# 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 12, 2010

Re: **Q1 2010 Results et. al.**

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Dear Partners:

For the quarter ended March 31, 2010, a total of $6.8 Million was added to the various funds by new and existing partners. The additions on a per fund basis are:

PIF2 (US Accredited): $0.2 Million

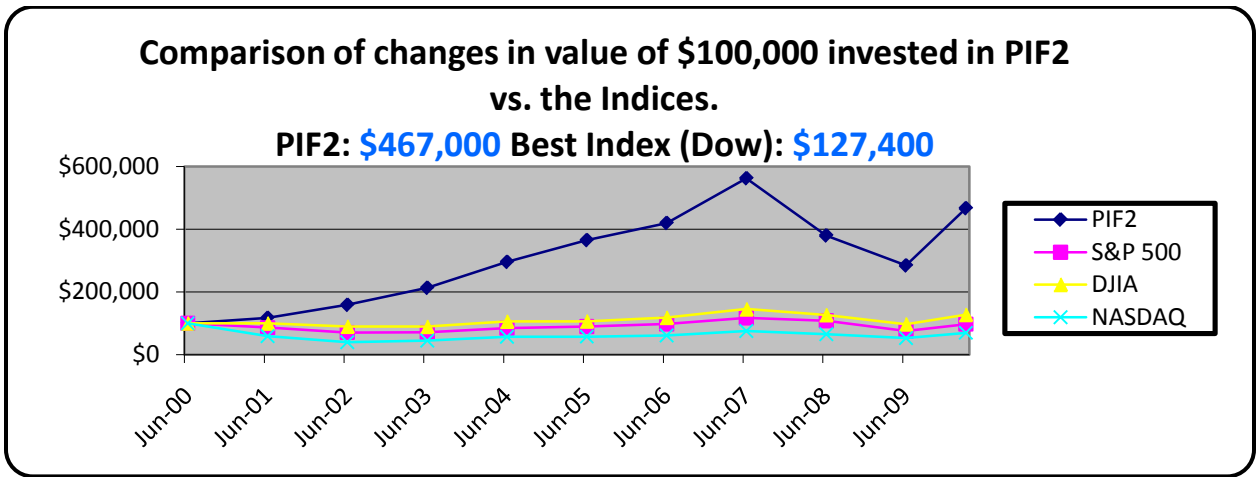
PIF3 (Offshore/IRA): $0.5 Million

PIF4 (US Qualified): $6.1 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 – 6/30/07 | +23.0% | +20.7% | +20.6% | +34.0% |
| 7/1/07 – 6/30/08 | -13.3% | -11.2% | -13.1% | -32.4% |
| 7/1/08 – 6/30/09 | -23.0% | -19.1% | -26.2% | -25.2% |
| 7/1/09 – 3/31/10 | +31.2% | +31.5% | +29.2% | +64.2% |
| 1/1/10 – 3/31/10 | +4.8% | +5.9% | +5.4% | +10.4% |
| **Annualized** | +2.6% | -3.8% | -0.3% | +17.6% |
| **Cumulative** | +27.4% | -30.5% | -2.9% | +367.0% |

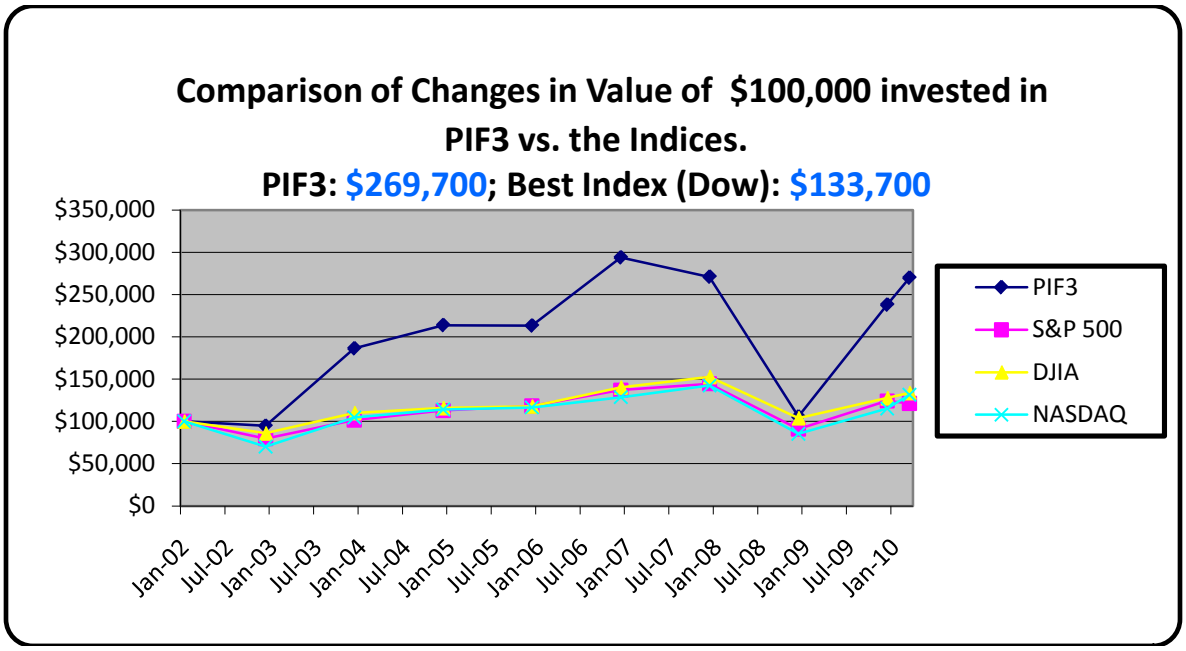



**PIF2 Investors:**

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 $654,300 as of March 31, 2010 (net to investors). This equates to an annualized return of 19.1% 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 $126,800 on March 31, 2010 – an annualized gain of 2.2%. The Dow gains include reinvested dividends. In the graph above, the start date for PIF2 is shown as June 2000 for readability. The correct start date is October 2000.

**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 – 12/31/07 | **+8.9%** | **+10.7%** | **+5.5%** | **-7.8%** |
| 1/1/08 – 12/31/08 | **-31.9%** | **-39.9%** | **-37.0%** | **-60.9%** |
| 1/1/09 – 12/31/09 | **+22.7%** | **+45.4%** | **+26.5%** | **+125.0%** |
| 1/1/10 – 3/31/10 | **+4.8%** | **+5.9%** | **+5.4%** | **+13.4%** |
| **Annualized** | **+3.6%** | **+3.4%** | **+2.4%** | **+12.9%** |
| **Cumulative** | **+33.7%** | **+31.5%** | **+21.4%** | **+169.7%** |

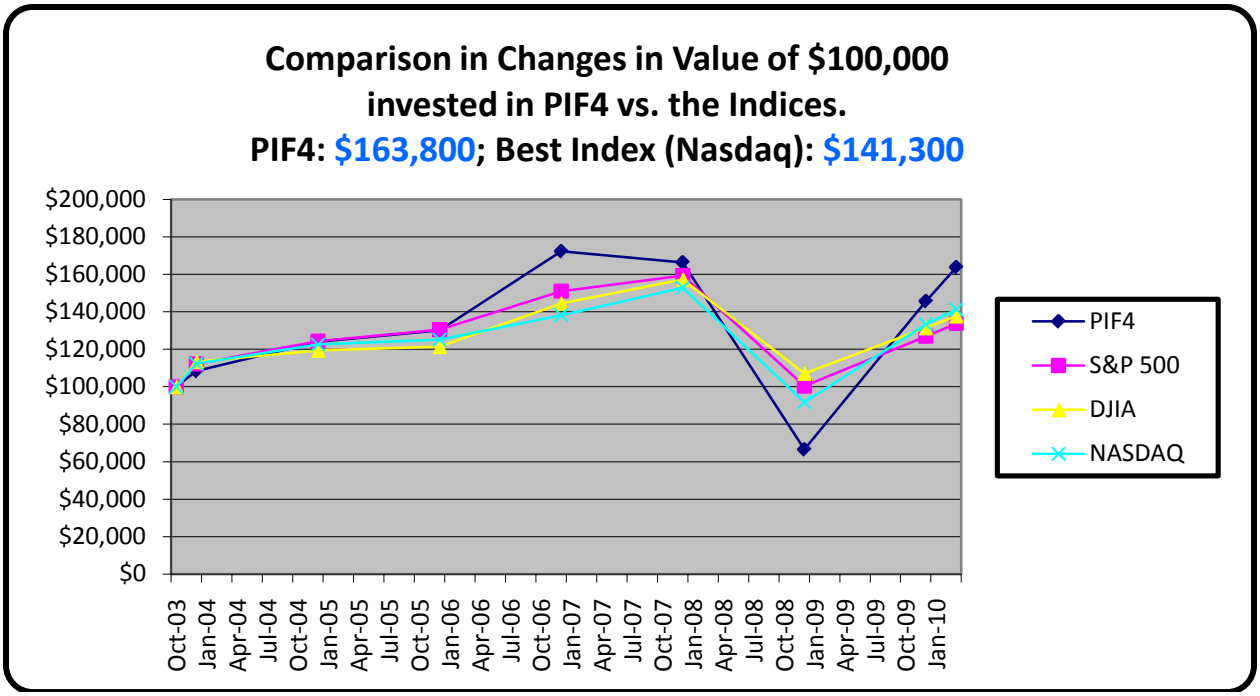



**PIF3 Investors:**

A $100,000 investment in PIF3 at inception on February 1, 2002 was worth $269,700 as of March 31, 2010 (net to investors). This equates to an annualized return of 12.9% 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 $133,700 on March 31, 2010 – an annualized gain of 3.6%. The Dow gains include reinvested dividends. In the graph above, the start date for PIF3 is shown as Jan. 1, 2002 for readability. The correct start date is Feb. 1, 2002.

## 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 – 12/31/07 | +8.9% | +10.7% | +5.5% | -3.4% |
| 1/1/08 – 12/31/08 | -31.9% | -39.9% | -37.0% | -60.0% |
| 1/1/09 – 12/31/09 | +22.7% | +45.4% | +26.5% | +118.8% |
| 1/1/10 – 3/31/10 | +4.8% | +5.9% | +5.4% | +12.4% |
| **Annualized** | +5.1% | +5.5% | +4.6% | +7.9% |
| **Cumulative** | +37.8% | +41.3% | +33.8% | +63.8% |




**PIF4 Investors:**

A $100,000 investment in PIF4 at inception on October 1, 2003 was worth $163,800 as of March 31, 2010 (net to investors). This equates to an annualized gain of 7.9% since inception. The best index over the same period was the Nasdaq Composite and an investment of $100,000 in the Nasdaq Composite on October 1, 2003 was worth $141,300 on March 31, 2010 – an annualized gain of 5.5%. The Nasdaq gains include reinvested dividends.

## General Comments

All three funds beat all the indices by wide margins in Q110. The funds were up between 10 and 13% while the best index was up by under 6%. And, over the last year, all three funds are up over 150%, while the best index is up less than 60%. In fact, PIF3 is up over 190% in the last 13 months!

All the funds have also outperformed all the indices over periods of 5 years or longer – after all fees and expenses. Pabrai Funds substantially outperformed all the indices with large margin from inception through June 2007. We have under-performed since mid-2007. However, that underperformance gap is being closed at a fairly rapid pace. I would not be surprised to see the funds begin to outperform the benchmarks, as measured from mid-2007, in the next few quarters. It has already begun to happen. PIF2's mid-2007 to present numbers are now better than the S&P 500.

## The Gyrations of An Auction-Driven Marketplace

Why did Pabrai Funds decline so much in 2008 and why did we recover so quickly and strongly in 2009? The primary reason for the large drawdown was that everything was being sold indiscriminately in late 2008. We saw stellar businesses in our portfolio experience 90+% declines in their quoted market value.

As an example, one of our large holdings, Ternium, saw its stock price decline from $44.60 to $5.50 within 6 months. We had been buying Ternium in the mid-twenties/share in 2007 and I'd estimated it's intrinsic value at the time at around $55/share. I had planned to exit at anything over $49.50/share. Ternium got within 10% of our sell price in less than year after we began accumulating. Our $48 Million bet on Ternium was worth about $80 Million in less than a year. And then it went from a valuation of $80 Million to under $10 Million in a few months.

As I write this letter, Ternium's stock price has nearly fully recovered to $41. We fully exited our Ternium position at a slight profit in Q409.

Ternium is a world-class Latin American steel producer with large operations in Mexico and Argentina. They are controlled and managed by the Rocca family who are simply the best of the best. Ternium has many deep moats including world-class management, ownership of low-cost iron-ore mines, a flexible and vertically integrated multi-country platform that includes mini-mills, blast furnaces and distribution centers. They also have dominant/virtually locked captive markets in Mexico and Argentina.

Many steel producers are now discovering that being subject to sky-high iron ore prices that they have no control over is no fun at all. With ownership of low-cost iron ore mines, Ternium does not have this problem. And Ternium is conservatively financed and mildly leveraged.

When the crisis hit in 2008, Ternium's sales and volumes collapsed. The company navigated beautifully and, in fact, generated positive cash flow as they trimmed inventories and working capital. Thus we have a business valued by Mr. Market at $5 Billion in 2007. Then at over $9 Billion in Mid-2008 - followed by a collapse to $1 Billion in Q408. And today, Ternium's market cap is over $8 Billion. All this – five to nine to one to eight took place in under 24 months.

Pabrai Funds did nothing with our Ternium stake over much of this period. We just stood pat, but it did have a significant impact on our reported performance and NAVs. And Ternium isn't the only one. We saw 80-90% declines on several holdings – most of which are up strongly in the last few months.

> *"Cash combined with courage in a time of crisis is priceless."*
>
> - Warren Buffett

Well, we certainly had no lack of courage. In the last 7 weeks of 2008, Pabrai Funds made 10 brand new investments (versus finding 1-3 good ideas a quarter typically). We have generated very significant returns on these 2008 picks. Virtually all of them have done very well - some change hands today at over 4-7 times what we paid for them. However, we did have a severe paucity of cash. This coupled with the large redemption requests meant that we could not take full advantage of the opportunity set. I've vowed to never again find myself in that situation again.

As an aside, if we had been at 25% cash at the start of Q408, instead of being down 60% in 2008, we would have been down around 45%. We would easily have generated a 3-4x return on that cash. And today, we'd likely be at all-time highs - well past the 2007-highs.

## Investment Opportunities

We have been net sellers of equities over the last few months. While we've been able to put some money to work recently, our cash position is among the highest in the last several years. I like that.

> *"All men's miseries derive from not being able to sit in a quiet room alone."*
>
> - Blaise Pascal

I'm not trying to time the market. Have never done that. However, our 20-25 position portfolio with typical bets sized at 5% means that in periods like the present, we're unlikely to be able to find enough bets to get fully invested. And in distressed times like 2002 or 2008, we are very likely to get fully invested.

> *"The big money is not in the buying and the selling but in the waiting."*
>
> - Charlie Munger quoting Jesse Livermore

We are happy to sit and wait patiently for the game to come to us.

**Alignment of Interests**

All three funds are below their historic NAVs and hence no fees were earned by any of the funds for the quarter. My immediate family has a stake of 455,562 units of PIF2; 8417 units of PIF3; 1,224,824 units of PIF4 and about 25,000 units of PIF4 in a retirement account. This stake is worth about $42 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, hedge funds or private equity 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. Investors who add funds when we are below the high-water mark (like now), get a free ride (no fees) until we're back at the high water mark plus 6% annualized from that date. It is a great deal.

**2009 Annual Meeting Transcript**

The 2009 Annual Meeting Transcript has been posted on our website. It can be viewed at:

http://www.pabraifunds.com/website/2009_PIF_AM_Transcript.pdf

The transcript is best read in conjunction with the slides:

http://www.pabraifunds.com/website/2009_PIF_AM_Slides.pdf

## Interview with Steve Forbes

Recently I sat down for with Steve Forbes for a video interview. It was fun. Here the link:

http://www.forbes.com/2010/04/09/pabrai-buffett-munger-intelligent-investing-video.html

## 2010 Annual Meetings – Save the Date

As is our usual modus operandi, there will be two annual meetings sequentially at Chicago, Illinois & Orange County, California.

The **California** meeting is scheduled to be on **Saturday, Sept. 11, 2010** 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 will have 10 rooms set aside for the event at a TBD rate. Please call the hotel directly and book your room 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 thus scheduled to be on **Saturday, Sept. 25, 2010** at 4:00 PM at 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. Good deals on O'Hare hotels are usually available on the major travel-related websites.

Agenda:

| | |
|---|---|
| 4:00 – 4:30 PM: | Meet and Greet |
| 4:30 – 6:30 PM: | Presentation and Q&A |
| 6:30 – 7:15 PM: | Cocktail Hour |
| 7:15 PM: | Dinner |

The invites will go out in July 2010. Your significant other and kids of all ages are welcome to attend. I look forward to seeing you in September.

## Next Opening – July 1, 2010 (all funds); May 1, 2010 (PIF3)

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

The minimum investment for PIF4 has been increased back to $2,500,000 (2007 level) 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, 2010.

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 $10,000,000 for US Tax-exempt accounts and $2,500,000 for offshore investors. Next opening date for PIF3 is May 1, 2010.

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

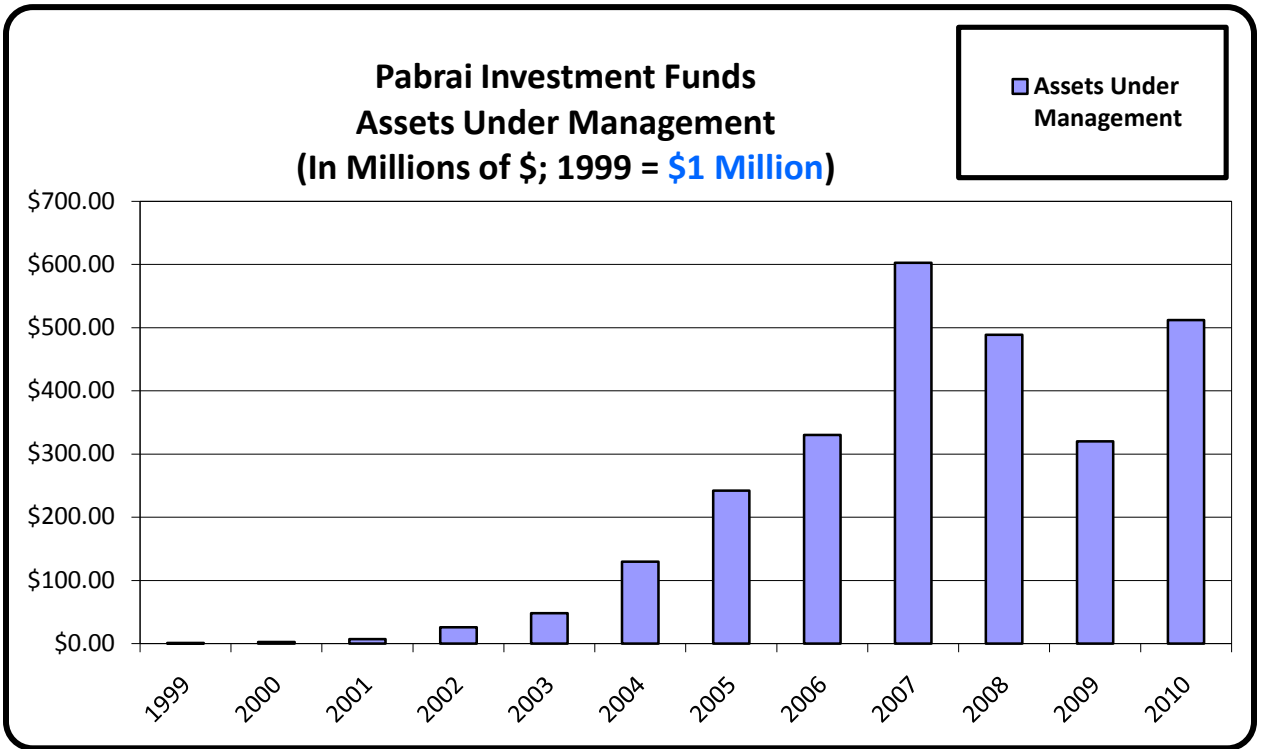
PIF2/PIF4 open once every quarter to add funds from new/existing investors (1/1, 4/1, 7/1, 10/1) while PIF3 is open to add funds on the 1st day of every month.

## Final K-1's (for US Investors)

All the K-1's for US Investors (PIF2 and PIF4) were sent in password-protected PDF form to your email account on file in mid-March. If you have not yet received yours, please nudge Isabelle at isecor@pabraifunds.com or +1949.453.0609.

**Assets Under Management**

There is over $511 Million in assets under management between all the funds as of April 1, 2010.




Thanks for your continued interest, referrals and support. Feel free to call me at +1949.453.0609 or email me at mp@pabraifunds.com with any queries or comments.

Warm regards,



Mohnish Pabrai

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## 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 |
| 3,013,111 | 6/30/2007 | $56.25 |
| 2,934,990 | 6/30/2008 | $38.01 |
| 2,468,091 | 6/30/2009 | $28.45 |
| 2,476,137 | 9/30/2009 | $40.39 |
| 2,389,042 | 12/31/2009 | $42.29 |
| 2,393,860 | 3/31/2010 | $46.70 |

**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 |
| 6,438,615 | 12/31/2007 | $27.09 |
| 5,415,189 | 12/31/2008 | $10.57 |
| 5,038,658 | 12/31/2009 | $23.79 |
| 5,060,930 | 1/31/2010 | $22.91 |
| 5,060,930 | 2/28/2010 | $24.31 |
| 5,060,930 | 3/31/2010 | $26.97 |

**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 |
| 16,899,746 | 12/31/2007 | $16.64 |
| 15,737,042 | 12/31/2008 | $6.66 |
| 15,725,066 | 12/31/2009 | $14.57 |
| 16,096,711 | 3/31/2010 | $16.38 |

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.