



Interview With Mohnish Pabrai

In 2002, I attended the Yellow BRK'ers Party at Ironwoods Golf and Country Club in Omaha, Nebraska. John Gartmann, he of the enormous "Yellow BRK'ers" tophat, told me about a fellow at the party.

"Do you want to meet the next great one?"

I said, "Sure, who is it?"

He pointed out this tall East Indian fellow with a denim shirt on, surrounded by a few people chatting away.

"That's Mohnish! You've got to meet him, he's made me a ton of money."

Unfortunately, I never had the opportunity to meet him, because Warren was leaving and I rushed out of the room to try and get a picture. Susie Buffett took a picture of me with her father - the one you see on the homepage for this board. Unfortunately, I didn't get my chance to meet Mohnish.

When I went back home to Vancouver, I kept an eye on Mohnish and his Pabrai funds. I examined his website, his performance and read all his client letters. I realized this guy was the real thing. One thing was for certain, at the 2003 Yellow BRK'ers Party, I wasn't going to waste my chance to meet and talk to him. Naturally, Mohnish was surrounded by a much larger crowd of fans this year, and I was only able to speak to him briefly.

Who is he? Mohnish is originally from India and graduated with a Computer Engineering degree from Clemson University in 1986. After working for Tellabs, Mohnish started a successful IT

consulting company called TransTech in 1990.

During the tech boom, Mohnish started another company, internet incubator Digital Disrupters, which had a very painful and swift demise. It was a learning experience! In 2000, he sold TransTech to Kurt Salmon Associates.

During late 1999, with nine other investors contributing \$100,000 each, he started Pabrai Funds (www.pabraifunds.com) with \$1,000,000 in assets. Pabrai Funds was modelled on the original "Buffett Partnership." In the ensuing four years, Mohnish has not only beaten the major indices, he's demolished them!

Total assets of his three partnerships totalled \$59 million as of October 1, 2003. A \$100,000 investment in the Pabrai Funds on July 1, 1999, would be worth \$306,164 as of September 30, 2003 - a compound return of 31% per annum! Not a very long stretch of time, but Mohnish ranks well within the top 1% of investment managers during that period.

I had the opportunity to ask Mohnish some questions, and he was gracious enough to answer all of them! For the MSN Berkshire Hathaway Shareholders Board, our third interview is with the amazing Mohnish Pabrai.

Q & A Period With Mohnish Pabrai

What lead you to Berkshire Hathaway and Warren Buffett, and when did you become a shareholder?

Until 1994 I had no good approach for investing in stocks or funds and, in general, lagged the market with the few sporadic investments I made. I happened to read Peter Lynch's book "One Up on Wall Street" in 1994 and that really made a lot of sense to me. I wanted to dig more on investing using Lynch's approach.

After reading his 2nd book, I picked up "The Warren Buffett Way". I didn't know

anything about Buffett except Lynch talking about him in a very respectful manner. That just opened up a whole bunch of reading and thinking that I had never been exposed to and it resonated tremendously with me. Spent the next 2 years reading the Buffett annual reports and every book on Buffett, Graham etc.

I've never been a big Berkshire shareholder. It's a tiny part of the portfolio. Never could get it at the compelling value prices that I could find other stuff using Buffett's approach. I bought my first BRK shares in 1998, so I could attend the annual meeting and be legal.

I know you were unsuccessful in your recent bid for the Ebay auctioned "Lunch With Warren Buffett." Have you ever had the opportunity to spend time with Warren, Charlie or fellow Indian Ajit Jain?

Not anymore than most of the shareholders who attend the BRK and Wesco annual meetings. Warren has always replied to every letter I've written to him very promptly - I believe he handles all his correspondence that way. I've met Ajit in Omaha, but just a brief hello.

At your 2003 Pabrai Funds AGM, you discussed "Learning Dhandho From My Dad", where "Dhandho" means "business or livelihood" in Hindi and Gujarati.

My father Tony, who passed away years ago, also had a strong entrepreneurial spirit as well, but today I'm always wondering "If only I could have shared what I know now, with my father when he was facing the challenges of entrepreneurship and real estate ownership."

Were you able to share any of your Berkshire and Buffett experiences with your father

Om before he passed away?

My father passed away in 1997. I was just getting my arms around the Buffett investment model at the time and had yet to attend the first shareholders meeting. Any conversations about Buffett and investing with my dad were very limited as I had, at best, a fledgling raw framework at the time. When I met him in India in 1997, he was ill and hospitalized. He passed away 2 weeks after that.

Now that I have the entire framework and have fully correlated it with my father's Dhandho experiences, I would love to have just an hour or two to discuss it with my dad. More than Buffett, I'd love to have lunch with my dad and would be willing to give many times what I was willing to pay for the Buffett lunch - but of course money cannot buy that priceless opportunity.

Did your father know that you originally funded TransTech with your 401K and credit cards? What did he have to say to you about utilizing such expensive borrowed funds?

Yes. He encouraged it. Said it was the right thing to do. Staying at Tellabs was high risk (staid boring corporate path). Starting a business was low risk, high return and high adventure. I was single and, worst case, I would lose everything (wasn't much to lose), declare personal bankruptcy and start over.

Not only are you an ardent disciple of Warren Buffett, but you seem to spend a great deal of time utilizing Charlie Munger's idea of "Mental Models." How large an impact in your investment success has this played, and any idea why more investment managers and entrepreneurs don't view business in this manner?

Munger's mental models are very fundamental to investing. For me, at this juncture, its like breathing. It's naturally applied to virtually every investing situation. Also applies equally well to entrepreneurship.

The Latticework framework is fundamentally responsible for the investment results thus far and into the future. Basically, I'm using Graham/Buffett/Munger frameworks and the major aspect of Munger is Latticework, but its impact is enormous.

Eventually, I believe more investment managers and entrepreneurs will use it. It is not a naturally intuitive way of approaching investing. One needs to connect seemingly disparate pieces of data and think about the world in a broadbased way that most folks don't. Investing is much more of an art than a science with the individual mental models being critical.

You made some interesting comments at your recent presentation for members of The Indus Entrepreneurs. In particular, you described the distinction between "risk" and "uncertainty" for entrepreneurs.

Are there any authors you could recommend that describe this fundamental difference between success and failure for entrepreneurs, or could you expound on it further?

Despite the common belief, the overwhelming majority of entrepreneurs are not risk-takers. They try hard to eliminate risk and make nearly risk-free bets. Successful entrepreneurs are usually very good at dealing with high uncertainty and low risk.

The best book on the subject is "The Origin and Evolution of New Businesses" by Amar Bhide. He spent many years interviewing dozens of entrepreneurs. Also, any biography/autobiography of nearly every entrepreneur from Sam Walton to Richard Branson to Michael Dell is in sync with Bhide's thesis. Branson's "Losing My Virginity" is a very good read for any would-be entrepreneur and demonstrates low-risk entrepreneurship very well. Even today, with over \$7 Billion in annual revenues, Virgin makes near risk-free bets with its new ventures.

Charlie Munger at the last AGM discussed how businesses are never prepared for a "six-sigma" event. This has become all too evident with the tech-wreck and 9/11, which seriously affected the technology and insurance industries. While you had enormous success at TransTech, the tightening of capital markets played a significant role behind the demise of Digital Disruptors. What lessons have you learned and applied regarding underestimating business "risk?"

Digital Disruptors was a big mistake. It was a very expensive way to get an education in business fundamentals. You learn much more from failures than from success and from that vantage point Disruptors was an incredibly valuable learning experience on a number of fronts. Those lessons will stay with me for life and I'll never ever make those same mistakes again.

I am now firmly of the opinion that capital is unnecessary for the successful formation and growth of nearly all businesses. I've had three business ventures thus far in my career. Two were started with virtually no capital and made a lot of money. One started with lots of capital and lost lots of money. In general, having lots of capital in a startup just amplifies the mistakes. It's in sync with Bhide's conclusions.

You once wrote an article entitled, "What Microsoft Could Learn From Warren Buffett," in which you discussed the reasons behind why Microsoft needed a strong capital allocator and benefited by a significant amount of capital in its vaults. Berkshire Hathaway has two very strong allocators of capital, and as a reinsurance business also requires a very strong balance

sheet.

Recently, Microsoft has decided to pay a dividend due to the new dividend tax rules. Do you think they made a good decision based on the most efficient use of capital, and do you think Berkshire Hathaway should now pay a dividend?

Microsoft's dividend is paltry and irrelevant whether they pay it or not. I do believe they should keep huge amounts of cash like they do, but deploy it in a Berkshire Hathaway format. The key is to have a Buffett-like capital allocator at the helm.

If Microsoft reduced their cash to zero and gave the entire \$50 Billion to shareholders, it would mean a one-time dividend equal to about 16% of the market cap. Shareholders are better off letting the company keep the money as an insurance policy - insuring the value of the other 84% does not erode. It's the 84% of market cap that's critical, not the 16%.

BRK should not pay a dividend as long as the messiah is at the helm. He'll always allocate it better than any of us could.

The success of the Pabrai Funds, both in performance and growth, has been absolutely extraordinary since inception. For people entering the business of asset management, what is the best piece of advice you could share with them?

Before taking other people's money one should have done investing for a few years with your own funds and compare the performance to the best money managers around. If your long-term results are great, then, I think Nike expresses it best: Just Do It!

What will the future look like for you? Would you ever consider dissolving the Pabrai Funds to start a company that

utilizes float?

Buffett the investor is relatively easy to emulate and improve one's results, but it's impossible to replicate Buffett the CEO. Also, P&C insurance float is extremely dangerous due the high risk of error on the wrong side with reserves. Buffett and Munger make it look easy because they are so good, but it's very very high risk stuff. If I ever use float as a vehicle, I'd be much more interested in low-risk float like Blue Chip Stamps, Register.com, Network Solutions, Stewart Enterprises, Service Corp. etc.

Float and Pabrai Funds are not mutually exclusive. After the funds have some scale, we could acquire, say an 80% stake in a business like Register.com, keep it public and take control of the allocation of the float. If such an opportunity presents itself and there is sufficient capital at hand, it would be an interesting addition to the model. Getting all the benefits of leverage with none of the risk is always good.

What does a typical day for Mohnish Pabrai look like?

The typical day depends on whether markets are over-valued or under-valued. With the Dow at 10,000, I find it an exercise in futility to look at most stocks - even at 52-week lows. If the Dow gets to 5000 or less, it'll be far more rewarding to do some bottom fishing.

My current typical weekday is to wake up at about 6:45 AM. My wife leaves for work at about 6:00 AM and is back by 2:00 PM. I get myself and the kids ready and we walk to school. It's just 2-3 blocks and a nice walk in the year-round terrific Southern California weather.

I get to work around 8:45 AM and take a break for lunch around 1:15 PM. At about 3:30 PM, I take my daily afternoon siesta. I've got a small 10 x 10 room in the office setup for my afternoon nap - complete with comforter, pillows etc. The room has no windows, so it's midnight when I shut the lights, which is great. I wake-up and go home around 5:30 PM. Usually workout for an hour and then am with the family and kids till they go to bed at 8:30 PM.

My wife and I go on dinner-movie dates twice a week (from about 8:30 to 1:00 AM) and

our housekeeper cleans the home while we're out and the kids sleep. I am getting my duplicate bridge restarted and will be playing online one night a week.

I rarely go to bed before 1:30 AM. Usually the time from 9:00 PM to 1:30 AM is spent doing investment related reading or general reading etc. Most of the drilldowns that I do on businesses are done at night. Most of the sifting through stocks to find companies to do a drill-down on I do during the day. Nowadays there is a lot of general reading. If the Dow went to 5000, it would be nearly 100% investment related reading.

I am out of town for a couple of days each month and usually have no more than 1 lunch meeting a week to meet up with someone. The rest of the schedule is free - which allows time to be spent as I see fit. All administrative tasks for the funds are mostly outsourced and my assistant, Julie, works 12 hrs a week (9-1, MWF) to keep me organized. I don't spend much time with people or even on the phone. Most interaction is via email, which I find very time-efficient.

It's a utopian existence. I find myself "out of sync" when I'm on vacation etc. Everyday is like a vacation day for me at Pabrai Funds as I wouldn't want to spend my time any other way.

Mohnish, on behalf of the MSN Berkshire Hathaway Shareholders Board, I can't thank you enough for giving us your time for this interview. I look forward to seeing you at the next Yellow BRK'ers Party, and we eagerly await your future endeavours.

**conducted by Sanjeev Parsad on October 21, 2003 for the MSN Berkshire Hathaway Shareholders Board*