PABRAI INVESTMENT FUNDS

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

From: Mohnish Pabrai, Managing Partner

Date: October 10, 2007

Re: **Third Quarter 2007 Results et. al.**

Dear Partners:

For the quarter ended September 30, $70.4 Million was added to the various funds by new and existing partners. The additions on a per fund basis are:

PIF2 (US Accredited): $0.3 Million

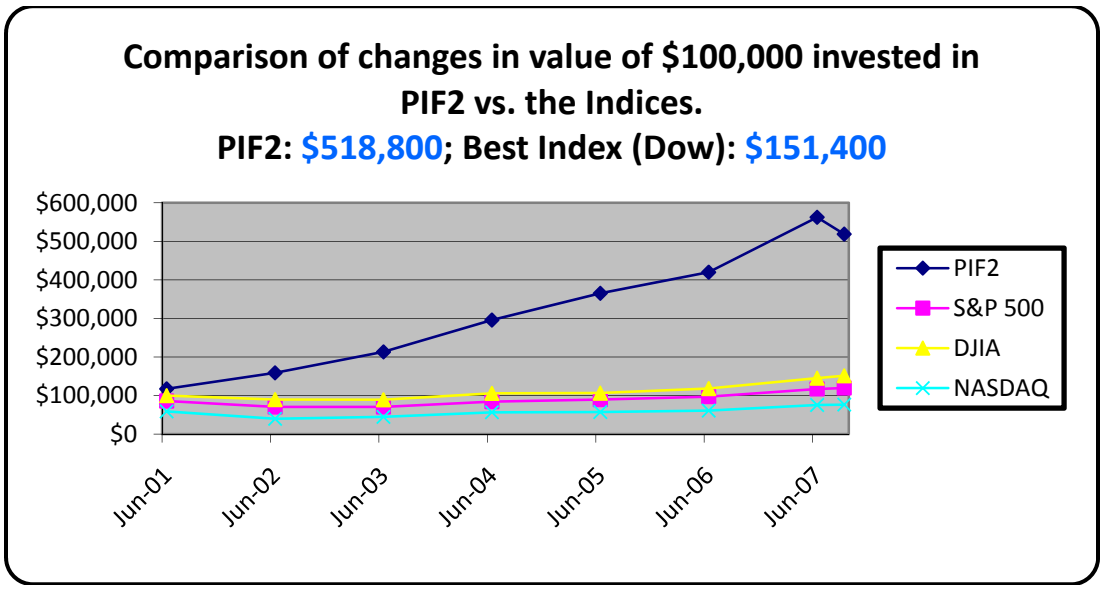
PIF3 (Offshore/IRA): $36.1 Million

PIF4 (US Qualified): $34.0 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 – 9/30/07	**+4.2%**	**+4.0%**	**+2.0%**	**-7.8%**
1/1/07 – 9/30/07	**+13.3%**	**+12.5%**	**+9.1%**	**+10.2%**
Annualized	**+6.1%**	**-3.8%**	**+2.6%**	**+26.5%**
Cumulative	**+51.4%**	**-23.5%**	**+19.7%**	**+418.8%**

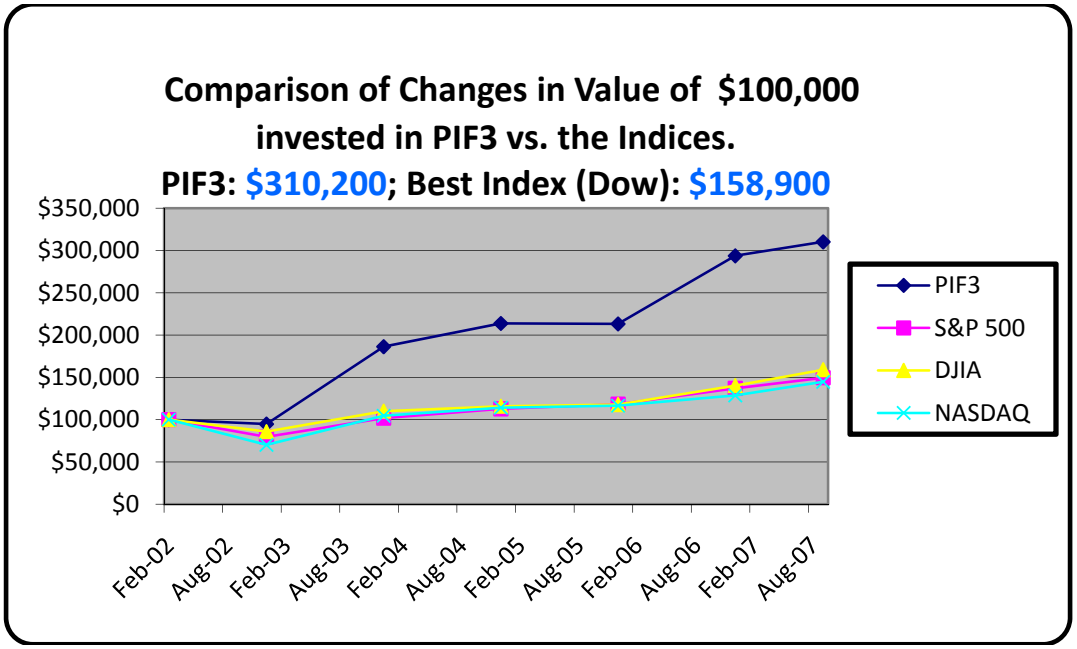


PIF2 Investors:

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 $726,800 as of September 30, 2007 (net to investors). This equates to an annualized return of 27.2% 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 $149,900 on September 30, 2007 – an annualized gain of 5.0%. 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 – 9/30/07	+13.3%	+12.5%	+9.1%	+5.6%
Annualized	+8.5%	+6.7%	+7.4%	+22.1%
Cumulative	+58.9%	+44.7%	+49.5%	+210.2%

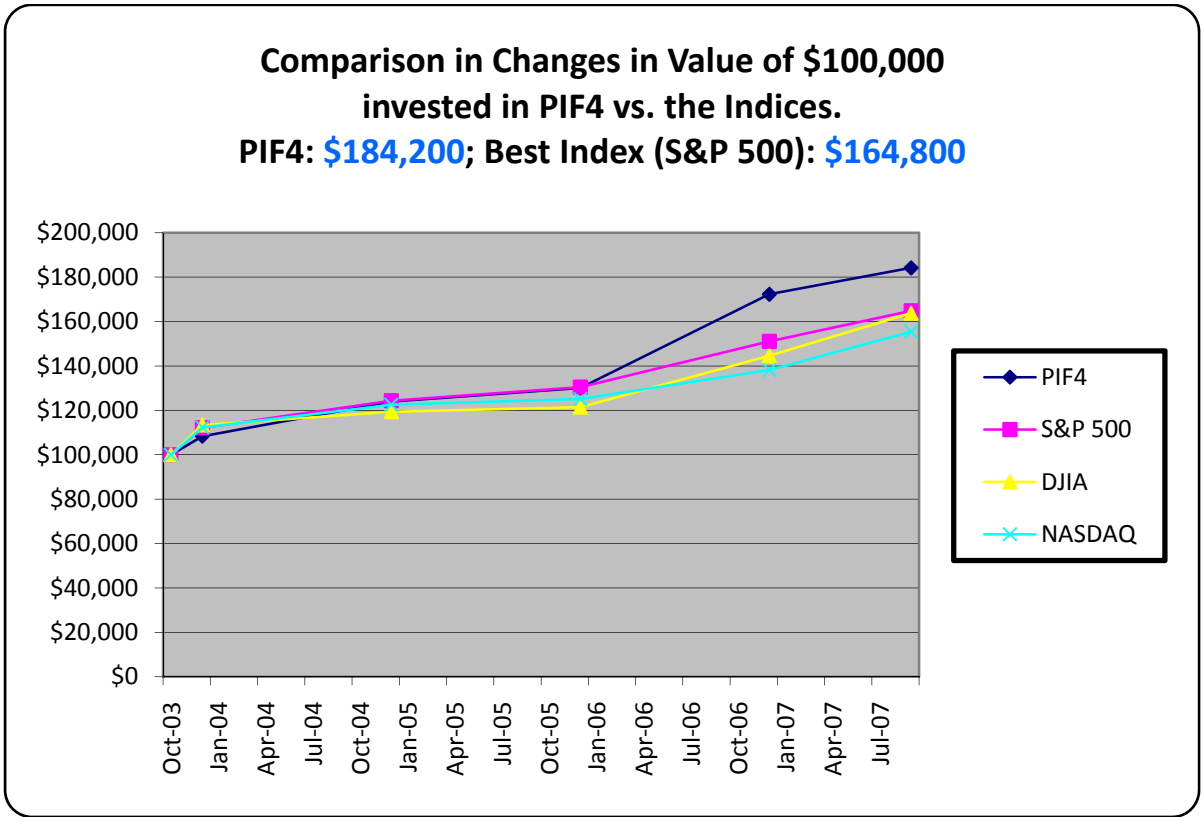


PIF3 Investors:

A $100,000 investment in PIF3 at inception on February 1, 2002 was worth $310,200 as of Sept. 30, 2007 (net to investors). This equates to an annualized return of 22.1% 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 $158,900 on March 31, 2007 – an annualized gain of 8.5%. 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 – 9/30/07	+13.3%	+12.5%	+9.1%	+6.9%
Annualized	+13.1%	+11.7%	+13.3%	+16.5%
Cumulative	+63.8%	+55.4%	+64.8%	+84.2%



PIF4 Investors:

A $100,000 investment in PIF4 at inception on October 1, 2003 was worth $184,200 as of September 30, 2007 (net to investors). This equates to an annualized return of 16.5% 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 $164,800 on September 30, 2007 – an annualized gain of 13.3%. The S&P gains include reinvested dividends.

General Comments

The indices were all up modestly for the quarter. However, the various Pabrai Funds registered NAV declines. While year-to-date (YTD) performance is positive for all the funds, they are all lagging the various indices (with the sole exception of PIF2 beating the S&P 500 YTD). Why is that?

The composition of the various fund portfolios has always been quite different from the indices. Pabrai Funds is vastly more concentrated and most of the individual holdings aren't a part of any of the three indices. These differences are partially what give me the confidence to state that, over the long haul (5-10 years), all three funds are very likely to outperform all three indices by a meaningful margin. Over the last eight years we've seen ample evidence of this.

Since inception all three funds are solidly ahead of the benchmark indices. Infact, even when looking at performance over just the last 12 months (something I try to discourage), the indices are up 16-22% while the three funds are up 33-35%.

With our concentrated portfolio, over a month, a quarter or a year, we can easily underperform. Over the past 8¼ years, all three funds have experienced several such shorter periods of significant underperformance versus the indices. Being concentrated is the key ingredient to our long-term success. Sometimes we need to endure some short-term pain to get the longer term gains. Also, when the broader markets exhibit high volatility, in general, that is good for us. It increases the odds of us picking up a bargain or two.

One of the best indicators of future performance of any mutual fund or hedge fund is the fund-wide discount to underlying intrinsic value at any given time. Here the news is pretty good. The aggregate holdings of all the Pabrai Funds presently trade at significant discounts to my estimate of their underlying intrinsic value. Intrinsic value calculations can never be exact and the future can unfold quite differently than envisioned. Nonetheless, this large discount and our rock-solid investing framework makes me an optimist on the future prospects of Pabrai Funds over the long haul.

Benchmarking PIF2's (US Accredited Fund) Performance Record Vs. the Indices

On Sept. 30, 2007, PIF2 completed exactly seven years. With seven years of performance history, it is possible to draw some meaningful conclusions about PIF2's results versus the best index.

Performance Comparison: PIF2 vs. The Best Index
(Annualized – as of 9/30/07)

	1 Year	3 Years	5 Years	7 Years
PIF2	**+34.6%**	**+21.3%**	**+37.1%**	**+26.5%**
Best Index	**+21.7%** (Dow)	**+13.9%** (Dow)	**+18.9%** (Nasdaq)	**+6.1%** (Dow)

It is best for investors to focus on the 5-year and 7-year performance numbers. Those are the most meaningful. I am very pleased with these numbers. Over the last seven years, PIF2 delivered an annualized return (after my outrageous fees and all expenses) of 26.5% versus 6.1% annualized one would have made by investing in the best of the three indices (the Dow). We also substantially outperformed over 1, 3 and 5 year periods. We fully delivered on our long-term out-performance objective.

Benchmarking vs. Other Funds

Pabrai Funds is not a mutual fund. However, with no shorting, no leverage and no use of derivatives, we are much closer in portfolio composition to a mutual fund rather than a typical hedge fund. We do have some advantages over mutual funds. Pabrai Funds is allowed to be far more concentrated than most mutual funds. Virtually all of the 450+ families invested in Pabrai Funds think long-term and we don't have much in the way of annual redemptions. It is a far cry from the mutual fund norm of daily subscriptions, redemptions and rapid-fire switching in and out of funds.

Seven Year Comparison

Out of a universe of about 4690 mutual funds tracked by Lipper, PIF2 outperformed all but 30 of them over the last seven years. Thus PIF2 beat over 99.4% of funds – after all fees and expenses. The actual numbers are likely even better as the 4690 does not include funds that did not survive the full seven years (survivorship bias).

Five Year Comparison

Out of a universe of about 5244 mutual funds tracked by Lipper, PIF2 outperformed all but 71 of them over the last five years. Thus PIF2 beat over 98.6% of funds – after all fees and expenses. And like the seven year data, since this only includes the survivors, the actual numbers are likely even better.

The median mutual fund delivered an annualized return of 12.5% and 4.1% over a five-year and seven-year period respectively. As a comparison, the best index did 18.9% and 6.1% over the same periods. Just as Bogle predicted, the median mutual fund lags the broad indices over time.

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.

Alignment of Interests

All three funds are below their 6/30/07 NAVs and hence no fees were earned by any of the funds for the quarter. My immediate family has a stake of 670,376 units of PIF2, 7300 units of PIF3 and 1,238,743 units of PIF4. This stake is worth about $58 Million.

Besides the previously disclosed stake and small investment in Dardashti Capital (worth about $1.1 Million), my family has no interests in any other mutual funds or hedge funds. I have a deep vested interest in the future performance of Pabrai Funds.

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

Pabrai Funds 2007 Annual Meeting Slides

We had two very successful annual meetings in September in Chicago and Southern California. I'm very grateful to Nikki, Diana and Isabelle for all their diligence in organizing the various facets of the meetings and dinners so flawlessly. Attendance was at an all-time record at both meetings with 290 folks attending in California and 270 in Chicago. Partners came from all over the United States and Canada. In addition we had some especially adventurous folks fly in from Hong Kong, London, Ireland, Italy, Mexico City etc. One couple from New Delhi arrived in Chicago on the day of the meeting and flew back the next day. They weren't fazed at all by the long flights and told me they plan to be back every year! That puts the pressure on me. Now I'll have to think of something meaningful to say every year. ☺

The annual meeting slides are now on the website for your perusal:

http://www.pabraifunds.com/website/2007_PIF_AM_Slides.pdf

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

Much of my presentation content and all of the rich Q&A session at both meetings is not on the slides. We hope to have the transcript for both meetings prepared and posted on the website in the next few months. A few bloggers have posted their take on the annual meetings. Check it out. Here are some links:

http://rationalangle.blogspot.com/2007/09/pabrai-funds-meeting.html

http://www.fool.com/investing/value/2007/09/28/the-buffett-disciple-descends-on-chicago.aspx

http://dahhuilaudavid.blogspot.com/2007/10/pabrais-annual-meeting-at-chicago-sept.html

http://www.fool.com/investing/value/2007/10/04/pabrai-channels-the-oracle.aspx

http://www.fwallstreet.com/blog/mohnish-pabrai.htm

This year we had a standing-room only crowd for the Chicago meeting. Unfortunately, we've exceeded the limits of the Carlucci's auditorium. So, for Chicago, there will be a new venue next year. We've been having the meeting at Carlucci's for seven years (since 2001). Their staff (especially John Campagna) has been wonderful to work with and they've always done an exceptional job for us. Every year, we'd just email them the date and number of people and they handle the rest. I will miss being at Carlucci's in September.

Removing 2-Year Lock Up et. al.

In 2005, when the SEC had proposed new regulations requiring hedge funds to register with them, they allowed exemptions if funds had a 2-year or longer lock-up. Registering with the SEC would have increased our costs of running the funds considerably. It would have also required us to add a Chief Compliance Officer and increased administrative burdens on me.

While I believe folks only ought to invest with Pabrai Funds if their time horizons are 5-10 years or longer, I've never been a fan of multi-year lock-ups. However, when weighing the pros and cons, we opted to go with a 2-year lock-up and avoid registration.

Subsequently, the SEC's registration requirements were successfully challenged in court and repealed. Thus, at this time, we can remove the 2-year lockup with no need to register with the SEC. For PIF3, this only required a directors' resolution, which has been done. So PIF3 no longer has a 2-year lockup. For PIF2 and PIF4, removal of the lock-up requires a vote by the investors. This proposed amendment will be sent to all the investors to vote on later this month.

After the lock-ups are removed, we will be back to allowing redemptions once a year (on Dec. 31) with a minimum 60 days advance notice. So, if you need to redeem part or all of your interest, please let us know before Nov. 1, 2007.

Monthly/Quarterly Reporting

Pabrai Funds is required to report audited performance once a year end (at fiscal year end). In addition the funds are required to report the unaudited NAV each time there are subscriptions or redemptions. PIF2 and PIF4 have taken in new subscribers quarterly for a while (and hence have reported quarterly). PIF3 takes in new subscribers monthly (and hence reports its NAV every month). I've proposed a change whereby our reporting frequency is ***required*** to be quarterly for PIF2/PIF4 and monthly for PIF3. In other words, should the funds stop accepting new funds/investors in the future, investors will see no difference in the way we've been reporting for the last few years.

This requires an investor vote for PIF2 and PIF4 investors. This amendment is being sent for your approval along with a 2-year lock-up removal amendment in the next few days. Investors will be able to vote on each amendment separately. For PIF3, this change was approved by a directors' resolution and monthly reporting is the norm now.

Assets Under Management – Adding more Speed-breakers

There is an inverse correlation between size and performance. Pabrai Funds now has over $625 Million under management. Under present market conditions, I am planning to stop accepting new money around the $1 Billion mark.

A few months back, I eliminated virtually 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. These have served to reduce inflows. To that end, I'm continuing to apply more "speed-breakers" to reduce asset inflows. The minimum initial investment for all the funds is $2.5 Million. The only exception is IRAs and Foundations/Endowments. For those, the minimum is $10 Million.

I am very comfortable with our current asset size and I believe $1 Billion in assets is manageable and we'll continue to deliver long-term results that are superior to the broad indices at that size.

Next Opening – January 1, 2008 (all funds); November 1, 2007 (PIF3)

There are two funds open to <u>new investors</u> to add funds - PIF3 and PIF4.

The minimum investment for PIF4 is now $2,500,000 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 January 1, 2007.

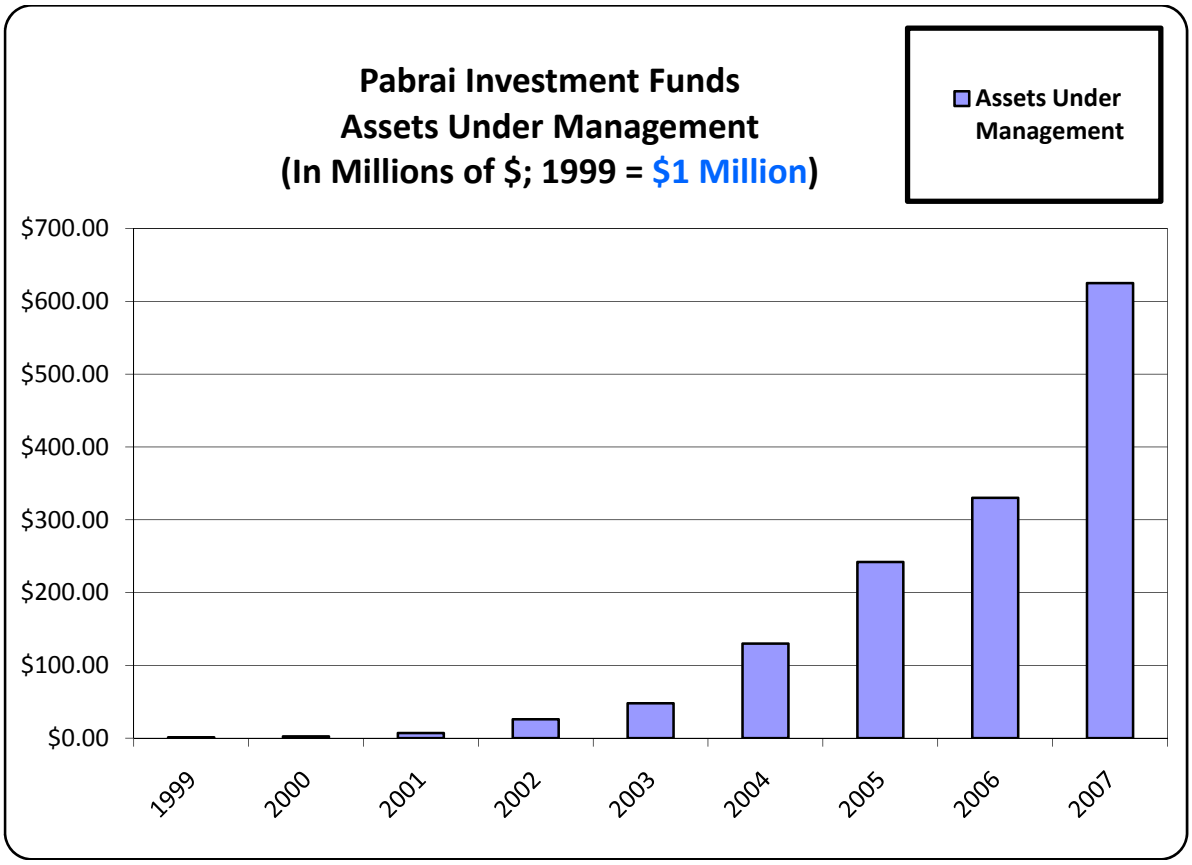
To invest in PIF3, one needs to be a non-US accredited offshore investor. Tax-exempt accounts like IRAs, Roth IRAs and US Family Foundations can invest in PIF3 as well. The minimum investment to join PIF3 as a new partner is $10,000,000 for US Tax-exempt accounts and $2,500,000 for offshore investors. Next opening date for PIF3 is November 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).

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 $625 Million in assets under management between all the funds as of October 1, 2007.



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

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
3,018,411	9/30/2007	$51.88

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
3,329,538	3/31/2007	$31.43
3,432,459	4/30/2007	$32.51
3,569,517	5/31/2007	$33.16
4,378,778	6/30/2007	$34.05
4,509,970	7/31/2007	$31.54
4,860,082	8/31/2007	$30.41
5,546,800	9/30/2007	$31.02

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
12,539,890	3/31/2007	$18.59
14,248,858	6/30/2007	$19.95
16,095,115	9/30/2007	$18.42

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.