# PABRAI INVESTMENT FUNDS

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

From: Mohnish Pabrai, Managing Partner

Date: April 15, 2007

Re: **First Quarter 2007 Results, et. al.**

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Dear Partners:

For the quarter ended March 31, a total of $32.9 Million was added to the various funds by new and existing partners. The additions on a per fund basis are:

PIF2 (US Accredited): $6.0 Million

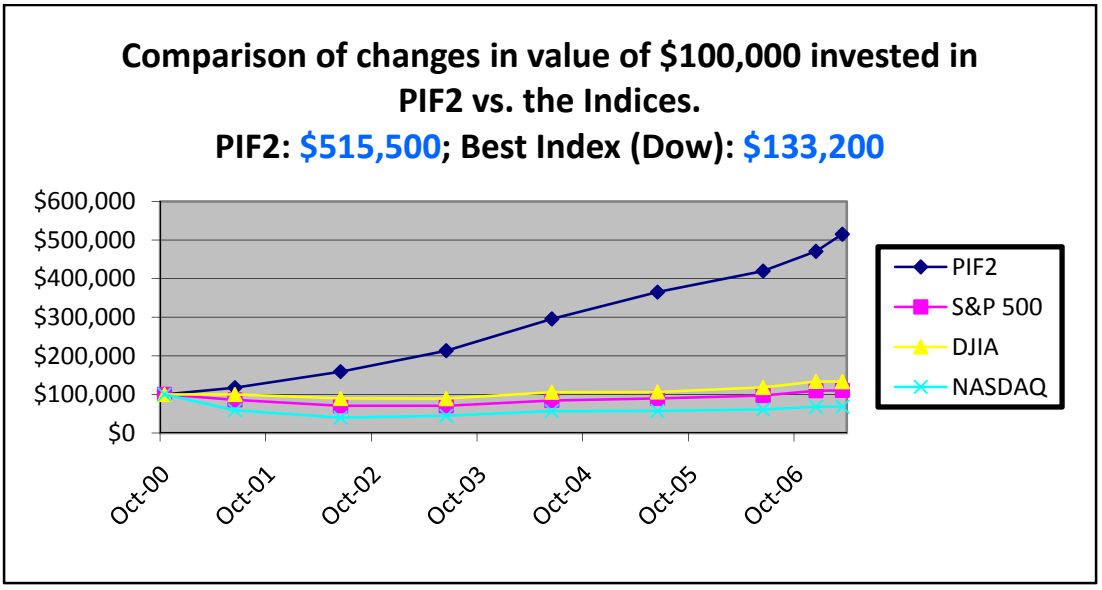
PIF3 (Offshore/IRA): $12.3 Million

PIF4 (US Qualified): $14.6 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 – 3/31/07 | **+12.8%** | **+12.1%** | **+13.5%** | **+22.8%** |
| 1/1/07 – 3/31/07 | **-0.3%** | **+0.4%** | **+0.6%** | **+9.5%** |
| **Annualized** | **+4.5%** | **-5.7%** | **+1.5%** | **+28.7%** |
| **Cumulative** | **+33.2%** | **-31.7%** | **+10.4%** | **+415.5%** |

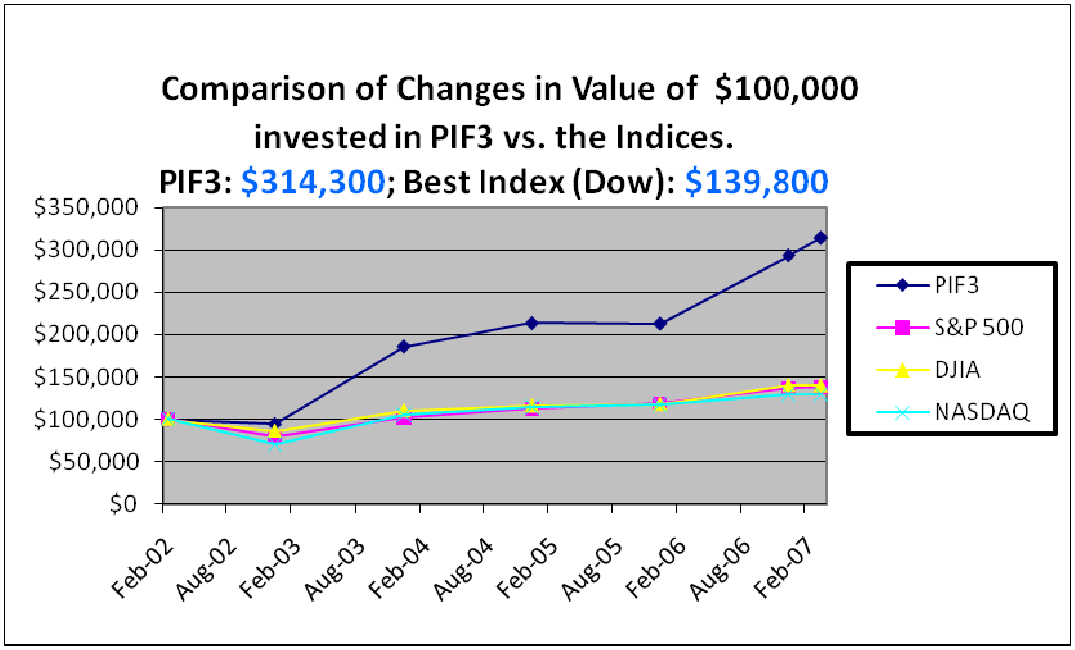



**PIF2 Investors:**

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 $722,200 as of March 31, 2007 (net to investors). This equates to an annualized return of 29.1% 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 $131,800 on March 31, 2007 – an annualized gain of 3.6%. 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%** |
| 1/1/07 – 3/31/07 | **-0.3%** | **+0.4%** | **+0.6%** | **+7.0%** |
| **Annualized** | **+6.7%** | **+5.1%** | **+6.4%** | **+24.8%** |
| **Cumulative** | **+39.8%** | **+29.2%** | **+37.9%** | **+214.3%** |

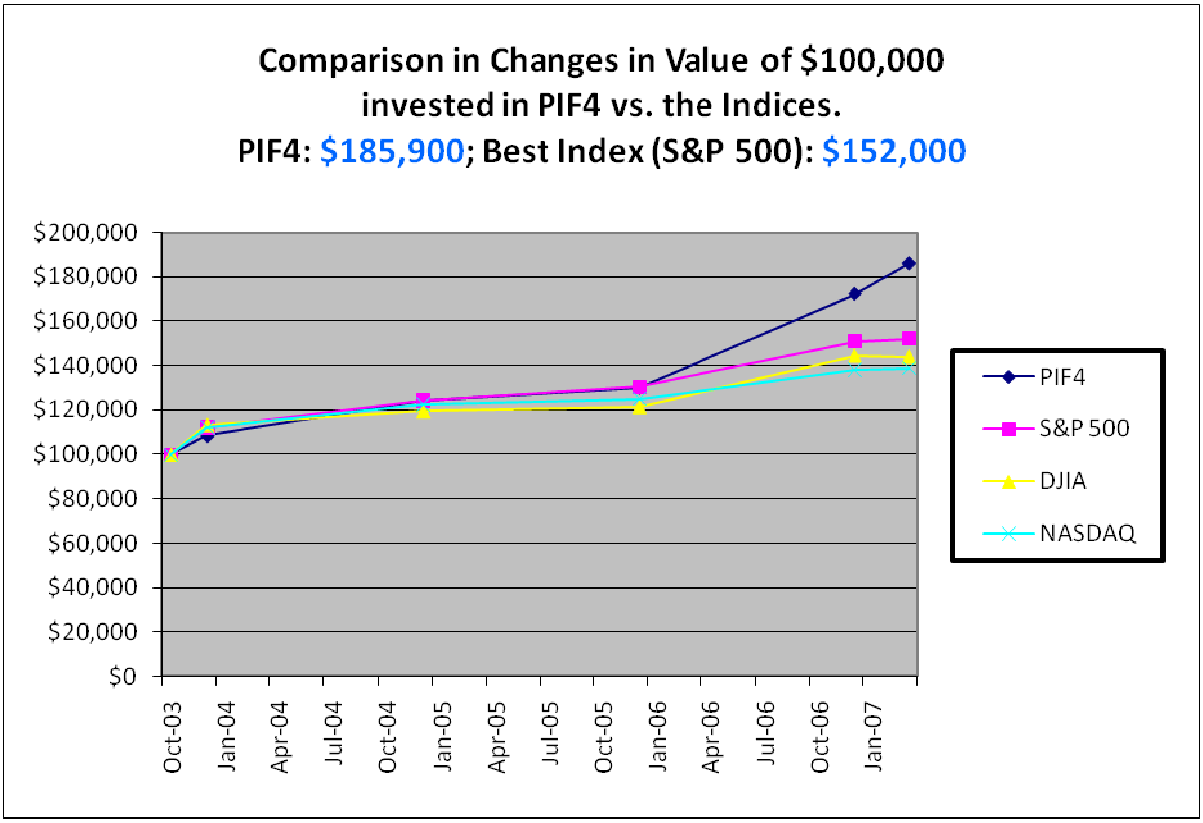



**PIF3 Investors:**

A $100,000 investment in PIF3 at inception on February 1, 2002 was worth $314,300 as of March 31, 2007 (net to investors). This equates to an annualized return of 24.8% 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 $139,800 on March 31, 2007 – an annualized gain of 6.7%. 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% |
| 1/1/07 – 3/31/07 | -0.3% | +0.4% | +0.6% | +7.9% |
| **Annualized** | +11.0% | +9.8% | +12.7% | +19.4% |
| **Cumulative** | +44.1% | +38.8% | +52.0% | +85.9% |




**PIF4 Investors:**

A $100,000 investment in PIF4 at inception on October 1, 2003 was worth $185,900 as of March 31, 2007 (net to investors). This equates to an annualized return of 19.4% 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 $152,000 on March 31, 2007 – an annualized gain of 12.7%. The S&P gains include reinvested dividends.

## General Comments

All three funds performed well in the first quarter of 2007. PIF2, 3 and 4 were up 9.5%, 7.0% and 7.9% respectively (net to investors, after all fees and expenses). While it is nice to see the strong performance in 2006 continue into 2007, it is best not fixate on quarterly or yearly performance. My own focus is on periods of 5 to 10 years or longer and our objective is to outperform the best of the three benchmark indices over that timeframe. In our nearly eight year history, I'm happy to note that we have delivered on that objective in spades.

## PIF3 (Offshore / IRA Fund) Completes Five Years

I believe five years is the absolute minimum amount of time an investor ought to focus on when evaluating a money manager. Ten years or longer is even better. On January 31, 2007, PIF3 completed exactly five years. Here is some salient performance data on how PIF3 has performed over the first five years since its launch:

**Performance Comparison: PIF3 vs. The Best Index**
**(Annualized – as of 1/31/07)**

| | 1 Year | 3 Years | 5 Years |
|---|---|---|---|
| PIF3 | **+32.3%** | **+16.2%** | **+24.7%** |
| Best Index | **+18.9%** (Dow) | **+10.3%** (S&P 500) | **+7.3%** (Dow) |

I am very pleased with these numbers. Over the last five years PIF3 delivered an annualized return (after my outrageous fees and all expenses) of 24.7% versus 7.3% annualized one would have made by investing in the best of the three indices (the Dow). PIF3 has more than fully met its long-term out-performance objective.

When PIF3 was launched in February, 2002, we had a total of $651,000 in assets from two brave investors. A full year after its launch, assets were still under $3 Million. I remember being concerned at the time about the high expense ratio investors had to bear because of the paucity of assets. Today, PIF3 has over $100 Million in assets. I am grateful for the support our offshore and IRA investors have demonstrated with their dollars over the years.

The expense ratio for PIF3 the year ended 12/31/06 was under 11 basis points (0.11%). Going forward, I think the odds are high that we'll consistently be able to keep expenses under 10 basis points for all three funds. With no management fees and low operating expenses, Pabrai Funds has among the lowest frictional costs across the entire mutual fund and hedge fund industry. Our future performance is unknown, but our future expense ratios

are known. They are highly likely to continue to be ultra-low – and that brings a smile to my face.

## Benchmarking PIF3 Versus Other Funds

PIF3 is not a mutual fund and is typically classified as a hedge fund. However, with no shorting, no leverage and no use of derivatives we are much closer (in typical portfolio holdings) to a mutual fund than a hedge fund. PIF3's annualized 24.7% return over the last five years would have ranked it in the top 2.6% of all funds tracked by Lipper. That is, within a universe of 5333 mutual funds, PIF3 would have ranked number 139. As an aside, 115 of the 139 funds ahead of PIF3 belong to one of the following specialty categories:

1. Gold/Natural Resources
2. Emerging Markets
3. Real Estate

Lest we get overly exuberant, let me again state the obvious: I do expect Pabrai Funds to outperform the best of the three indices over the long haul. I have no idea by how much we will outperform, but am willing to wager that it will be substantially less than the last 7¾ 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. Just one out of 200 money managers beats the indices by over 3% consistently. I consider a 3% out-performance versus the best index to be a superb long-term accomplishment.

On an unrelated note, we had incurred approximately $38,000 is organizational expenses to get PIF3 launched in 2002. Most of this related to the legal expenses to create the BVI based entity, the offering memorandum and other legal documents. I had fronted these funds and was reimbursed 1/60$^{th}$ of the amount every month. With our completion of five years, these expense reimbursements are behind us as well. The expenses were amortized over five years and thus fairly shared by the entire investor base over the last few years.

## Alignment of Interests

All three funds are at all-time highs. PIF3 earned a fee of $606,131.83 on 1/31/07, $124,405 on 2/28/07 and $926,211.07 on 3/31/07. Since this is an offshore fund, I cannot reinvest these fees back into the fund. PIF2 earned a fee of $3,402,665.64 and PIF4 earned a fee of $4,223,130.11. All PIF2 and PIF4 fees were reinvested back into the respective funds by Dalal Street.

My immediate family has a stake of 602,801 units of PIF2, 7,300 units of PIF3 and 1,012,793 units of PIF4. This stake is worth over $50 Million. Besides the previously disclosed stake and small investment in Dardashti Capital (worth about $1.3 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.

### Pabrai Funds Staff Size grows to 2.2

In February Diana Dillman joined Pabrai Funds as a part-time Administrative Assistant. She is doing great and we're very happy to have her as part of the team. When we had about 1/20$^{th}$ the current assets, the total staff size (including me) was 1.3 people. Now, between Isabelle, Diana and me, we are at a grand total of 2.2 people.

### 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 $248/night for the 15$^{th}$. 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.

**The Dhandho Investor – Released and Available at Amazon, Borders, Barnes & Noble etc.**

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

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

It is now released and available at Amazon, Barnes & Noble etc. Since it was published by Wiley, it can be bought in scores of countries around the globe. Here is the Amazon link:

**http://tinyurl.com/wj4tx**

Please do not be shy about recommending it to your friends and family. At $18.45, I think it is a tremendous value – even if I say so myself - ☺.

***The Dhandho Investor:***
**Book Signing at Dairy Queen in Omaha on May 4, 2007 from 8:30 – 10:00 PM.**

I am excited once again to get my gunked-up windshield cleaned up nicely in Omaha next month. Start your Woodstock of Capitalists weekend experience with an exercise in good taste: Enjoy a free cone of ice cream at the West Dodge Dairy Queen in Omaha between 8:30 pm – 10:00 pm on Friday, May 4.

The reception, which has become a tradition, will also give you a chance to visit with several authors, newsletter editors and stock analysts about Warren Buffett and Berkshire Hathaway. The event is being sponsored by Morningstar, The Omaha Reader, Hudson News Booksellers, The University of Nebraska at Omaha Business School and John Wiley and Sons Publishers.

I'll be there with my family and look forward to signing your copy of ***The Dhandho Investor*** and meeting you. You'll be able to buy the book at DQ at that time as well.

The West Dodge Dairy Queen in Omaha that is hosting us is located at:

**Dairy Queen**
404 N. 114th St. (at Dodge)
Omaha, Nebraska
402-333-4623

The following books will be available for purchase and the authors will be happy to sign them for you.

• *A Weekend With Warren Buffett and Other Shareholder Meeting Adventures*, by Randy Cepuch (Thunder's Mouth Press, 2007)

• *Morningstar Stock Investor newsletter* edited by Paul Larson (complimentary copies available for each DQ guest)

• *101 Reasons to Own the World's Greatest Investment; Warren Buffett CEO; and Warren Buffett Wealth*; by Robert P. Miles (John Wiley and Sons)

• *The Dhandho Investor*; by Mohnish Pabrai (John Wiley and Sons, 2007)

Attendees will receive a complimentary Berkshire Hathaway stock analyst report and opinion by Morningstar. No reservations are necessary, but you'll need to show your annual meeting credentials for the complimentary ice cream cone. Other DQ products will be available for purchase. Be There!

## Interview with The Motley Fool (Fool.com)

Recently I was interviewed by Email Lee of The Motley Fool and they published the interview in two installments. Here are the links:

Pabrai's Perspectives on Investing [Fool.com] February 22, 2007

Pabrai's Perspectives on Investing: Part 2 [Fool.com] February 23, ...

Here are the direct HTML links as well:

http://www.fool.com/investing/value/2007/02/22/pabrais-perspectives-on-investing.aspx

http://www.fool.com/investing/general/2007/02/23/pabrais-perspectives-on-investing-part-2.aspx

**Upcoming Events: Presentation to USC Marshall School of Business Students April 23, 2007; 6:00 – 7:30 PM**

On April 23, I've been invited to speak to students at the University of Southern California's Marshall School of Business. My talk is entitled ***The Dhandho Investor*** (what else!). The talk is part of a course on Value Investing that was recently introduced by Professor Green. I spoke to Professor Green's students last year and am excited to be invited back. He has graciously allowed me to bring upto 10 guests. If you'd like to attend, please email me at the earliest (mpabrai@pabraifunds.com) and I'll confirm your slot as well as provide the exact venue within the business school. First come, first served. The talk will be held on USC's main campus at the Marshall School of Business on Monday, April 23 from 6:00 to 7:30 PM.

Unlike the other two talks mentioned below, this one is a tremendous value – it's free!!

The USC students will have all read The Dhandho Investor prior to the talk. I'd suggest the same to any guests who plan to attend as well.

**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 at 7:00 PM. The title of my talk is:

   **The Dhandho Investor: Abhimanyu's Dilemma**

   The fee is $895, I believe. This conference has under 100 total attendees. If you do plan to attend, I'd suggest signing up at the earliest.

2. **2nd Annual Value Investing Congress West**
   Renaissance Hollywood Hotel (Home of the Oscars), Hollywood, California
   May 8-9, 2007. I've been informed that I'm on at 8:45 AM on Tuesday, May 8.
   http://www.valueinvestingcongress.com/

   The topic is ... what else ...

### The Dhandho Investor: Abhimanyu's Dilemma

The conference is priced at $2,995. The price keeps going up as the weeks go by.

## Assets Under Management – Attempting to Reduce Inflows

There is an inverse correlation between size and performance. Pabrai Funds now has about $500 Million under management. Under present market circumstances it is highly likely that we would be closed to all new money coming in before we get to $1 Billion under management. To that end, I've begun to apply some "speed-breakers" to reduce asset inflows. A few months back, I limited any meetings with potential investors to being in or within five miles of my office – and no more than one meeting a week. At that time, I began declining virtually all asset gathering type travel entirely.

More recently, I have virtually eliminated ***all*** calls or one on one meetings with potential investors. I've also eliminated virtually all calls or meetings with existing investors if the primary subject is likely to be about their adding more assets. I have suggested to these good folks that they might want to peruse our website, attend our annual meetings and email a few questions if those channels prove inadequate. Even though we had over $30 Million come in in Q107, I know that quite a bit more would have come in if I were more open to dialog with potential investors.

Should the Dow drop 40% in value, we would have a plethora of investment opportunities available. In that situation, we could put several billion dollars to work quite effectively. If that were to happen, we'd ease off on these speed breakers. Of course, at that hypothetical point, most investors would be reticent about equity markets and Pabrai Funds and I suspect inflows would be down to a trickle.

We also raised the minimum initial investment for IRAs, Foundations and Endowments to $10 Million (from the previous level of $1 Million). We have very few slots left in this category (under 20) and would like these slots to be available for any future endowments or foundations that express interest. This will serves as another speed breaker on assets. In Q107 over $4 Million in assets came in from IRA investors.

## Next Opening – July 1, 2007 (all funds); May 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 July 1, 2007.

To invest in PIF3, one needs to be a non-US accredited offshore investor. Tax-exempt accounts like IRAs, Roth IRAs, Foundations and Endowments can invest in PIF3 as well. The minimum investment to join PIF3 as a new partner is $10,000,000 for US Tax-exempt accounts and $100,000 for offshore investors. Next opening date for PIF3 is May 1, 2007.

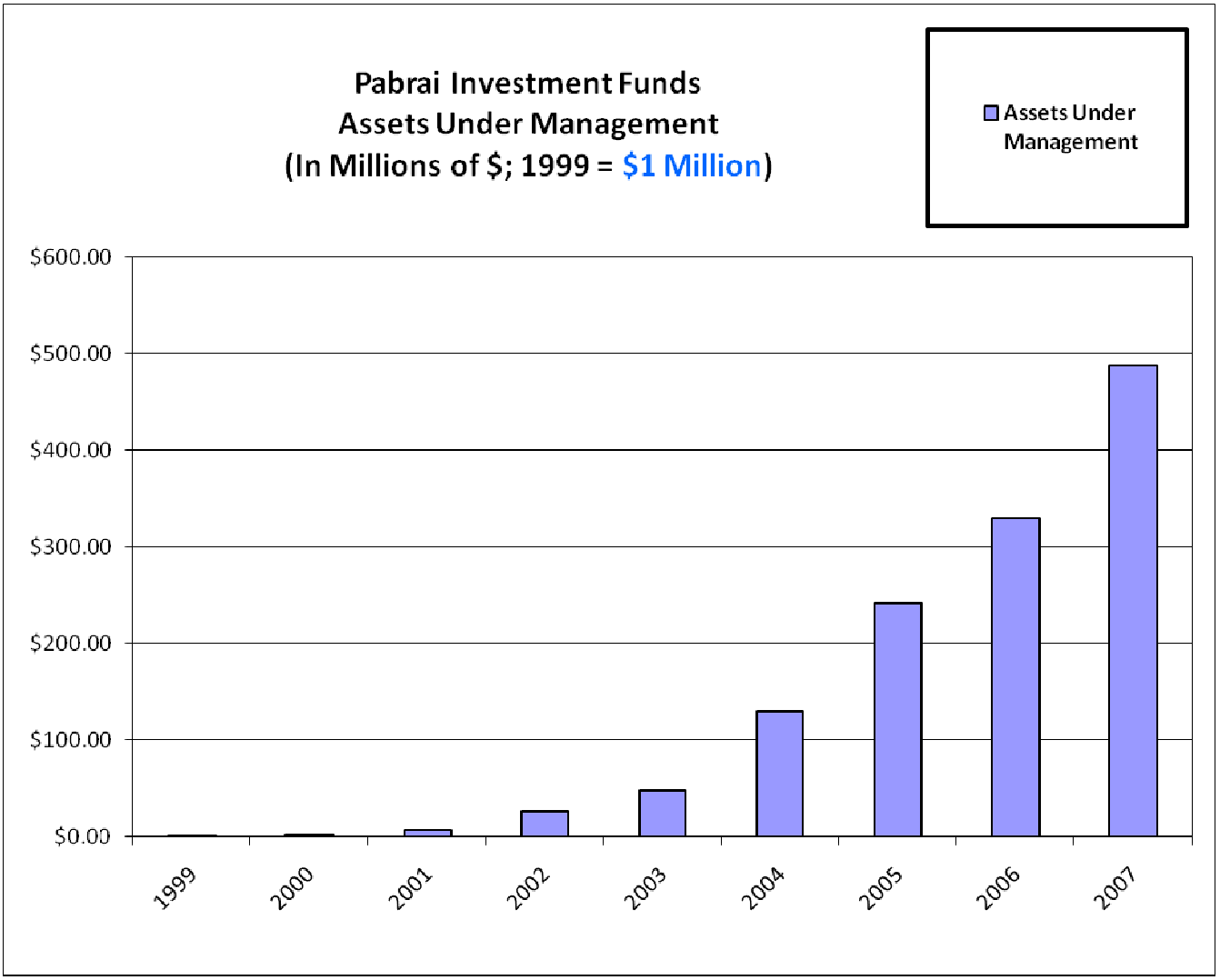
**Existing partners** in any of the Pabrai Funds can add funds in increments of $25,000 at each opening (with a $25,000 minimum).

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 5/1/07 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 $487 Million in assets under management between all the funds as of April 1, 2007.




Thanks for your continued interest, referrals and support. Feel free to 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 |
| 2,901,803 | 3/31/2007 | $51.55 |

### 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 |
| 2,930,608 | 12/31/2006 | $29.37 |
| 3,095,663 | 1/31/2007 | $30.14 |
| 3,177,865 | 2/28/2007 | $30.41 |
| 3,329,582 | 3/31/2007 | $31.43 |

### 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 |
| 11,528,330 | 12/31/2006 | $17.23 |
| 12,539,891 | 3/31/2007 | $18.59 |

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.