PABRAI INVESTMENT FUNDS

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

From: Mohnish Pabrai, Managing Partner

Date: June 7, 2005

Re: **Updated Performance Numbers for all Funds**

Dear Partners:

On the June 1 subscription date a total of $13 Million was added to the various funds by new and existing partners. In addition, $2.2 Million was added in PIF3 on May 1. Here are the additions on a per fund basis:

PIF2: $0.3 Million

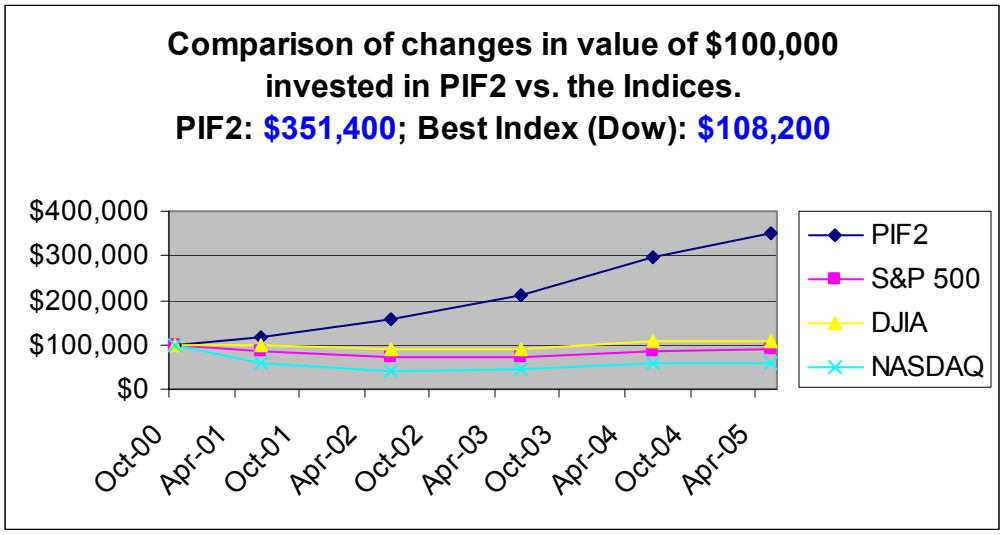
PIF3: $5.9 Million

PIF4: $9.0 Million

Here are the updated performance numbers on all the funds:

PABRAI INVESTMENT FUND 2 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 – 5/31/05	**+2.4%**	**+1.6%**	**+6.2%**	**+18.8%**
1/1/05 – 5/31/05	**-2.0%**	**-4.7%**	**-1.0%**	**+2.5%**
Annualized	**+1.7%**	**-11.4%**	**-2.4%**	**+30.9%**
Cumulative	**+8.2%**	**-42.5%**	**-10.6%**	**+251.4%**

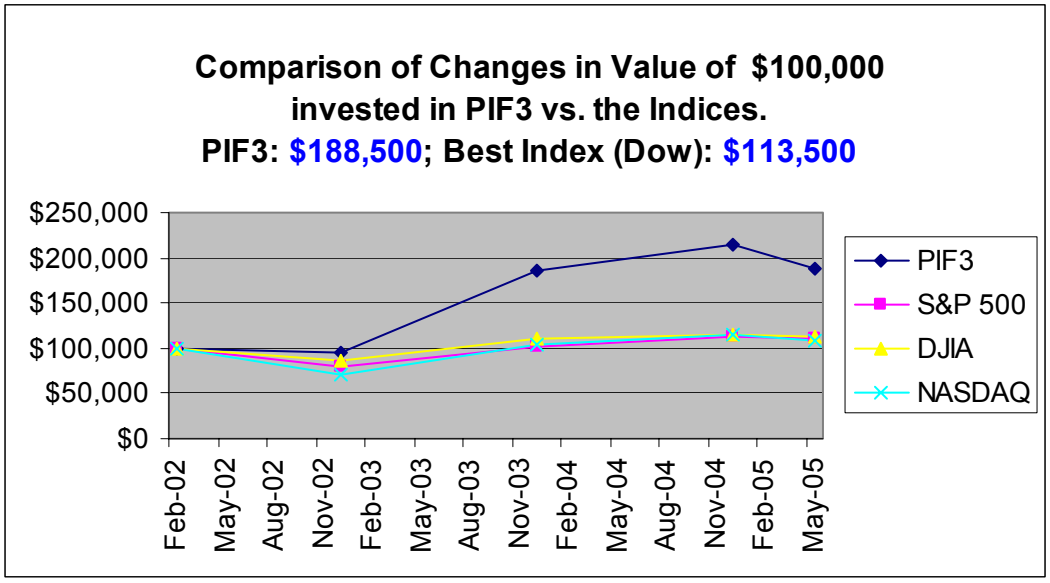


PIF2 Investors:

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 $492,300 as of May 31, 2005 (net to investors). This equates to an annualized return of 30.9% 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 $108,200 on May 31, 2005 – an annualized gain of 1.3%. The Dow gains include reinvested dividends.

PABRAI INVESTMENT FUND 3 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 – 5/31/05	**-2.0%**	**-4.7%**	**-1.0%**	**-11.8%**
Annualized	**+3.9%**	**+2.6%**	**+3.4%**	**+20.9%**
Cumulative	**+13.5%**	**+8.8%**	**+11.7%**	**+88.5%**

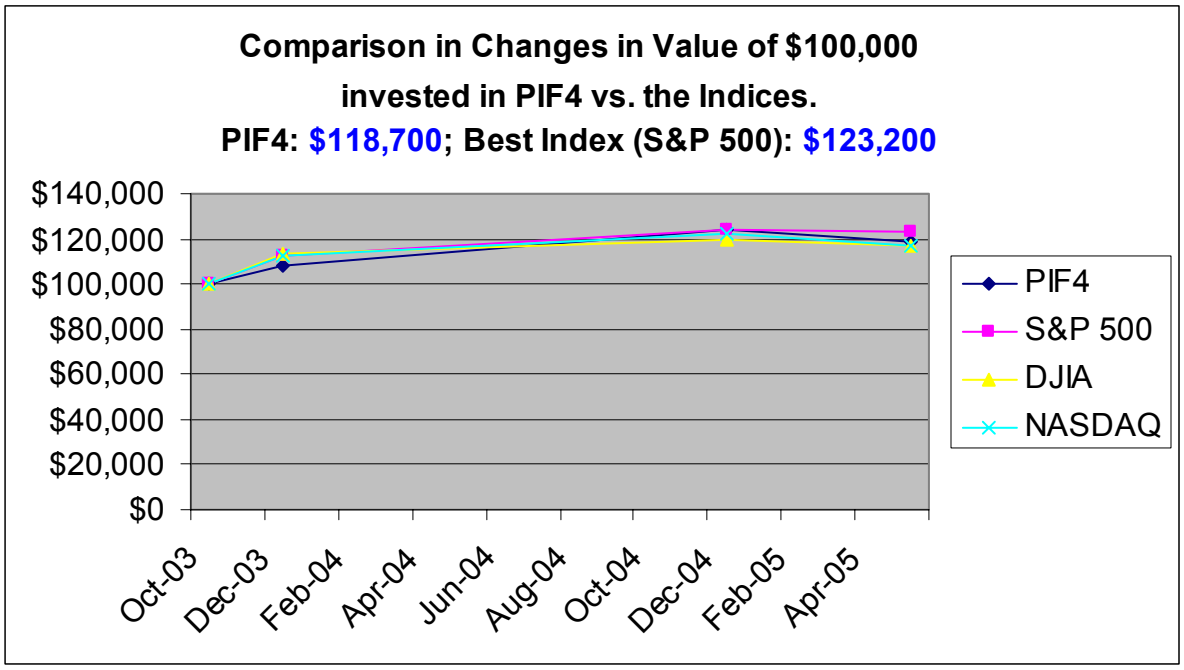


PIF3 Investors:

A $100,000 investment in PIF3 at inception on February 1, 2002 was worth $188,500 as of May 31, 2005 (net to investors). This equates to an annualized return of 20.9% since inception. The best index over the same period was the Dow and an investment of $100,000 in the DJIA on February 1, 2002 was worth $113,500 on May 31, 2005 – an annualized gain of 3.9%. The Dow gains include reinvested dividends.

PABRAI INVESTMENT FUND 4 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 – 5/31/05	**-2.0%**	**-4.7%**	**-1.0%**	**-4.3%**
Annualized	**+9.9%**	**+9.8%**	**+13.3%**	**+10.8%**
Cumulative	**+17.0%**	**+16.8%**	**+23.2%**	**+18.7%**



PIF4 Investors:

A $100,000 investment in PIF4 at inception on October 1, 2003 was worth $118,700 as of May 31, 2005 (net to investors). This equates to an annualized return of 10.8% 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 $123,200 on March 31, 2005 – an annualized gain of 13.3%. The S&P gains include reinvested dividends.

General Comments

We have three funds to serve three distinct classes of investors:

PIF2: US Accredited Investors – At its 100 investors limit and hence closed to new investors.

PIF3: Non-US Investors and IRAs/Foundations. Can have 100 IRA/Foundation investors and unlimited offshore investors. Open to new investors.

PIF4: US Qualified Investors. Can have upto 500 investors. Open to new investors.

Even though I'd much rather manage a single fund, SEC guidelines do not allow us to pool all the 350+ investor families into a single fund. However, they are managed virtually identically and, over time, will have an 80+% overlap in holdings.

Performance differences between the funds relate primarily to differing start dates, differing asset inflows, differing trade sequence between funds and tax considerations when selling. I have explained the reasons why the funds may have differing performance in the short-term in more detail in my April 2005 Letter to Partners. Over the long haul, five to ten years from now, I'd expect all three funds to have similar performance numbers – with all three very likely to do better than the best of the three indices.

Since the beginning of the year PIF3 and PIF4 are down, while PIF2 is up a bit. Performance numbers over a few months are mostly meaningless and it is best not to fixate on short-term periods. It is the portfolio's underlying intrinsic value that matters in the long run and my estimate of the per unit intrinsic value of all three funds is meaningfully higher than it was at the beginning of the year. With the NAV being close to flat to negative for all three funds and the intrinsic value being higher, I believe it bodes well for our future.

I have no idea exactly when or under what circumstances our various holdings will approach intrinsic value. Pabrai Funds does not fixate on catalyst based investing. Value is its own catalyst. However, even if it take a few years, the results should be quite acceptable.

There are probably a few mistakes I've made in the selection of the present portfolio that will fully reveal themselves over the next few years. I've made ample mistakes in portfolio selection over the last six years and yet the results thus far are not too shabby. I fully expect that, even with a healthy error rate, Pabrai Funds is highly likely to outperform the three benchmark indices over the long haul.

The Seemingly Pristine Performance Record of PIF2

If you look at the record of PIFI/PIF2 since inception, it looks fabulous. Every $100,000 invested in PIFI at inception on July 1, 1999 and subsequently rolled over into PIF2 was worth $492,300 as of May 31 '05 – an annualized rate of 30.9% - after all fees and expenses.

Well, inspite of the wonderful performance and never having had a down fiscal year, PIF2 has had some very significant gyrations in the past. With the benefit of hindsight, I think it is worth delving into the largest reported drop a little more closely. On May 31, 2002, PIF2

had a NAV of $17.43 and on Sept. 30, 2002 the NAV was $10.70 – a drop of 38.6% in just four short months.

I had several new partners join Pabrai Funds and make their first investment on June 1, 2002. About $3 Million in new funds came in on June 1 – which was a huge 20% increase to PIF2's assets. These new partners were looking at a statement just four months later that was telling them that their stake was down by 38.6%. For every $100,000 they had invested, they now had just $61,400 to show for it.

If you look at the NAV of PIF2 today, it has more than doubled from June 1, '02 and more than tripled since October 1, '02. I cannot forget that virtually all of the new and existing partners showed tremendous faith – not only did they not call me seeking an explanation, they added to their position as the NAV fell. Infact, it amazed me how resilient my partners were in the light of the big drop. It is even more amazing considering that I had at that point just three years of total lifetime experience in managing other people's money.

Since we have the benefit of hindsight, let's look at the prices Mr. Market was quoting for some of our portfolio positions during that four month period and where they are today. We still own some positions today that we owned then. So I will limit disclosure here to some of the holdings we've exited:

1. **Laser Pacific Media (LPAC):** We bought our position in 2002 at an average price of about $2.50. It closed at $2.71 on May 31 '02 and $1.83 on Sept. 30 '02. We sold our LPAC position less than a year later when the company was acquired by Kodak for $4.22/share. In four months the stock dropped over 32% and a year later had risen over 130%. When I bought it, Laser Pacific was a nice little business with a decent moat trading way below what an intelligent private buyer would pay for it. I had no idea how it would play out, but had confidence that the market would ascribe it a significantly higher valuation in a few years.

2. **Embraer (ERJ):** Embraer is Brazilian aircraft manufacturer that trades on the NYSE as an ADR. They are a fabulous business and effectively have a monopoly on the 40-100 seat regional jet market worldwide. The combination of the very best product produced by the lowest cost producer with state-of-the-art aircraft engineering and manufacturing prowess implies a durable moat that's very wide and deep.

I bought the stock right after 9/11 when it collapsed in price at an average price of $12.43. It was trading at $23.90 on May 31, 2002 and had dropped back down to $13.30 on Sept. 30 – a drop of 44.3%. As and when Mr. Market assigned a low price quote to ERJ, I continued to buy in 2002 and beyond (upto 10% of assets). We exited our position earlier this year at a little over $30/share. Over the period we held ERJ, they paid some very significant stock and cash dividends as well.

Charlie Munger's Latticework of mental models plays a large role at Pabrai Funds. With Embraer, many of these mental models came in handy. Embraer faced a flurry of order cancellations and deep production cuts as a result of 9/11. The first question I asked myself was whether air-travel for humans would increase or decrease a few years out. It was clear it would continue to increase for many many years.

Second, I drew upon my extensive experience with third world countries – having been born and raised in one. Many investors have this generic notion of "emerging markets". My take is that a business is a business is a business. During my childhood, I saw all sorts of great, good and mediocre businesses throughout India. I had a front-row seat on the ones my dad ran – which was invaluable. In virtually all cases, most of the factors that determined how they performed in the future were micro, not macro – just like in the United States and elsewhere. And yet investors put businesses into bizarre categories – growth, value, emerging markets, Asia etc. It's all about buying well-understood businesses well below what they are worth. I understood Embraer's simple business model and gained further comfort from their US GAAP accounting which was required because of the ADR. The fact that they are based in Brazil versus the US is an advantage, not a disadvantage.

Thirdly, like India, Brazil has excellent technical institutes and produces great engineers. While India has historically exported its best and brightest to the United States, the best Brazilian engineers stay home (with the lifestyle, I don't blame them). And a company like Embraer, if not Google, is atleast the equivalent of going to work for Microsoft in Brazil. So Embraer gets to hire from a far better talent pool (in my opinion) than Boeing in the United States and certainly far better than financially strapped Bombardier in Canada. The best US brains go to Google and Microsoft, not Ford or Boeing. In addition, Embraer's engineers are a loyal and dedicated lot working at a far lower wage than their Bombardier counterparts. That combo is huge. Same advantage with Embraer's manufacturing staff as well. The wage and cost advantage is near permanent.

Add to this the effective monopoly position and terrific execution after I bought. Since 2001, they have started manufacturing jets in China in a joint venture, sold 100 jets to Jet Blue that will be delivered in the next few years and innumerable wins with major airlines around the globe. India's premier airline, Jet Airways, is keenly interested in Embraer jets. I'll delve further into Embraer at the annual meeting. Finally, I will keep an eye on this one – we'll have to see if Pabrai Funds can outperform Embraer over the next ten years.

3. **Frontline (FRO):** I discussed Frontline at some length at the 2003 annual meeting. Please take a look at the 2003 Annual Meeting Slides and Transcript for a full narrative. In August and September of 2002, we put 10% of assets into Frontline at an average price of $5.90. It was trading at $3.99 on Sept. 30. On Aug. 26, FRO was trading at $7. It dropped 43% to $3.99. Ofcourse we exited in a few months at an average price of $9.15. And amazingly, FRO trades today north of $40/share. Mr. Market provided a range of $4 to $64 in under 3 years on this stock. I do not feel selling Frontline was a mistake as I

went in with the notion of a no-brainer arbitrage between the liquidation value of the business and Mr. Market's quoted price for it. As that gap closed, we sold.

In order to hold FRO until $60/share, I would have had to handicap the way oil tanker shipping rates would play out over the next few years. That was way outside my circle of competence. Liquidation value analysis of FRO was well within circle of competence and hence I limited myself to taking advantage of the arbitrage spread between liquidation value and quoted market price.

4. **Tesoro Petroleum (TSO):** I discussed Tesoro at some length at the 2004 annual meeting. Please take a look at the 2004 Annual Meeting Slides and Transcript for a full narrative. We bought Tesoro at an average price of about $7.52/share from June '02 onwards. By Sept. 30, it was trading at $2.80/share – an average unrealized loss of 62.8%. Tesoro bottomed out at $1.33/share around that time. We sold our position at an average price of $15 in 2004 and Tesoro today changes hands at $45/share.

It is amazing that a Fortune 500 company with over $10 Billion in revenue could see it market cap go all the way down to under $100 Million and then rise over 30 fold in under three years. I have no regrets about selling at the price we did. The current price implies that future refining margins will be significantly higher than the average for the last several years. Based on my understanding of the cyclical nature of oil refining margins, I have a hard time buying that thesis.

Note the minimal correlation between the businesses – that is not a coincidence. I ideally want all positions to be minimally correlated. However, also note also that inspite of the widely disparate SIC codes and minimal correlation, all four dropped significantly over the same short period of time. No effort has ever been made to curtail short-term volatility at Pabrai Funds. From my vantage point, volatility is irrelevant – except to buy more to take advantage of lower prices. It is the start and end points that matter. As long as investors think in five to ten year periods, we're on the same page.

I am hoping this discussion of some of the underlying holdings during a period of high volatility is illustrative of the way Pabrai Funds is managed. The mindset is to own pieces of a few businesses that are well understood and bought at a significant discount to perceived intrinsic value. Sometimes I am wrong and we lose money. Most of the time, however, we've been right and have made money. On balance, over the long haul it is highly likely to work out just fine. All I ask of my partners is to measure my results over a meaningful portion of time – five to ten years at the very least.

To illustrate that point further, in 1969 one could have bought Berkshire Hathaway at $40/share. By 1974, it was changing hands at $38/share. And if I recall correctly, five years later, it was at $400/share and today at $85,000. Berkshire's intrinsic value went up dramatically from 1969-74, but the stock's quoted market price did not reflect it. So you

would have had a -5% return after five years of having given your money to the greatest capital allocator in the history of mankind.

In my opinion, the only way to judge a money manager is to understand the framework employed and the unleveraged results that framework has produced over long periods – ideally covering periods of significant bull, bear and flat markets.

Alignment of Interests

PIF2's NAV is at an alltime high and very slightly higher than 6% annualized than the last time a fee was paid (12/31/04). So a fee of about $8,300 was paid. As I have always done, I've reinvested this fee back into PIF2 at the June 1 NAV of $35.14. The other funds are below their historic highs so no management fees are payable by PIF3 and PIF4.

Dalal Street (wholly owned by me) and myself (IRA etc.) have a stake of 497,467 units of PIF2, 6564 units of PIF3 and 121,614 units of PIF4. This stake is worth about $19 Million.

My family and I do not have any investments in any other mutual funds, hedge funds or private partnerships. I can't think of any other investment vehicle where I'd rather have my family put all its assets. Thus I have a deep vested interest in the future performance of Pabrai Funds.

Finally, 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.

Dhandho!: Capital Allocation at its Finest

On May 18, I presented *"Dhandho!: Capital Allocation at its Finest"* to the members of the Southern California chapter of The Indus Entrepreneurs (www.tie-sc.org and www.tie.org) at the University of California at Irvine. Here is a link to the slides:

http://www.pabraifunds.com/website/Dhandho_TiE_SC_2005.pdf

Much of the content of the talk, including the rich Q&A, is not on the slides. I hope to have a transcript posted to the website in a few weeks.

An Evening with Charlie Munger

I belong to a group called Young Presidents' Organization (www.ypo.org). YPO is about 55 years old and made up of about 9000 CEOs worldwide in various chapters. Most of the initial investors in Pabrai Funds were YPO'ers – it was a YPO'er who kept persistently after me to start Pabrai Funds in 1999 and became the largest initial investor. I can say with

confidence that if I weren't a member of YPO, there would be no Pabrai Funds. It has been a huge life-altering experience.

A former YPO'er and close friend of Charlie Munger's arranged an event on May 25 at the Huntington Library in San Marino, California for Charlie Munger to speak to a small group of current and former YPO'ers. Charlie and his wife Nancy have been significant donors to the library for a long time and they gifted $22 Million for a research building that just got completed. Harina and I attended and had sent an email to my friend Sanjeev Parsad to post on his Berkshire Message board on MSN. Here is a link to the PDF that Sanjeev prepared from that email:

http://www.pabraifunds.com/website/Charlie_Munger_YPO_2005.pdf

Harina and I immensely enjoyed hearing Charlie's candid and insightful perspectives on a wide range of issues.

2005 Annual Meetings – Save the date

As we did last year, there will be two annual meeting sequentially at Chicago and Orange County, California. The Chicago meeting is scheduled to be on Saturday, Sept. 17, 2005 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. 24, 2005 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

Please note that we will be in the Grand Ballroom this year. Hyatt developed this beautiful property recently. It overlooks the Pacific and one of the best beach strips in Orange County. Book early and make a weekend of it with your spouse or family. We do have 10 rooms set aside for the event at $185/night for the 24th. 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.

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 – 6:00 PM: Presentation and Q&A
6:00 – 7:00 PM: Cocktail Hour
7:00 – 9:00 PM: Dinner

As usual, you'll get formal invites no later than June 30. Your significant other and kids of all ages are welcome to attend. We had over 230 attendees at both meetings last year and I look forward to seeing you in September.

New Office Manager at Pabrai Funds – Ms. Isabelle Secor

When Julie Shiposh joined me in 2003 as a part-time Office Manager, she was pursuing a graduate degree and we knew it was a two–year deal. Well, the two years went by pretty quickly - Julie has finished her coursework and is relocating to the Midwest with her family this week. I enjoyed working with Julie and was always impressed with her diligence, dedication and meticulous attention to detail. Thank you very much Julie. I'd like to wish you all the very best in all your future endeavors.

Ms. Isabelle Secor is the new part-time office manager. Julie and Isabelle were able to overlap to help with the transition. Isabelle has extensive experience in a wide range of administrative tasks and I look forward to working with her. You can reach Isabelle at isecor@pabraifunds.com or +1949.457.9391. Welcome Isabelle!

Pabrai Funds continues to fulfill its mandate with a total staff of 1.3 humans.

Next Opening – August 1, 2005 (all funds) and July 1, 2005 (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 August 1, 2005.

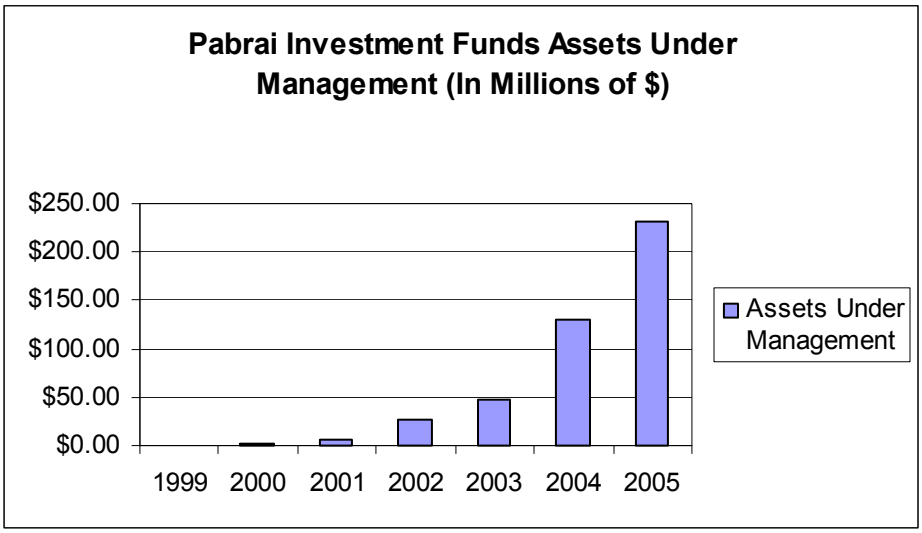
To invest in PIF3, one needs to be a non-US accredited offshore investor. Tax-exempt accounts like IRAs, Roth IRAs and US Family Foundations can invest in PIF3 as well. The minimum investment to join PIF3 as a new partner is $1,000,000 for US Tax-exempt

accounts and $100,000 for offshore investors. Next opening dates for PIF3 are July 1 and August 1.

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

Assets Under Management

There is about $231 Million in assets under management between all the funds as of June 1, 2005 – up from $1 Million in 1999 at inception.



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
2,461,339	7/31/2004	$27.90
2,471,654	9/30/2004	$29.08
2,541,507	11/30/2004	$33.01
2,514,655	12/31/2004	$34.27
2,602,698	1/31/2005	$32.25
2,658,428	3/31/2005	$34.73
2,673,965	5/31/2005	$35.14

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
1,978,599	1/31/2005	$20.58
2,004,109	2/28/2005	$20.58
2,059,811	3/31/2005	$19.34
2,187,705	4/30/2005	$17.71
2,399,527	5/31/2005	$18.85

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
6,450,877	1/31/2005	$12.11
7,029,416	3/31/2005	$12.10
7,786,519	5/31/2005	$11.87

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.