and I'm just kind of curious about some of the people you follow and some of their issues they've had recently, if you have any knowledge about that?

A: I don't have a deep amount of insight into that. Longleaf has a large amount of assets, lots of different moving parts. I don't have any insights that will tell you what's going on. I definitely look at what the smart guys are doing. Many times I would disagree, but we disagree with almost everything we see because we buy very few things that we see. It's typical that we look at a portfolio and most things in that portfolio don't excite us. That is probably the

case in the Longleaf portfolio, but it's also the case in almost any other portfolio we look that.

Q: Hi my name is Kirk from Palos Verdes and just a basic question. Do you have any recent samples of where you sold a position at a loss and you just decided you were wrong about something and why?

A: One of the reasons why I didn't put it up is that we haven't had much in terms of recent losses. But you know we've had plenty of losers in the past and we've talked about them in the past. Let me just rattle off names that we've lost money in the past. We lost money on Sears, we lost money on Exide bonds, on Budget bonds, on Delta Financial, CompuCredit. The other folks in the room will have some other names.

If you look at something like Sears (we sold the position), even when we sold it there was a wide gap between their assets and what the stock trades at. But we came to the realization that that is unlikely to ever benefit shareholders, and I wish I had come to that realization before I ever bought Sears. The thing is that between the Sears assets and shareholders getting the benefit of those, there are 200,000 employees. I don't think Sears as a company, as a going concern, is going to go anywhere as I am deeply skeptical about any kind of turnaround. In fact, I asked this same question in Chicago. What portion of the room shops at Sears? Let's say in the last two months if you've been to a Sears store, can you just raise your hands?

We've got a few brave souls, one, two, three, four, five…well they're Canadians. Sears Canada is a different story. We can't talk to the Canadians because they have much better businesses in Canada - until Target comes. But in the US, if I asked the same question 10 or 20 years ago people would ask me, why am I asking the question. Almost every hand would go up. The business has a fundamental problem. Retailing is a very hard business. Sears was a business where we lost a significant amount of capital. We have it on the checklist that just because there is a gap between value of the real estate and what you can buy the business for, that doesn't mean it will work. I don't think Sears will ever be able to get to the point where they can monetize that in a profitable manner for the shareholders. That's an example of an insight I hope stays with us some time.

Q: David Chang from Los Angeles. Great to see you, Mohnish. In today's presentation and in the past couple of years when you talked about the investments you made, the typical holding period was one to two years perhaps a little bit more. I'm curious whether that is a result of your own style of investing, and whether you would even like to hold some of these longer given that one of your mentors Warren Buffett is very famous for such long term holds.

A: Good to see you David. For the holding period, we are sensitive to tax issues so we don't want to generate a lot of short term gains. We typically want to get long term gains. And very few things that we buy get to full intrinsic value or close to intrinsic value in less than a year. We don't typically even have the opportunity to monetize in less than a year. That's one reason why we have that holding period. The second reason is that Warren and Berkshire are in a very different place in the sense that they have large amounts of capital. You know of course he hates paying taxes, so with the large amount of capital they have, the opportunity set is more limited. If you sell a Coca-Cola where you have a huge gain and you pay the tax man and then you reinvest it, you have to find another Coca-Cola and that's not as easy to do. I've always found that if you buy something at 40 or 50 cents and when it gets to let's say 90 cents you sell it and then you go back and buy something else at 50 cents and again you sell it at 80 or 90 cents. That's a pretty good model and that's what we focus on doing. As long as we can keep doing that where we can get the 50 cent dollars and sell them at 90 cents then it works out.

That's why the holding periods naturally tend to go over a year. We tend to see some kind of convergence in one to three years which is why you see those types of holding periods for us. We've had situations where we held much longer with much poorer gains because that was triumph of optimism over reality. It hasn't always worked so well. We've had some positions we've held for seven or eight years where the results haven't been that great.

Q: Hi my name is Adrian from Australia. I have a somewhat related question. How important are near term catalysts for you in making an investment decision; and if you look at your Japanese example, are there any near term catalysts that you see?

A: There is no catalyst. I'm trying to create a catalyst over here.

Q: How do you think about investments like that when they don't have a near term catalyst? How many of your investments are that type?

A: We've never focused on catalysts. It's completely irrelevant to me that there is something that is visible to me, because usually if it's visible to me it ought to be visible to many other people. Then the stock wouldn't be where it is unless you have some severe distress in the markets.

We've always felt that value is its own catalyst. They have done studies where if you invest in net nets in Japan you did fairly well over time. Even in Japan there are a couple of quirky things but we couldn't find anything that was less than 20 or 30 cents on the dollar. There is some kind of floor where when things start

touching 23, 24 cents on the dollar, they tend to bounce up. The stocks that we were buying a year ago which were cheap, we aren't able to buy today. They are not anywhere as cheap as they were. So value is its own catalyst. We haven't focused on catalysts and I don't think we ever will.

Q: So in Japan, for example, you are just prepared to buy and take a view that you might be there for several years but in due course, the value will return.

A: I'll talk about it probably in the next couple of years. We may be in Japan for a while if the opportunity is there, but we probably won't have individual holdings for that long. I'll talk about it more in a year or two.

Q: Hi Mohnish. Richard Griebe from San Diego. Over past years you've occasionally bought options, call options and different things like that. Last year you mentioned you were doing some covered calls. My question is, going forward after experiences that you've had, what do you see yourself doing in the portfolio? And then with that, is there any place in your checklist that has anything to do with the options?

A: I've played around with covered calls in my personal portfolio. In the funds I've never done anything with derivatives. On the personal side I've done okay. I've made some decent money, and I haven't checked lately, but it's averaged north of 30% a year. But a quirk in this is that I don't think we can put huge amounts of capital in, so if I'm doing my own account I can play with it.

Secondly, my conclusions are that there are other places, especially in the markets that we have today, that are less work and easier to get some incredible returns. I'm pretty sure we will never go down the path of the funds doing anything in this area. In fact, I'm evaluating right now whether I myself ought to turn that off for some time. In the markets we are in today, I find we have opportunities which are available to us which are straight 3x and in some cases a straight 4x. Any kind of option play when I compare to those opportunities is going to pale away.

We are seeing things that are 25 or 35 cents of the dollar. At least for now the options stuff is not as interesting and the funds will never go there. In any case, if the funds were to do something on that front, we'd have to first go through amendments with the partners so there are some hurdles which I myself am not excited about.

Q: The checklist doesn't imply then…

A: The checklist has a lot of questions on leverage and we are always doing options with covered calls. It's a very safe way to do options in the sense that unless you are wrong about the underlying value of the business, you are not going to be hurt too much. You are always collecting premiums, you've got the stock already there and no matter what it runs up to you are going to be able to deliver a stock without any pain. None of that is going to be a high risk strategy, but there are just other options presently. The main thing about the checklist is that there's a whole section on leverage that makes you very aware of the pitfalls of leverage.

Q: Hi Mohnish. It's Ryan Morris. I just moved to Santa Monica after I saw you in Toronto at the Fairfax dinner. I'm a Californian now. I just wanted to ask you - from what you are saying, before you liked to buy at 50 cents, sell at 90 cents; as opposed to the Buffett kind of style of buy the dollar that increases every year indefinitely.

A: Well he's even smarter - he buys at 50 cents and lets it go to 5 bucks.

Q: Yeah exactly – over time. Given that, I was wondering how much you focus in on and what kinds of patterns you look at for why that thing is trading at 50 cents in the first place. Or, is it just on focusing on verifying that it is in fact 50 cents…

A: In many cases it is apparent why it's trading there. Usually there is some type of distress or some nuance with the security. Let's take Japan for example. I had already talked to you about the 17 year cycles. Let's say there is a grandfather who's on his deathbed in Japan and he's about to pass away. He calls his son and grandson and he holds their hands. As he's taking his last breath he says never buy a Japanese stock - it only goes down. Then he dies. What else would he tell them after 30 years right? After 30 years of banging his head he says you are done. Then the son is on his deathbed and he calls his son and he holds his hand and says never buy a Japanese stock and then he passes away.

If I look at the Japanese stocks, my take is that this is a very peculiar and interesting situation. First, all the reports are in Japanese. These are not like your Sony's or Toyota's of the world which have ADRs, have North American sales, North American plants, worldwide investor bases, and reports in English. These are small businesses, some not so small businesses, with a billion dollars in sales. But it's all in Japan. They are not major exporters. The only natural audience that would want to own these things for the most part would be Japanese citizens. It's like the US in 1982. If you ever talk to someone about a stock in 1981 or 1982 they just think you've lost your mind. If some person in Japan brings up to his friends about Taisei Oncho, they just think he's an idiot

because they look at the history. People in investing look at the past. The recent past experience determines how they think about it.

When I look at these Japanese companies, I see this broader based market dynamic. There's some idiot on the other end (I'd love to meet him!) who keeps selling this stock to me. I just want to understand what's going through his mind when he's selling the stock. The reason they are selling is that they've thrown in the towel. I understand why this business is trading where they are trading. I also understand that it's not logical. The nature of markets is that eventually gravity takes over and equities eventually get weighed the way they should.

Q: My name is Mathew Peterson. I'm from Manhattan Beach, California. I wanted to expand a little bit on that option question that was just brought up. It sounds like obviously you are not very attracted to options. If you were able to get past some of the hurdles of amending documentation and what not, would you ever consider using modern portfolio tools like the sale of a put to move into a long position on an equity that you wish to own at a lower price?

A: The issue with that is it sounds great when you talk theoretically, but let's talk about the sale of a put. Let's say, for example I like American Express. I don't like it at $50 a share but I like it at $35 a share. I sell the $35 put and I collect my premium and I just wait. Then the Fall of 2008 happens or the Spring of 2009 and it goes down to $10. The problem with the put is that the point at which your cash is going to get yanked from you is at the absolute worst time. It's at a time when you don't want that cash being yanked from you. One of the things I learned during the last crisis is cash is king. You do not want it to be on any kind of auto-trigger where it can be yanked from you because of this type of nuance where you wrote the put and it got put to you. You are better off ignoring the models and what they show in terms of these things. In these extremely distressed times, you can make 4x or 5x your money if you have the cash because there's such a wide range of opportunities. But if the cash has been pulled away and American Express gets put to you at $35 and then it sits at $10, then you just stare at your belly button. It's just not a good feeling. I'd rather have that cash available when it's at $35 or $25 and $10 and make the decision at that point whether I want to go in or not. If AMEX goes to $35 from $50, there's probably a whole bunch of other things that are vastly more attractive because it's not a blue chip.

Q: Jonathan Herson from Los Angeles California, Mohnish thanks so much for holding this meeting again. I ask the same question every year so I'm just going to repeat myself but before I do I have to say I love the updated book section on your website. It's good. I've even read the family books and I'm not married or have kids. As always, I just want to know what are you reading now and what

have been some of your favorite books in the past year? Same question three years in a row.

A: Well hopefully the books have changed.

Q: Yeah hopefully.

A: One interesting book is a book I heard about from Charlie Munger which was a great read called, "In The Plex" which is the Google story. I thought that was a well written book and it gave a lot of insights into how these engineers are out to dominate the world. There is a book I recently ran into by Tim Hartford called Adapt. That's another kind of fun read; I thought that was pretty good. Those are two that standout recently, and then there's two books that just came out. I haven't read them entirely but I started to plough into them and they will be interesting reads. One is called 1491 which was written a few years back and the other is called 1493. The first one is about the time period just before the arrival of Columbus in the US and the other one is after his arrival. There's a lot of evidence surfacing that reality was quite different than what we've been taught historically about the way the Americas were just before Columbus' arrival. The guy has a great writing style, so those looked like good reads and I'm hoping to plow into them.

Q: Anaj, from Thousand Oaks, California. How do you stay away from the market shadow clouding your decision making. You said you don't talk to management. Does this mean you don't listen to conference calls or read analyst reports?

A: We do listen; we just don't engage in chitchat with them.

Q: Do you read analyst reports?

A: For entertainment. Analyst's reports are okay. I do get them, and I take a look at them. In some cases they have been very useful. There used to be a guy who was an analyst, at Jefferies called Magnus Fhyr. He was a Norwegian guy and he was covering the shipping industry. I found his reports incredible. In fact, we learned a lot from those reports and made investments. He did a tremendous job of how he looked at the businesses. For the most part, I don't think they're independent thinkers. Their stocks at $15, they put a target of $17 or $13 - that sort of thing. They aren't looking at it the way an owner would and/or someone who would want to be a long term investor in the business. So the analysts are disappointing from that point of view.

Q: One question - I know you follow Berkshire pretty closely. Do you think it's undervalued?

A: Yes, Berkshire is quite undervalued. Second stock tip - what a good day.

Q: Vipul Patel from Brentwood, California. Thank you for answering my previous question. I have two questions. One is, how do you avoid the value traps and second is, would you invest in technology companies (like, Buffett wouldn't) because these days you see a lot technology growth companies around?

A: I've never felt that there is any such thing as a value trap. They are investing mistakes but I don't think they are value traps. If an investment flat lines or declines on you, people have a cute way of saying it's a value trap. If you were intellectually honest, you would find a proper reason for why things didn't work out.

For the second question, rapid change is the enemy of the investor. In general, we don't have much interest in industries with rapid change. The funeral service business is great that way. Humans don't change much on that front over even decades and centuries. We tend not to go into businesses which have a rapid change component.

Q: I'm from Chicago, Illinois. I want to thank you for hosting this and thank you for your performance over the years. I also want to ask you my annual question about beta. What do you think your beta is on these stocks, when you say 50 cent dollars? And one follow up question, do you have any other comments on Berkshire and Warren?

A: I don't even know how to calculate beta, and one of my unfortunate trajectories in life is that I never got to go to business school. I never got to learn how to calculate all the Greek letters, beta included. So I can't help you there. Buffett and Berkshire - he is doing well. They are extremely well positioned. They have plenty of liquidity, and they've got a great reputation. They have a number of businesses which are tied to housing, which will limp along for probably longer than Warren seems to think. Those will take a while to come back, but they have plenty of other things that are doing well, and it should work out fine.

Q: Mohnish, this morning's Barrons has an interview with Jim Grant, where he says that he has closed his Japanese investment fund because Japanese stocks never go up, because Japanese executives don't own the stock. He mentions one Japanese company that just spent a cap-ex that was higher than its market value. Would you comment on that?

A: Well, Jim is a very smart guy, but we don't agree with everything he says. Time will tell whether our Japan bet pays off or not. I suspect it will.

Q: I'm Bruce Weiller, Santa Monica. Just wondering how high you would go on foreign investments in your fund - are you limited by your documents?

A: I would not be limited on that front. If we have great opportunities to go to 100%, we would do that. We don't have a mandate to have a certain percent in the US. I wasn't deliberately trying to reduce US exposure, it just so happens that we are opportunistic. We go where value is - that's where we lead to. We weren't trying to do large caps, we weren't trying to do foreign investments. I would say even 18 months ago I wasn't even interested or thinking of doing Japan. But we just went where our nose led us.

Q: Are you looking at other foreign country investments?

A: Japan is unusual and I don't look at it from a country basis typically. Except that, for example, I'm deeply skeptical of Chinese companies. I'm similarly deeply skeptical of small cap Indian companies, even though there are a lot of opportunities there. There are governance issues that come up on both of those. Even large cap Indian companies have a lot of governance issues. We tend to be skeptical, but there are still plenty of opportunities in those geographies. We missed most of them because of those biases.

I'm unlikely to do anything in Zimbabwe, I'm unlikely to do anything in Russia. I have a checklist question "Is the business based in Zimbabwe or Russia?." And so we get our answer and that would be a straight no, we won't go there.

Q: Tony Sylvester from Walnut California. Among the 13Fs, who do you follow the most? There's like 200 of them.

A: We are probably following a few dozen of them. And following doesn't take much time. We just kind of scan it and look at it.

Q: Any names? Companies that you admire?

A: You would do well to look at Berkshire starting out, to look at Fairfax, to look at Seth Klarmans, to look at Longleaf, Fairholme. I would just say there are the usual suspects. Guru Focus is a good site. They have a lot of managers on the list and I don't follow all of them, but a decent number of them are worth looking at.

Q: I just wanted to ask one follow up question. You talked about beta, and risk was brought up earlier. In modern portfolio theory, they define risk as

volatility relative to the average. Buffett likes to define risk more in terms of the probability of a permanent loss of capital. I recently read a great book called, "Against the Gods, the Remarkable Story of Risk" by Peter Bernstein. It's on your list and I wanted to get your thoughts on risk because I work in a commercial insurance world and we define it simply as the probability of injury or loss. That simple. Can you talk about how you view risk and how it pertains to your investment analysis?

A: I would go with Buffett's definition - we are concerned with loss of capital. We think volatility is our friend. In fact, if markets move 200 and 300 points up and down every day, that's wonderful for Pabrai Funds. I hope they keep doing that. In fact, it will be even better if it moves a thousand points a day up and down. That that sort of volatility generally will lead to opportunities that we wouldn't get otherwise. We are not doing anything with volatility other than taking advantage. Volatility is our friend. Volatility has nothing to do with risk.

Q: My name is Maulik Joshi from San Jose California. I want to know what are your top two or three sources of ideas, investment ideas? Is it 13Fs, reading 10Ks or looking at charts?

A: The best way, in fact I wish I would learn to do this, is to just take ideas from the other great investors. You should shut your brain off and everything else and just read 13Fs. Maybe you get two or three ideas in a year, and you are done. Just keep doing that, and you will do quite well. A fund can be simply reverse engineered, using the ideas of the great investors, and investing in the ones that they fully understood.

Q: How many stocks on average do you look at very seriously for every investment decision?

A: I look at a large number of stocks, but most I stop looking at within a couple of minutes. Most of the time we are done because either it is so far outside the circle of competence that there is no point and I know it's not even worth messing with; or the valuation is so far off base that it's not worth messing with. Typically those are two factors that wipe out almost everything. Very simply, if you were to say for example, first, I will only buy things that other great investors already own; and second, you say I will only buy things that are trading at one fourth of intrinsic value. You eliminate almost everything and what's left would be pretty interesting.

Q: Unaudible.

A: There is a fair amount of value in real estate. The issue that comes up is that Pabrai Funds and myself specifically, are extremely lazy. Direct real estate

investing is vastly more work than I typically do, and my wife would say I do no work. We are not set up in terms of that type of heavy lifting. Secondly, real estate is very local. If you are going directly into real estate, you need to have very significant local knowledge. Third, there is an issue with whether you are going to effectively be flipping - buying things cheap and maybe just turning them around and selling them; or if you are going to hold it, that means you will buy something, rent it out, etc. Both strategies may work. It's a completely different competence.

I have some friends who focus on that with very high returns, and they are doing well. But I also see the way their days and nights go. It's a very different approach and you could do well with it in many different areas. We have made significant investments in real estate through the public markets and we've done quite well where we haven't exited. In many cases we have already got more than a 2x return, and we'll probably get more. We've been able to find very smart operators who are willing to roll their sleeves up and do the work and we've just sat on the stock and have done fine.

The issue with real estate businesses is that very few of them have good capital allocators at the helm. They are good at real estate, but they are not good at timing and allocating capital at the right time. We have some investments with some folks that are phenomenal at capital allocation and they have core principles that I agree with. I hope we get to hold the businesses for a while. We'll do well with that. But there is a lot of opportunity in direct real estate ownership as well with single family, multi-family homes especially in some of the distressed markets as long as you've got the ability to roll up your sleeves and do the work. In some cases you are able to do flips which can get you a good decent amount, and in other cases you can rent out and do okay. There are some folks in the room who do that and who do that quite well.

Q: Ajay from Bakersfield, California. Quick question - in the last meeting in Chicago you talked a lot about commodities and how some commodities are not really a commodity and some are commodities. There are grays and it is not always black and white. There are some commodities which become a choke point. It's a good concept. Can you go over your thoughts on that?

A: On the commodity front, you need to focus on the cost curve. With all commodities you can pull up the cost curve. You can think about cost curves in terms of quartiles and which is the lowest 25% producer. Let's say in the oil business, Saudi Arabia will be a first quartile producer and the Canadian Oil Sands would be a fourth quartile producer.

Canadian Oil Sands produces oil at a very high cost per barrel and Saudi Arabia produces at a very low cost per barrel. There is a big difference in these two

ways of producing oil and it has a huge impact on what the returns might be. If you have the ability to buy into a low cost producer in that first or second quartile at a reasonable valuation, even oil prices or whatever commodities prices you are looking at don't need to be very high to make money.

You can have speculative bubbles and different things going on in commodity pricing, but for most part it's the marginal last ton that gets used that sets the price. In terms of pricing you can figure it out. If you can figure out what will be consumption of commodities over time and you see the cost curves, you can tell what the pricing is expected to be. For the last guy producing, he is going to basically make a very small profit or might even break even. If you are at the low end of the cost curve then you will know with a pretty decent margin what your minimum cash flows might be.

You can look at the same thing in retail. In retail you can look at, for example, gross margins and net margins and compare retailers on that basis. If you look at banks you can look at return of assets and you can compare banks base and return assets. You can do this in different industries but this is how you do it in commodities.

The first part is where it is on the cost curve. What are the commodities and where is it on the cost curve. The second is that each commodity is different in the sense that there are some commodities where three or four countries control 80 or 90% of the trade. I talked about iron ore and metallurgical coal. That becomes an oligopy where those countries have a lot of control. China cannot build its cities if Australia and Brazil aren't supplying the coal and iron ore. There is no way for them to get that amount of coal or iron ore to build it if they don't get it from these sources. If you own a Brazilian iron ore mine which is right next to the coast which is a first quartile producer, and you are able to buy it at a price that doesn't have a big premium, you will probably do very well with that investment because of the dynamics.

There are other commodities like copper. Copper is produced all over the world, and there is no choke point. It's produced in all kinds of different price points. With copper, the only advantage you can gain is where they are on the cost curve. In the coal or in the case of met-coal and iron ore you can gain two advantages – where they are on the cost curve and what geography they are in, and both of those in combination.

You can look at commodities with moats and with competitive advantages based on that and do okay. I don't think that some of these things have easy substitutes. I don't think you can build large scale civilization without iron ore. You just can't do that.

Q: My question is a follow up. In CFA Journal this last month, one of the donors in your Foundation, Fairfax, Prem Watsa, talked about gold. Did you read the article about what he said about gold?

A: I don't think Prem is a fan of gold.

Q: He's not, that's what I want to ask you.

A: Well I'm not a fan of gold either. Warren expressed it well. He says if you put all the gold in the world together you would get a cube which is 63 feet on each side. The value of the cube would buy you five Exxon Mobils, it would buy you in addition to five Exxon Mobils, all the farm land in the US, and in addition to all of that it would give you over $1 trillion of walking around cash.

Do you want to have the cube of gold which Warren says you can go up against and polish and feel good about, or would you like to have producing assets like Exxon Mobil and US farmland and whatever else? That's a good way to think about it. The gold situation I find interesting because when I was in high school my father ran a gold jewelry factory in the Middle East. We were in Dubai. I was finishing high school, and right at that time the Hunt Brothers tried to corner the silver market.

In my father's very small factory, he had a guy on his staff who had expertise in refining silver. These jewelers approached my dad. They said they were getting people coming in with all their pots and pans, ornaments and everything else silver, and we are buying this stuff pretty cheap from these guys. Because the prices were so high, can you melt it down and refine it and get it back to us quickly so we can sell it off and not have a commodity risk because we've already taken ownership of it.

The jewelers did not want price risk. They saw silver as a bubble. They just wanted to buy it cheap - exactly what we are seeing right now. You see all these guys with a gold sign, "we buy gold" at different street corners in California. It was the same thing in the Hunt brothers' time. At that time, my dad completely shut down all the gold manufacturing within two days and converted the whole factory into a silver refining operation. He set a pricing which was, if you want it back in 3 hours then this is the price; and if you want it in 3 days then it was a bargain price. There was just an unbelievable amount of silver that came through that plant. Everyone was willing to pay all kinds of premiums and my US education got paid by that Hunt brothers' silver bubble. Then the bubble burst and he went back to producing gold ornaments. Well, it was fun while it lasted.

So the interesting thing about that particular bubble and the current bubble in gold is that you don't have just the Hunt brothers going out and buying silver. What you have is, you have all across the world very heavy duty buying of gold going on by all kinds of entities. If I look at that time in 1980 it was just these two rich guys trying to go at it. Now it's a whole bunch of freaked out millionaires, billionaires, sovereign funds, governments you name it who are going at it. The flipside of gold is that unlike other commodities it never disappears. So any ornament sold in any Indian wedding is always there. We are now seeing a massive amount of gold that is owned by individuals that is coming on the market, and there are people like my dad who are on a turbo mode refining it and pumping it out.

Now, though, you have a huge demand on the other end which is different from the Hunt brother's demand. It's hard for me to tell when the music stops but I'm pretty sure the music will stop. Gold is interesting because you have a pretty small 63 ft. cube that can easily fit in this room. The dynamic of a large amount of money going into a very small space, which is exactly what Prem's concern is, is making the price rise because people don't trust anything else.

We've been through a lot. Think of the history in the US in the last century - the depression, two world wars and all these recessions and all the different crises, the Cuban missile crisis and currencies, high inflation, stagflation and everything. This too shall pass. All these things that we are seeing right now that seem like a permanent picture will pass and when it passes gold will lose some luster as it goes. People underestimate the amount of gold that comes on the market when you have these elevated prices.

On that note, it's time to bring this to a close and enjoy our cocktail hour. Thank you for coming and I hope you enjoy dinner.