PABRAI INVESTMENT FUNDS

114 Pacifica, Suite 240
Irvine , CA 92618-3321
USA

Tel. +1949.275.5652
mpabrai@pabraifunds.com
www.pabraifunds.com

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

From: Mohnish Pabrai, Managing Partner

Date: April 8, 2006

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

Dear Partners:

On the April 1 subscription date a total of $5.5 Million was added to the various funds by new and existing partners. In addition $0.7 Million and $0.3 Million were added to PIF3 on February 1 and March 1 respectively. The additions on a per fund basis are:

PIF2: $0.8 Million

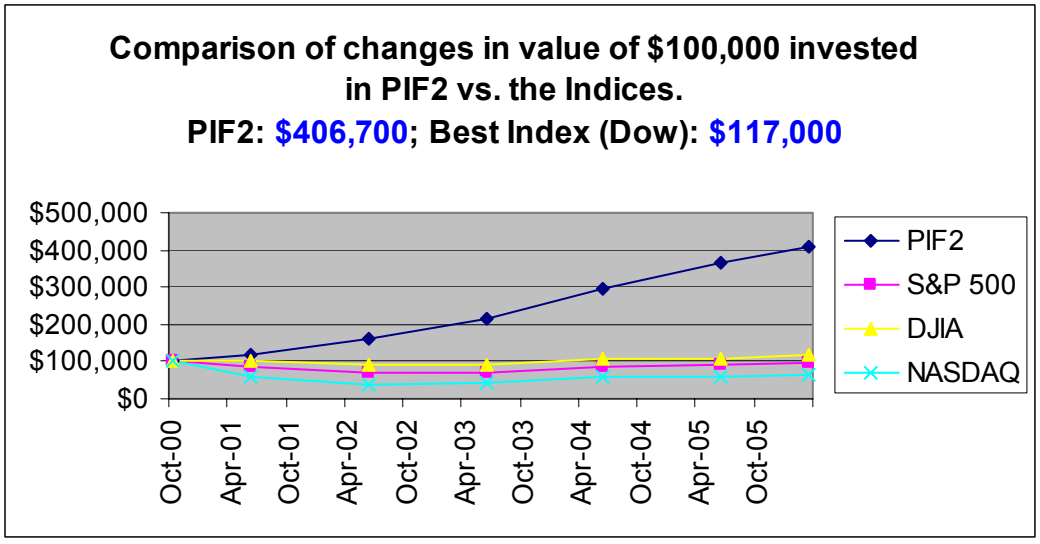
PIF3: $1.3 Million

PIF4: $4.4 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 – 3/31/06	**+10.1%**	**+14.5%**	**+10.2%**	**+11.3%**
1/1/06 – 3/31/06	**+4.2%**	**+6.4%**	**+4.2%**	**+9.1%**
Annualized	**+2.9%**	**-7.4%**	**-0.2%**	**+29.1%**
Cumulative	**+17.0%**	**-34.5%**	**-1.3%**	**+306.7%**

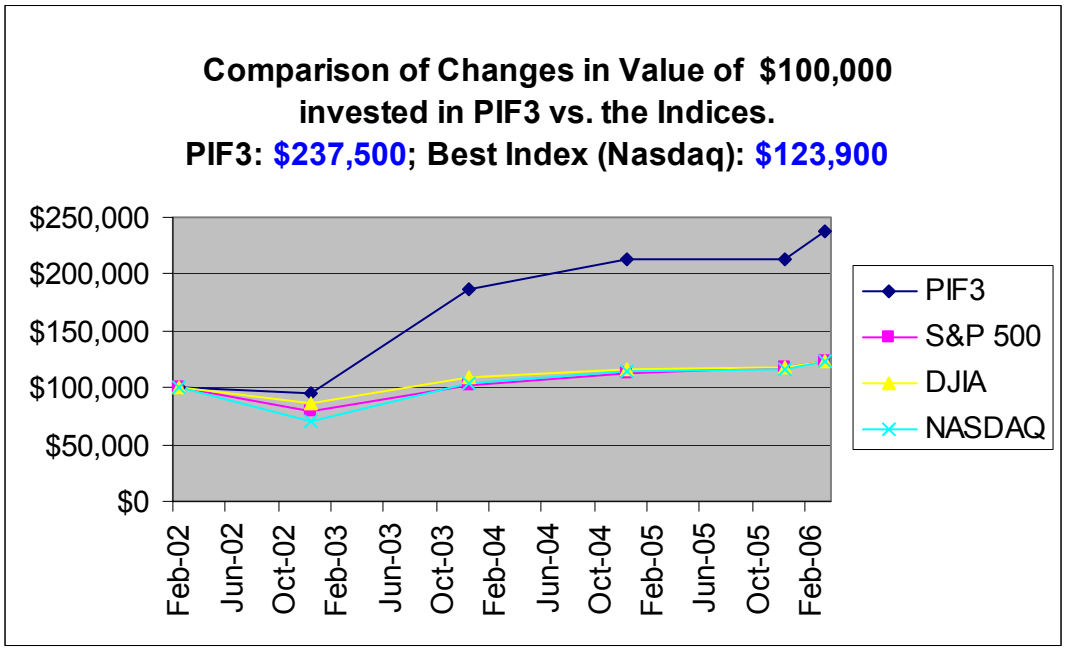


PIF2 Investors:

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 $569,800 as of March 31, 2006 (net to investors). This equates to an annualized return of 29.4% 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 $115,800 on March 31, 2006 – an annualized gain of 2.2%. 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 – 3/31/06	**+4.2%**	**+6.4%**	**+4.2%**	**+11.4%**
Annualized	**+5.1%**	**+5.3%**	**+5.2%**	**+23.1%**
Cumulative	**+22.8%**	**+23.9%**	**+23.3%**	**+137.5%**

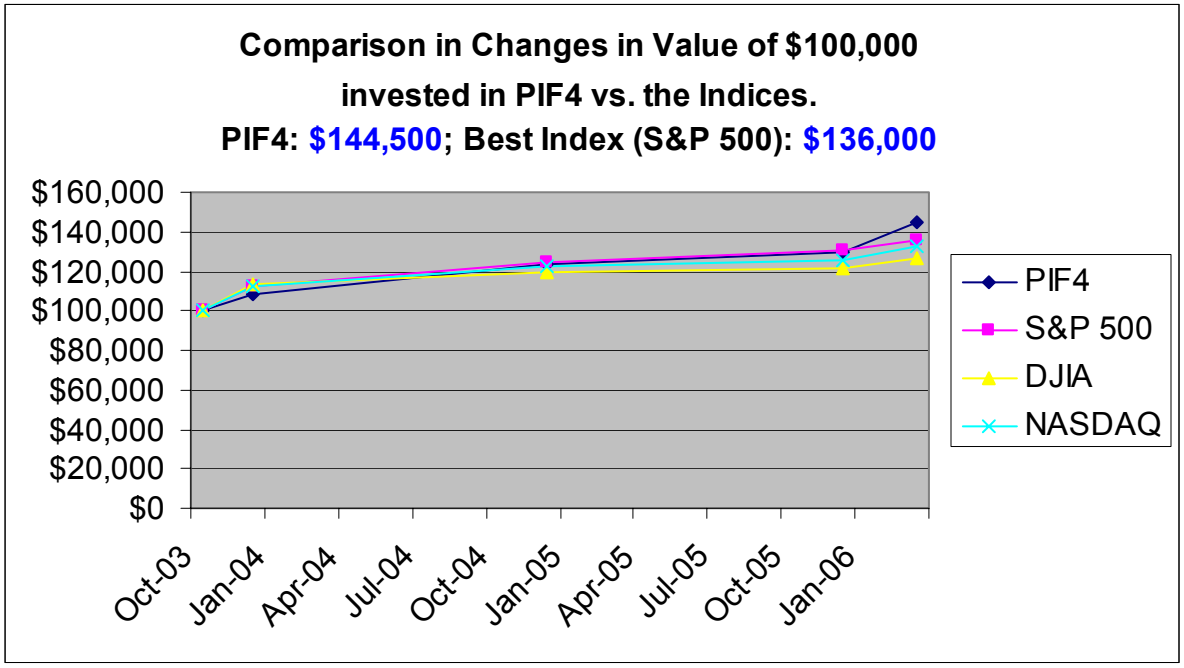


PIF3 Investors:

A $100,000 investment in PIF3 at inception on February 1, 2002 was worth $237,500 as of March 31, 2006 (net to investors). This equates to an annualized return of 23.1% since inception. The best index over the same period was the Nasdaq Composite and an investment of $100,000 in the Nasdaq on February 1, 2002 was worth $123,900 on March 31, 2006 – an annualized gain of 4.4%. The Nasdaq 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 – 3/31/06	**+4.2%**	**+6.4%**	**+4.2%**	**+11.1%**
Annualized	**+9.9%**	**+12.1%**	**+13.1%**	**+15.9%**
Cumulative	**+26.6%**	**+33.2%**	**+36.0%**	**+44.5%**



PIF4 Investors:

A $100,000 investment in PIF4 at inception on October 1, 2003 was worth $144,500 as of March 31, 2006 (net to investors). This equates to an annualized return of 15.9% 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 $136,000 on March 31, 2006 – an annualized gain of 13.1%. The S&P gains include reinvested dividends.

General Comments

We began 2006 on a good note. All three funds were up 9.1%, 11.4% and 11.1%, respectively for the first quarter. That's a little better than the three benchmark indices. The Nasdaq climbed 6.2% in the first quarter while the Dow and S&P were up 4.2% each.

What matters, however, is longer term performance. Here too, the news is good. Since inception, after all fees and expenses, all three funds have outperformed the broad indices. PIF2 has delivered an annualized return of 29.1%, while PIF3 and PIF4 have delivered annualized gains of 23.1% and 15.9% respectively. It is worth noting, however, that PIF3 is a little over 4 years old, while PIF4 has only had 2½ years of operating history. I'll be able to speak more intelligently about these funds after they are at least five years old. Nonetheless, the ship is certainly sailing in the right direction.

Pabrai Funds is 6¾ years old. A $100,000 investment in Pabrai Funds at inception on July 1, 1999 is now worth $569,800. This equates to an annualized return of 29.4% 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 $115,800 on March 31, 2006 – an annualized gain of 2.2%.

Past performance is exactly that – it is in the past! Partners would be best off setting their expectations for Pabrai Funds to outperform the best of the three indices by a small margin in the future. Just 1 in 200 money managers beat the indices by over 3% over the long haul. I consider an annualized 3% out-performance versus the best index to be a superb long-term accomplishment.

An Investment Team Size of One

Including me, the total staff at Pabrai Funds consists of less than two full-time people. The other folks who are critical to our smooth functioning are:

1. Ms. Isabelle Secor, Office Manager – Isabelle averages under 30 hours a week. Isabelle has moved from being "0.3" to "0.5" to now "0.7!" Are we getting bureaucratic?

2. Mr. Jared Parker, Administrative Support – Jared is a college student and averages under 5 hours a week. Jared is our critical "0.1" team member.

In my last letter to partners I noted that Pabrai Funds, in many ways, is a quirky set of funds. The quirks I discussed in the last letter are:

1. We charge no management fees (just performance fees above a threshold).
2. We don't discuss current portfolio holdings.

Another quirk is that at Pabrai Funds the entire investment team consists of one person. There are no analysts or associates or other general partners besides myself. All investment research, securities analysis and analytics are done by yours truly.

If there is another mutual fund or hedge fund with over $300 Million in actively managed assets and an investment team size of one anywhere on the planet, I am not aware of it. There was, however, one hedge fund that ended operations in 1970 that operated this way. The Buffett Partnership always had an investment team size of one – Mr. Warren Buffett. And in 1970, when he terminated the partnership, it had over $100 Million in assets, which in 2006 dollars would be over $600 Million.

Since 1970 until today, Mr. Buffett's capital under management at Berkshire Hathaway has mushroomed to well over $100 Billion. And even today, the investment team size at Berkshire Hathaway, for the bulk of the capital, is one individual - Mr. Buffett himself. And besides managing over $100 Billion, he is the CEO of one of the largest companies in North America with over 180,000 employees. And on top of that he still finds time to play 10-15 hours of bridge every week. Clearly a single human brain is not tapped out managing even $100 Billion in assets.

Some would argue that Charlie Munger works with Mr. Buffett and hence the team size is at least two. Mr. Buffett and Mr. Munger have an unusual relationship. Mr. Munger lives in Los Angeles while Mr. Buffett is a lifelong resident of Omaha. The two men speak a few times every month on the phone and likely meet less than 3-4 times a year. Mr. Buffett does consult Mr. Munger from time to time on certain investments or acquisitions, but there are two facets to this interaction:

1. For many investments or acquisitions, Mr. Buffett does not consult Mr. Munger at all. (E.g., when Berkshire acquired General Re, its largest acquisition ever, Mr. Munger did not know it was even in the works till the deal was nearly done.)

2. Sometimes Warren consults Charlie and if Charlie is negative or skeptical, he proceeds anyway.

Clearly this is not a traditional investment team. These are two individuals who proceed with investments even when they don't have consensus. One partner sometimes does not even bother to consult the other partner from time to time. And note that the person not being consulted in none other than Charlie Munger. Given the opportunity, how many investment professionals would decline the opportunity to get Charlie's opinion on an investment?

If there is such a thing as the Laws of Investing, they have been written by Graham, Buffett and Munger. And a small team size (ideally one) is one of these laws. Why is an investment team size of one so critical?

Let's take the example of Buffett putting 40% of the Buffett Partnership's $17 Million in assets into a single business in 1963. That business, American Express, had been hit hard by the Salad Oil Crisis. American Express had lent $60 Million against collateral that consisted of a warehouse full of vats of salad oil. They later found that the vats contained mostly sea water. American Express lost $60 Million and its stock price was cut in half. At the time, with a total market capitalization of about $150 Million, the $60 Million was a huge hit to its fledgling balance sheet.

Mr. Buffett analyzed the situation carefully and concluded that as long as the trust associated with American Express traveler's checks and charge cards was unaffected, the company's intrinsic value was significantly higher than the current price it was being offered at. Seeing virtually no downside and a massive upside, he placed the largest bet he's ever placed. Virtually all of his networth was invested in the Buffett Partnership. Thus he had effectively bet 40% of his networth on a scandal-ridden business making negative headlines daily.

As Charlie Munger says, "Invert, Always Invert." Let's assume that there is an investment fund with $1 Billion in assets and ten investment professionals. Each of these individuals has an outstanding investing record and a 150+ IQ and their modus operandi is that an investment only gets made when all ten are in agreement. There is simply no way our 150 IQ team of ten would:

1. All agree that American Express was a strong buy.
2. Ever be willing to bet 40% of fund assets on this deeply distressed business – even if, by some miracle, they reached consensus to make the investment.

Finally, even if this team did agree to put 5% of assets into Am. Ex., what would they do if the price declined another 30%? This is not a hypothetical question. In 1973 when Buffett bought a large stake in The Washington Post, he saw the price cut in half *after* he had acquired most of his stake. More recently, Berkshire saw the price of USG stock go from $18 to $4 – a 75+% drop - *after* they had completed acquiring their stake.

As you reduce the size of this 10 person team, the likelihood of making these bets rises. And as the odds rise, the annualized returns are likely to rise as well. These returns are likely at their highest when you have a single focused value investor at the helm.

Value Investing is fundamentally contrarian in nature. The best opportunities lie in investing in businesses that have been hit hard by negativity. Even the pundits of the Efficient Market Theory, Eugene Fama and Ken French, concluded that stocks in the lowest decile of price/book ratios outperformed stocks in the highest decile by over 11% a year from 1963-1990. If one had invested $10,000 consistently in stocks with the highest price/book ratios (the Googles of the world) in 1963, it would have grown to about $72,000 by 1990. Not bad. However, if you had invested those same dollars in the cheapest businesses, you'd have $915,000 by 1990. I'd say that's a statistically significant difference.

The problem is that the businesses in the lowest deciles are ones "with the most hair on them." Investing in them is clearly the ticket to wealth. But trying to get any type of active investment team to buy bucket loads of these hairy, hated and unloved businesses just ain't gonna happen. It is the same reason that Joel Greenblatt's Magic Formula (highlighted in *The Little Book that Beats the Market*) is likely to trounce virtually all active managers with very little work. And yet, most active managers won't buy any meaningful quantities of Magic Formula type stocks.

My conclusion is to put the odds in our favor and continue being quirky. Pabrai Funds has no plans to add additional folks to its one person investment team.

Stake in Dardashti Capital Management

I'm proud to call Shai Dardashti a very good friend. Some of you have met him at last year's Pabrai Funds annual meeting in Chicago. Shai is as die-hard a Warren Buffett/Value Investing disciple as I have ever encountered. Over the last year, Shai has regularly asked to be hired by Pabrai Funds as a securities analyst - and he's repeatedly offered to work for free.

During the ten years I ran TransTech, I got zero offers from anyone willing to work for free – it was hard enough trying to hire folks even at above-market wages! And yet, during the last seven years at Pabrai Funds, I've gotten offers from a number of exceptionally talented folks expressing deep interest in working at Pabrai Funds with zero compensation. It has been quite flattering. Many are from top-rated business schools and are likely to have very successful careers. I suspect that the purity of the Pabrai Funds model (and its execution) has something to do with it. My fixation on the advantages of an investment team size of one keeps me from adding team members.

Mr. Buffett routinely asks students the following question: If they could choose to receive 10% of the lifetime income of any one of their class-mates, who would they pick? He then goes on to say that folks were unlikely to pick the brightest kid or the one with the best grades. Instead, Buffett believes that the best candidates are folks who have impeccable integrity, above-average intelligence and boundless energy. He further warns that "without the first, the other two will kill you." Think Enron!

Well, Shai is off the charts on all three fronts: deeply-grounded integrity, very intelligent and very energetic. In addition, he is intensely passionate about value investing. I've felt that the one person I'd regret not having on my team in a few years would be Shai. I thought long and hard about how I could "hitch my wagon to Shai" and still have an investment team size of one at Pabrai Funds.

Shai has been very clear about wanting to run his own investment partnership in a few years. I suggested to Shai that perhaps I could help him get his partnership off the ground

immediately. It would be entirely his show. I'd be an investor, provide any guidance he wanted as well as provide the start-up capital for the first couple of years. In exchange, I'd have a minority stake in the General Partner.

To my delight, Shai accepted this proposition. I think he's tap dancing as I write this. Dardashti Capital Management is expected to go live with a couple of funds on July 1, 2006. Shai graduates from the University of Maryland in May and will be setting up his operation in New York City. He'll have the ability to have US Accredited investors, IRAs, Offshore investors, etc.

While Shai would be making all the decisions, he'd have Carte Blanche to consult me on any facet of his operation. For example, he could choose to get my two cents on specific investment ideas – and is free to disregard any input. Also, I'm not intending to feed him any specific investment ideas. Independence of thought is fundamental. Most of the individual holdings in Pabrai Funds and Dardashti Capital are likely to be quite different.

Other than holdings, the Dardashti Accredited Fund, LP and the Dardashti Offshore Fund, Ltd. are expected to be very similar to Pabrai Funds:

- No management fees; performance fee of 25% over 6% annualized performance.
- Highly concentrated – when fully invested, the top 10 positions are expected to make up 80+% of assets. Focused Value Investing Style.
- Shai expects to reinvest all fees (excl. what he needs to run the funds, pay taxes, etc.) back in the US fund.
- No shorting, no leverage and no derivatives.

If you'd like to learn more, feel free to contact Shai Dardashti at:

Email: shai@dardashticapital.com

Tel. +1240.476.6425

Web: www.dardashticapital.com

I'm sure Shai will hit his set of road bumps on this journey. I'm delighted to share this journey with him.

Alignment of Interests

All three funds are at all-time highs. However, PIF2 is slightly below the threshold for fees (6% annualized since the last high on 9/30/05). PIF3 and PIF4 did earn fees in the first quarter. PIF3 earned a fee of $127,192.85 on 2/28/06 and $351,181.63 on 3/31/06. Since this is an offshore fund, I cannot reinvest these fees. PIF4 earned a fee of $799,516.22 which was reinvested back into PIF4.

Dalal Street (wholly owned by me) and myself (IRA etc.) have a stake of 451,185 units of PIF2, 7127 units of PIF3 and 338,607 units of PIF4. This stake is worth over $23 Million.

As described above, I will have a minority interest in the General Partner of the forthcoming Dardashti Funds. And I do intend to invest some family assets in Dardashti Funds (well under $1 Million). Nonetheless, the overwhelming majority of my family's assets are invested in Pabrai Funds. Besides the planned stake in Dardashti funds, 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.

The 2005 Pabrai Funds Annual Meeting Transcript

The 2005 annual meeting transcript is on the website for your perusal:

http://www.pabraifunds.com/website/2005_PIF_AM_Transcript.pdf

(to access, the id is pabraifunds and password is warren)

Speaking at The Value Investing Congress – May 10-11, 2006

Whitney Tilson and Dr. John Schwartz have created a wonderful semi-annual conference on Value Investing. I attended the first Value Investing Congress in New York City in November and thought it was exceptional. They put together a terrific lineup of speakers including Seth Klarman and Joel Greenblatt. The next Value Investing Congress will take place in Los Angeles on May 10-11, and I'm excited to be one of the speakers.

Whitney and John have graciously extended a special $500 discount to "investors and friends of Pabrai Funds" interested in attending the conference. Please register before April 20 at www.ValueInvestingCongress.com and use the code **VICJLS5** to get the discount. The conference ends at noon on May 11th and they have arranged buses to take attendees to hear Charlie Munger speak at the Wesco annual meeting at 2:00 PM at the Hilton in Pasadena, California.

Speaking at The University of Southern California's
Marshall School of Business – April 13, 2006 at 6:00 PM

On Thursday, April 13 from 6:00-7:30 PM, I'm speaking to students at the USC's Marshall School of Business. It is part of a regular class, and they have space for an additional 6-8 "friends and investors of Pabrai Funds" to attend the presentation. The talk is entitled *"Dhandho: Heads, I Win; Tails, I don't Lose Much!"* If you'd like to attend, please send me an email (mpabrai@pabraifunds.com) at the earliest to reserve a spot and get the details on venue etc. First come, first served. Unlike the Value Investing Congress, this one is free!

Next Opening – July 1, 2006 (all funds); May 1, 2006 (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 July 1, 2006.

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 May 1, 2006.

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 now subject to the 2-year lockup period. The first time funds sent in on 5/1/06 can be redeemed is 1/1/09. Pabrai Funds processes redemptions on the FIFO (first-in first-out) basis.

Also note that, going forward, PIF2/PIF4 will open once every quarter to add funds from new/existing investors (1/1, 4/1, 7/1, 10/1) while PIF3 will continue to add funds on the 1st day of every month.

2006 Annual Meetings – Save the date

As we did this year, there will be two annual meeting sequentially at Chicago and Orange County, California. The Chicago meeting is scheduled to be on Saturday, Sept. 16, 2006 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.

The Orange County meeting will be held on Sept. 30, 2006 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 $190/night for the 30th. 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.

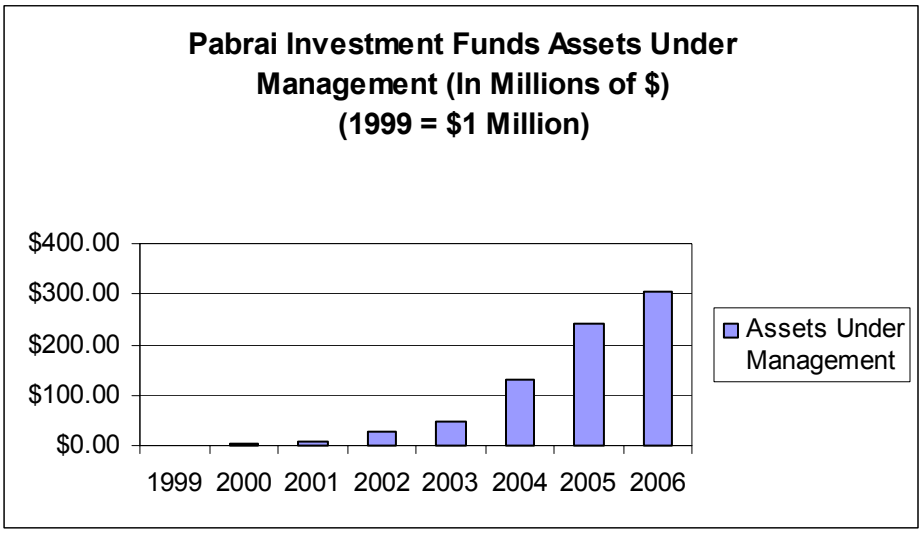
Agenda:

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 '06. Your significant other and kids of all ages are welcome to attend. I look forward to seeing you in September '06.

Assets Under Management

There is about $307 Million in assets under management between all the funds as of April 1, 2006.



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
2,733,298	7/31/2005	$38.03
2,774,863	9/30/2005	$39.59
2,791,234	11/30/2005	$36.65
2,602,256	12/31/2005	$37.27
2,621,925	3/31/2006	$40.67

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
2,508,255	1/31/2006	$22.78
2,522,903	2/28/2006	$23.21
2,533,429	3/31/2006	$23.75

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
9,675,772	3/31/2006	$14.45

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.