PABRAI INVESTMENT FUNDS

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To: All Limited Partners and Investors of the Pabrai Investment Funds

From: Mohnish Pabrai, Managing Partner

Date: January 17, 2007

Re: **2006 Results et. al.**

Dear Partners:

For the quarter ended Dec. 31, 2006, a total of $16.9 Million was added to the various funds by new and existing partners. The additions on a per fund basis are:

PIF2 (US Accredited): $1.0 Million

PIF3 (Offshore/IRA): $3.9 Million

PIF4 (US Qualified): $12.0 Million

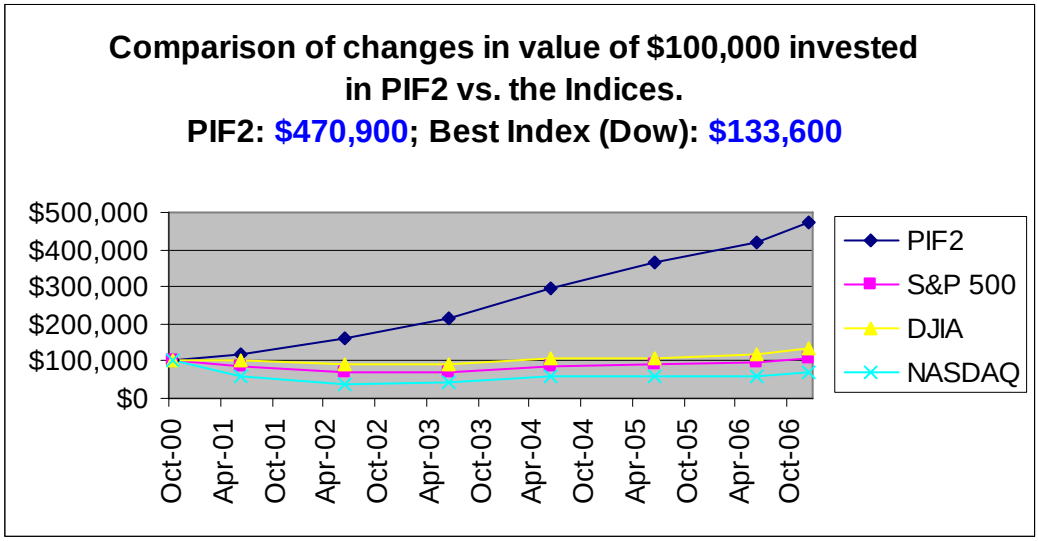
In addition, Dec. 31 was also the annual redemption date. A total of $9.8 Million was redeemed from the various funds. The redemptions on a per fund basis are:

PIF2: $2.6 Million PIF3: $0.3 Million PIF4: $6.9 Million

The updated performance numbers on all the funds are:

PABRAI INVESTMENT FUND 2 (US Accredited Investors) Performance Summary:

	DJIA	NASDAQ	S&P 500	PIF2 (net to investors)
10/1/00 – 6/30/01	**-0.2%**	**-41.0%**	**-14.0%**	**+17.4%**
7/1/01 – 6/30/02	**-10.3%**	**-32.7%**	**-18.0%**	**+35.3%**
7/1/02 – 6/30/03	**-0.5%**	**+11.4%**	**+0.3%**	**+34.2%**
7/1/03 – 6/30/04	**+18.6%**	**+26.8%**	**+19.1%**	**+38.7%**
7/1/04 – 6/30/05	**+0.7%**	**+1.1%**	**+6.3%**	**+23.4%**
7/1/05 – 6/30/06	**+11.1%**	**+6.5%**	**+8.6%**	**+15.0%**
7/1/06 – 12/31/06	**+13.1%**	**+11.6%**	**+12.7%**	**+12.1%**
1/1/06 – 12/31/06	**+19.0%**	**+10.4%**	**+15.8%**	**+26.3%**
Annualized	**+4.8%**	**-6.0%**	**+1.5%**	**+28.1%**
Cumulative	**+33.6%**	**-32.0%**	**+9.7%**	**+370.9%**

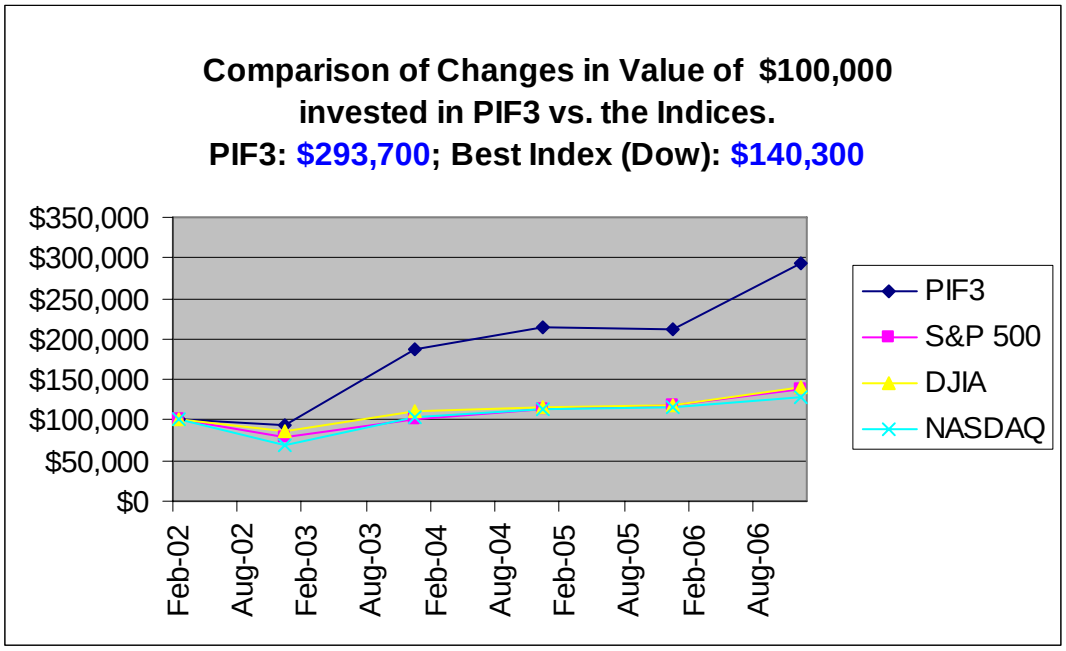


PIF2 Investors:

A $100,000 investment in PIFI at inception on July 1, 1999 and rolled over into PIF2 on 12/31/02 ($197,900) was worth $659,700 as of December 31, 2006 (net to investors). This equates to an annualized return of 28.6% since inception – after all management fees and expenses. The best index over the same period was the Dow and an investment of $100,000 in the DJIA on July 1, 1999 was worth $132,300 on December 31, 2006 – an annualized gain of 3.8%. The Dow gains include reinvested dividends.

PABRAI INVESTMENT FUND 3 (Offshore/IRA Investors) Performance Summary:

	DJIA	NASDAQ	S&P 500	PIF3 (net to investors)
2/1/02 – 12/31/02	**-14.1%**	**-29.9%**	**-20.4%**	**-5.2%**
1/1/03 – 12/31/03	**+28.3%**	**+50.8%**	**+28.7%**	**+96.5%**
1/1/04 – 12/31/04	**+5.3%**	**+9.2%**	**+10.9%**	**+14.7%**
1/1/05 – 12/31/05	**+1.7%**	**+2.1%**	**+4.9%**	**-0.2%**
1/1/06 – 12/31/06	**+19.0%**	**+10.4%**	**+15.8%**	**+37.8%**
Annualized	**+7.1%**	**+5.3%**	**+6.6%**	**+24.5%**
Cumulative	**+40.3%**	**+28.6%**	**+37.0%**	**+193.7%**

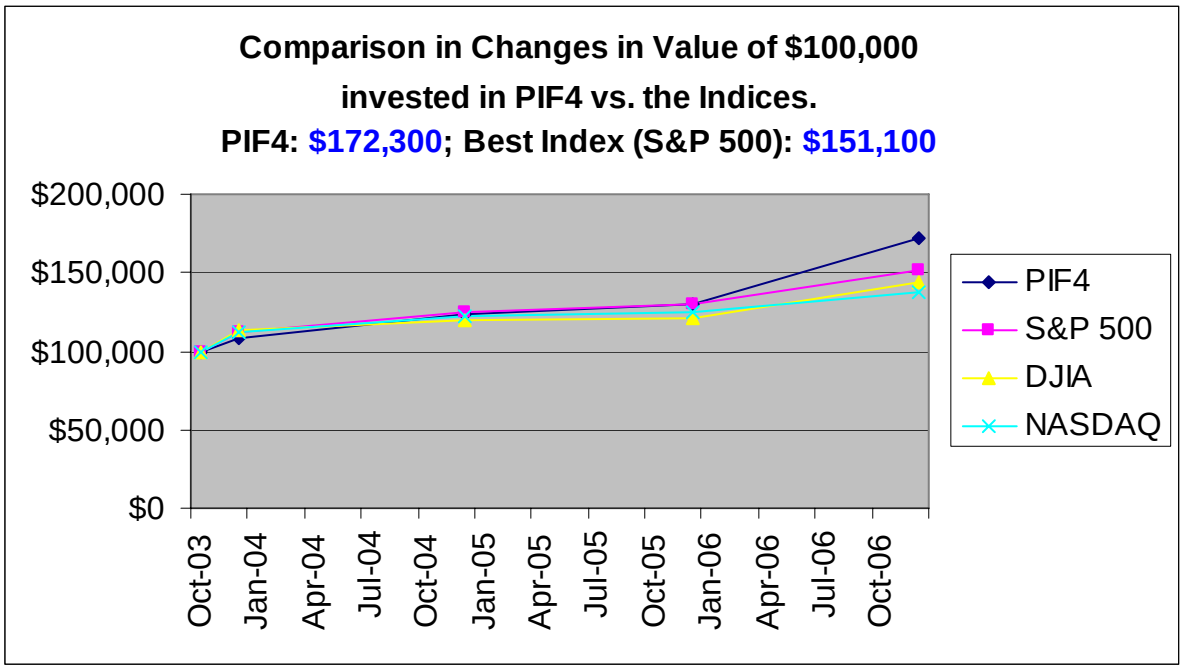


PIF3 Investors:

A $100,000 investment in PIF3 at inception on February 1, 2002 was worth $293,700 as of December 31, 2006 (net to investors). This equates to an annualized return of 24.5% since inception. The best index over the same period was the Dow and an investment of $100,000 in the Dow on February 1, 2002 was worth $140,300 on December 31, 2006 – an annualized gain of 7.1%. The Dow gains include reinvested dividends.

PABRAI INVESTMENT FUND 4 (US Qualified Investors) Performance Summary:

	DJIA	NASDAQ	S&P 500	PIF4 (net to investors)
10/1/03 – 12/31/03	**+13.4%**	**+12.3%**	**+12.2%**	**+8.4%**
1/1/04 – 12/31/04	**+5.3%**	**+9.2%**	**+10.9%**	**+14.4%**
1/1/05 – 12/31/05	**+1.7%**	**+2.1%**	**+4.9%**	**+4.9%**
1/1/06 – 12/31/06	**+19.0%**	**+10.4%**	**+15.8%**	**+32.4%**
Annualized	**+12.0%**	**+10.5%**	**+13.5%**	**+18.2%**
Cumulative	**+44.6%**	**+38.2%**	**+51.1%**	**+72.3%**



PIF4 Investors:

A $100,000 investment in PIF4 at inception on October 1, 2003 was worth $172,300 as of December 31, 2006 (net to investors). This equates to an annualized return of 18.2% since inception. The best index over the same period was the S&P 500 and an investment of $100,000 in the S&P on October 1, 2003 was worth $151,100 on December 31, 2006 – an annualized gain of 13.5%. The S&P gains include reinvested dividends.

General Comments

2006 was quite a good year for Pabrai Funds. Firstly, we were able to identify and buy stakes in some substantially undervalued businesses last year. This likely will bode well for Pabrai Fund investors over the next few years – assuming I'm generally right about the intrinsic value of most of these businesses. Secondly, all three funds beat the best of the indices by substantial margins in 2006. The Dow was up an astounding 19% last year (inclusive of dividends). Nonetheless, all three funds trounced the Dow. PIF2 was up 26.5%, PIF3 was up 37.9% and PIF4 clocked in an impressive gain of 32.6%. All these gains are net to investors – after my outrageous fees and all expenses.

The Importance of Clean Windshields

Since 1998 I've made my annual pilgrimage to Omaha. And a few years ago, I added Pasadena to the itinerary. A value investor trying to apply the principles of Buffett, Munger and Graham is constantly bombarded with a bunch of gunk. This gunk is all around us – newspapers, investing periodicals, television and the rants of so-called investment pundits. Going to the Berkshire and Wesco annual meetings feels like getting a giant dose of Windex on my windshield. The gunk is all cleared away. My windshield looks brand new and I'm ready to take on the gunkers for another year.

Recently I read *The Little Book of Value Investing* by Chris Browne of Tweedy Browne. While I didn't learn much new stuff, I did enjoy the book and recommend it. It served the same purpose for me as that of my annual pilgrimages to Omaha and Pasadena. It was a welcome dose of Windex that, once again, left me with a spotless windshield. Here are some interesting tidbits from the book:

- Between 80 and 90 percent of the investment returns in stocks occur around 2 percent to 7 percent of the time.

- From 1926 to 1993, the returns in the best sixty months (or 7 percent of the time) averaged 11 percent. The rest of the months, or 93 percent of the time, returns averaged 1/100th of a percent.

- Peter Lynch, the legendary and highly successful manager of the Fidelity Magellan Fund for many years, once remarked that he calculated that more than half of the investors in his fund lost money. This happened because money would pour in after a couple of good quarters and exit after a couple of not so good quarters.

- If you had ridden all the bumps and grinds of the market from 1990 to 2005 (through the go-go 1990s into the sell-off from 2000 to 2002), $10,000 invested would have grown to $51,354. If you had missed the 10 best days over that 15-year period, your return would have dropped to $31,994. If you had missed the 30 best

days – one month out of 180 months – you would have made $15,730. Had you missed the 50 best days, you would have come out a net loser, and your $10,000 would now be worth only $9,030.

Pabrai Funds has just 7½ years of history. It is not a very long time. But we've had some interesting data points already. Here are a few that stand out:

- Between June 1, 2002 and Sept. 30, 2002 (four months), PIF2 lost over 38% of its value. If you had invested $100,000 into PIF2 on 6/1/02, you received a statement in October '02 showing that it was now worth under $62,000. This is not a hypothetical statement. There are some of you that made your first investment in Pabrai Funds on June 1, 2002 and received just such a statement four months later. As an aside, that $62,000 is now worth over $270,000.

- For the first nine months of 2006, PIF2 was up just 3.4%. For the entire year, it is up 26.3%. Most of the gains for PIF2 in 2006 came in the fourth quarter. 80+% of the gains in 2006 came in 25% of the time. The story is similar with PIF3 and PIF4 as well.

- PIF2 has averaged an annualized return of 28.1% over the last 6+ years – after all fees and expenses. Its fiscal year ends on 6/30 and it has had no down years when measured from 7/1 to 6/30 in any year since inception. On the surface this looks like a pretty smooth ride. It has been anything but that. In calendar 2002 (1/1/02 – 12/31/02), the fund was down about 2.5%. And in calendar 2003, it was up over 104%. Returns have been quite lumpy. I expect this lumpiness to continue.

What conclusions can we draw from all of the above? Simply this that if one invests in equity funds, one needs to commit to the same for 5 to 10 years or longer. Trying to time the market is mostly a fool's errand. And one really ought to focus one's attention on long-term returns versus monthly, quarterly or yearly results. This has been our mantra since inception and I'm very happy that we've attracted an investor base that "gets it."

I do expect Pabrai Funds to continue to outperform the best of the three indices over the long-term. I have no idea by how much we will outperform, but am willing to wager that it will be substantially less than the last 7½ years. Partners would be best off setting their expectations for Pabrai Funds to outperform the best of the three indices by a small margin over the long haul.

Alignment of Interests

All three funds are at all-time highs. PIF3 earned a fee of $1,149,205.88 on 11/30/06 and $2,235,051.91 on 12/31/06. Since this is an offshore fund, I cannot reinvest these fees back into the fund. PIF2 earned a fee of $3,425,642.55 and PIF4 earned a fee of $7,376,082.57. All PIF2 and PIF4 fees were reinvested back into the respective funds by Dalal Street.

Dalal Street (wholly owned by me) and myself (IRA etc.) have a stake of 536,791 units of PIF2, 7,301 units of PIF3 and 783,009 units of PIF4. This stake is worth about $39 Million.

Besides the previously disclosed stake and small investment in Dardashti Capital (worth about $1 Million), my family has no interests in any other mutual funds or hedge funds. I have a deep vested interest in the future performance of Pabrai Funds.

Pabrai Funds charges no management fee, just performance fees – which are ¼ of the returns over 6% annualized (subject to high-water marks). I only get paid when you make money. When you win, I win. Our interests are completely aligned. I am very bullish on the long-term future of Pabrai Funds – as demonstrated by my being the single largest investor in the funds.

2007 Annual Meetings – Save the date

As is our usual modus operandi, there will be two annual meeting sequentially at Orange County, California and Chicago. This year, however, the order is reversed – the California meeting precedes the Chicago meeting. The **California** meeting will be held on **Saturday, Sept. 15, 2007** at 4:00 PM at our usual venue:

Hyatt Regency Huntington Beach Resort and Spa
(Grand Ballroom)
21500 Pacific Coast Highway, Huntington Beach, CA 92648 Tel. +1714.698.1234

We do have 10 rooms set aside for the event at $248/night for the 15th. Call the hotel directly and book your room at this rate at the earliest mentioning Pabrai Investment Funds. Alternately, Hyatt.com usually has good rates and you can book online as well. Please book early as the hotel usually is fully booked around that time. The hotel is closest to Orange County Airport (SNA), though LAX and Long Beach (LGB) are convenient as well.

The **Chicago** meeting is scheduled to be on **Saturday, Sept. 29, 2007** at 4:00 PM at our usual venue:

Carlucci's Restaurant
(The Auditorium)
6111 North River Road, Rosemont, Illinois 60018 Tel. +1847.518.0990

Carlucci's is a five minute taxi ride away from O'Hare airport. The Marriott Suites O'Hare and The Westin O'Hare are both next to the restaurant. In addition, there are a plethora of hotels in the vicinity.

Agenda:

4:00 – 4:30 PM: Meet and Greet
4:30 – 6:30 PM: Presentation and Q&A
6:30 – 7:30 PM: Cocktail Hour
7:30 PM: Dinner

The invites will go out in June '07. Your significant other and kids of all ages are welcome to attend. I look forward to seeing you in September '07.

Audit and Tax Update

PricewaterhouseCoopers has begun work on the tax returns for the US funds (PIF2 and PIF4). We expect to send out final K-1's to all partners by March 31, 2007. In the interim, for planning, you have the estimated K-1's which cover the period 1/1/06 through 11/30/06.

Dec. 31 is the fiscal year end for PIF3 and PIF4. PricewaterhouseCoopers has also begun work on its annual audit of these two funds. Their final audit report is expected to be mailed to you before March 31, 2007.

Electronic Statements

For PIF3, the administrator, Folio Administrators in the British Virgin Islands (BVI) currently emails as well as snail mails monthly statements to all investors. We have made a change whereby, going forward, the default is to only email the statements. If an investor would still like to continue receiving the paper statements, please email Tracy Russ at tracy@folioadmin.com and she'll do the needful. Mail to and from the BVI is quite slow and the paper statements are redundant.

For PIF2 and PIF4 also we're moving to electronic statements as a default as of April 1, 2007. Please check the email address we'll have printed on your 12/31/06 statement as that's where we will email your statement. If you'd like to change or add additional email addresses (or continue receiving paper statements) please contact Bob Sempsey at Michael J. Liccar & Co. (rsempsey@liccar.com; +1312.922.7505).

2-year lock-up; SEC Regulatory Changes

As you are aware, Pabrai Funds added a 2-year lock-up towards the end on 2005 in order to be exempted from the SEC's newly imposed onerous registration requirements. These new regulations were challenged in court and the SEC lost the case and reversed itself. At this time therefore we could remove the 2-year lock-up and not be required to register with the SEC.

As an alternate approach, the SEC has proposed changes which will affect who can invest in hedge funds. Specifically, they are proposing boosting the accredited investor requirement

from $1 Million in networth to $2.5 Million excluding one's principal residence. These proposed changes are likely to become law in the next few months.

I have never been a fan of lock-ups. Even though I believe no one should invest in Pabrai Funds without having a minimal timeframe of 5-10 years (or longer), I'd rather have exits available once a year. So, once the dust settles on the SEC's course of action, I hope to propose amendments that eliminate the 2-year lock-up and change the accredited investor requirements. My best guess at this time is that these changes are likely to take place sometime in calendar 2007. The amendments are intended to allow us to go back to allowing redemptions once a year (on 12/31) with a minimum 60-days advance notice and no minimum lock-up period.

Stay tuned.

Upcoming Book – The Dhandho Investor – April 6, 2007

I had a lot of fun researching and writing a book last year entitled,

The Dhandho Investor: *The Low Risk Value Method to High Returns*

The book is being published by Wiley and is slated to be released on April 6, 2007. You can pre-order a copy on Amazon now. Here is the link:

http://tinyurl.com/wj4tx

Please do not be shy about recommending it to your friends and family. At $19.29, I think it is a tremendous value – even if I say so myself - ☺.

Upcoming Events – Value Conferences

I've been asked to speak at two events in May 2007. Here are the details:

1. **4th Annual Value Investor Conference**
   The Ayres Hotel, Near LAX Airport (Hawthorne, California)
   May 7-8, 2007
   http://www.valueinvestorconference.com

   This conference is organized by Bob Miles. I'm scheduled to present on May 7th after 5:00 PM. The topic is the title of my upcoming book:

   The Dhandho Investor: The Low Risk Value Method to High Returns

   If you register before January 31, 2007, the fee is $745. After January 31, it is $895.

2. **2nd Annual Value Investing Congress West**
Renaissance Hollywood Hotel (Home of the Oscars), Hollywood, California
May 8-9, 2007
http://www.valueinvestingcongress.com/

The topic is ... what else ... the title of my upcoming book:

The Dhandho Investor: The Low Risk Value Method to High Returns

The conference is priced at $2,595 if you register before March 30, 2007. You can get an additional $500 off if you register before January 31 and use the "friend of Mohnish" discount code. Enter the code VICWSMP when you register online *before January 31.*

Next Opening – April 1, 2007 (all funds); February 1, 2007 (PIF3)

There are 2 funds open to new investors to add funds - PIF3 and PIF4.

The minimum investment for PIF4 is $1,000,000 and one needs to be a "qualified investor" as defined by the SEC. The offering and subscription documents for PIF4 have details on who is considered a qualified investor. Next opening is April 1, 2007.

To invest in PIF3, one needs to be a non-US accredited offshore investor. Tax-exempt accounts like IRAs, Roth IRAs and US Family Foundations can invest in PIF3 as well. The minimum investment to join PIF3 as a new partner is $1,000,000 for US Tax-exempt accounts and $100,000 for offshore investors. Next opening date for PIF3 is February 1, 2007.

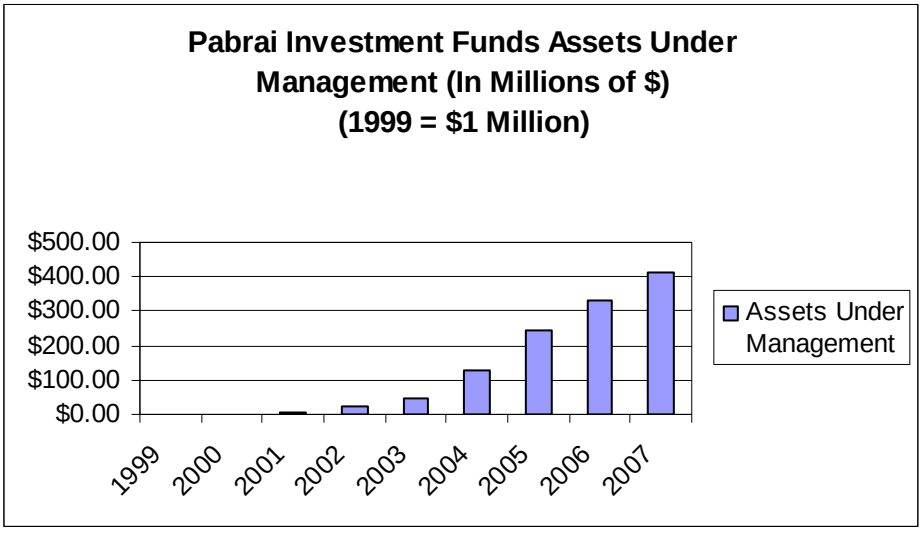
Existing partners in any of the Pabrai Funds can add funds in increments of $25,000 at each opening (with a $25,000 minimum).

Please note that all moneys received from existing and new subscribers for all three funds are subject to the 2-year lockup period. The first time funds sent in on 2/1/07 can be redeemed is 1/1/10. Pabrai Funds processes redemptions on the FIFO (first-in first-out) basis.

PIF2/PIF4 open once every quarter to add funds from new/existing investors (1/1, 4/1, 7/1, 10/1) while PIF3 is open to add funds on the 1st day of every month.

Assets Under Management

There is over $412 Million in assets under management between all the funds as of January 1, 2007.



Thanks for your continued interest, referrals and support. Feel free to call me at +1949.275.5652 or email me at mpabrai@pabraifunds.com with any queries or comments.

Warm regards,



Mohnish Pabrai

Appendix A

PIF2's Performance History (Net to Investors)

No. of Units	Date	PIF2 NAV
110,000	10/1/2000	$10.00
330,014	6/30/2001	$11.74
1,027,795	6/30/2002	$15.89
1,950,982	6/30/2003	$21.32
2,445,212	6/30/2004	$29.58
2,696,687	6/30/2005	$36.52
2,646,687	6/30/2006	$41.99
2,679,512	9/30/2006	$38.54
2,718,814	12/31/2006	$47.09

PIF3's Performance History (Net to Investors)

No. of Units	Date	PIF3 NAV
65,100	2/1/2002	$10.00
265,919	12/31/2002	$9.48
485,041	12/31/2003	$18.63
1,774,753	12/31/2004	$21.37
2,478,793	12/31/2005	$21.32
2,930,614	12/31/2006	$29.37

PIF4's Performance History (Net to Investors)

No. of Units	Date	PIF4 NAV
595,030	10/1/2003	$10.00
1,219,330	12/31/2003	$10.84
5,627,712	12/31/2004	$12.40
9,314,803	12/31/2005	$13.01
11,528,331	12/31/2006	$17.23

Past performance is not indicative of future results. Returns are presented net of all fees and expenses, include the reinvestment of income and are calculated using a simple rate of return. The securities discussed do not represent all securities recommended for the Funds. It is also not a recommendation to buy or sell and one should not presume they will be profitable.

Please be aware that our past newsletters may discuss specific securities that have performed well without necessarily addressing those that have underperformed within our Fund(s). Readers should not infer that all investment decisions within the Funds were profitable.