Pabrai Investment Funds/Dhandho
2015 Annual Meeting Transcript

Note: This is the transcript of the September 13, 2015 meeting held in Aliso Viejo, California and the September 20, 2015 meeting held in Rosemont, Illinois. Mohnish's presentation style is extemporaneous; hence, there were some differences in the two presentations. Transcripts of both meetings were merged to produce this single document. The transcript has been edited for readability.

The transcript should be read in conjunction with the Annual Meeting presentation slides (the password to the video is "Warren"). They can be viewed at:

https://vimeo.com/139966800

Welcome and Introduction:

We have a little more content than the previous annual meetings. Our format will be a little different from the previous years. I will go through a bit of a preamble before we get into our performance, postmortems and our discussion about Pabrai Funds and Dhandho Holdings. Lastly, we will go through the Q&A.

Ad: Beautiful Lands – Jeep Beautiful Lands Commercial

Ad: Fiat Blue Pill Commercial

If you were to go back to 1921, there were hundreds of automobile manufacturers in the US. At that time, the United States was an emerging market in the automobile industry. There were about 7.5 million cars on the roads in the country and about 2 million cars sold that year. That number was growing at about 25% a year. It was a high growth industry. Any way you looked at it, you would be correct in assessing that automobile ownership and growth was going to be very significant in the United States for a very long period of time. Because of that reality, there was a massive surge of companies that went public that focused on manufacturing automobiles. A lot of them had the word "motor" in them. If you wanted to get funded and go public, you could come up with some auto manufacturer with the name "motor" in it and you would get a huge valuation. About 10 years later in the 1930s, we were left with three auto manufacturers. Basically those who invested in the auto business ended up holding the bag. It turned out to be a terrible investment, even though the long-term trajectory of growth of the industry was absolutely right on.

In 1958, nearly 40 years later we had the "tronics" boom. There were a bunch of companies that were formed, and went public. The companies focused on having names which had various forms of "electronics" and "sonics" with different types of permutations and combinations in the name. Again, professing quite rightly that the transistor and Moore's law would be transformational in terms of how we would live our lives. That part was correct. But by 1962, almost all these companies had gone bust, so it didn't work out very well for investors.

Amazingly, almost exactly 40 years after that in 1998, 1999, we had the dotcom boom. Many of us were around to see that. There were the Pets.com and all the other variants. The internet was transformational. It would change the way we lived our lives and create a lot of efficiencies. Again there was extreme difficulty in picking the winners and avoiding huge losses. History does not repeat itself but it does rhyme. I have found it interesting that we had these three events which are all very similar, and they took place almost exactly 40 years apart from each other. 40 years is enough time for folks who witnessed the last bubble to have left the scene. It lays the groundwork for the next bubble. This is amazing. If you were to project forward to 2035, 2038, 2040 somewhere in that time frame, we don't know what the widget will be or what the nuance will be. Maybe we will be transported to Mars or something. We don't know. For sure it will be wrapped in a kernel of truth and even the people who are wrapping it would believe it. These previous three bubbles are very similar and they followed a similar trajectory. Bubbles are very common and almost all the time there is some bubble taking place somewhere. There is a book written by Ron Insana, the CNBC anchor. He wrote Trend Watching. In his book, he listed a whole bunch of different bubbles and you would be surprised how frequent and common bubbles are.

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Another bubble, which was somewhat different, was in the late '60s, early '70s. This was the Nifty Fifty. You bought these stocks and held them forever. The idea was that you are buying extremely good companies that had very strong growth trajectories for a long time, so price didn't matter because the companies were so good. If you look at the PE ratios, Polaroid was at 91 times earnings, McDonald's was at 86 times, Disney was at over 80 times, Kodak was at 48 times, and Kmart was at 54 times. The idea was that you buy these great businesses and you ignore price.

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Then we had the big downturn in 1973 and 1974. At first when stocks started to go down, the Nifty Fifty stayed put and it didn't move. People had been programmed to buy these stocks, hold them, and not worry about price. Then Forbes reported, one by one they were taken out back and shot. You had Polaroid down 91%, Avon 86%, Coca Cola down 75%, Disney down 75%. There are a couple of other nuances with this Nifty Fifty.

There were a number of tech stocks - Digital, IBM, Polaroid, Xerox, and Kodak. If you look back today, the tech stocks are all gone with the exception of IBM. I would say that IBM is here today because of the intervention by Lou Gerstner. As Buffett says, the industries with rapid change are the enemy of the investor. The portion of the Nifty Fifty with this rapid change characteristic didn't make it and most of the others did. Coke and Wal-Mart were there then, and they are with us today. If you held the Nifty Fifty all the way till today, you would have quite significantly underperformed the S&P. On top of that, you would have had very significant gyrations between then and now.

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As we look back, the Nifty Fifty took place about 45 years ago. If you look at the late '60s versus 2014, 2015, we have something similar playing out today with the Nifty Fifty of 2015. If you look at what I would call the Nifty Fifty of 2015, you have Amazon at close to 600 times earnings, Netflix at 240 times, Twitter 130 times. If Tesla made money, they would be over 100 times and the same with SolarCity. We don't know where Uber is, but Facebook is close to 100 times. Just like the Nifty Fifty, these underlying businesses are real businesses with great management teams and are very well run. Just like the Nifty Fifty in the late '60s, they have the same characteristics. These were not fly by night operators or moon shots. These were very solid established companies. It is very likely that many of these companies on the list will be with us 10- 30 years from now. The only caveat is the tech portion of the previous Nifty Fifty got wiped out. In this Nifty Fifty, we have a very strong tech component - it is almost entirely a tech component. It's hard to tell what will happen with these industries with rapid change and how it will play out.

2015 is very different from the dotcom boom we saw in 1999. In the dotcom boom, you had a lot of lower quality companies. Here you don't have low quality companies; you have high quality companies. It is a similar situation to the late 60's. We have these 40-45 year time periods because none of the current crop of investors have any experience with the previous bubbles. They have never dealt with it and they never experienced it.

They may have read about it. For example, when the dotcom boom was going on, there were articles written about "tronics" and "motors" that Buffett talked about. The response was - this time it's different. Quite frankly, I am a little skeptical about whether this time is different. We really don't know. It's hard to tell when these bubbles will pop and how they will pop. If they pop, will they flat line for a long time? From an investing perspective and from my vantage point, my response is to sidestep it. Don't go long or short, just watch the drama from the side and don't participate.

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There are a couple more data points - for example Tesla. They have about $4 billion in revenue and they are losing about $400 million a year. The market cap is close to 9 times revenue. Even if they made an 8% profit, which is the highest profit of any automaker (BMW for example, makes 7%), it would still be over 100 times earnings. The whole pure electric car space is about to get pretty crowded with a number of different players coming in from different perspectives. In the next few years we will see multiple different players.

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If you look at GM, their economic value is about $33 billion, which is less than Tesla. Their free cash flow is heading towards $12 or $13 billion - almost a billion a month. The PE is under 4 and they have about $65 billion in NOLs, which are shielding a lot of their income. They have a 200 plus mile car coming. In fact in the 2016-2018 time frame, there are a lot of pure electrics north of the 200-300 mile range cars coming out. Quite frankly if you look at Tesla, it has all the ugliness of the car business. Just like the other car companies, it has high CapEx and eventually they are going to end up unionized. All these different nuances are not the most favorable with the car companies, but they will be there in all of them.

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This is a quote I took from David Einhorn's most recent Letter to Partners. David was comparing NetFlix to their position in Micron and Greenlight. He said that Micron was valued at $20 billion and is now valued at about $17 billion. They have trailing earnings north of $3 billion. Then you have NetFlix which is valued at $40 billion with $240 million of trailing earnings. That $40 billion number has moved up since I prepared these slides. NetFlix is an incredible business, has an incredible management team and they have a huge runway ahead. These are all good things, but they don't own content. They have some content, but about 98% of the content going through their pipes is not owned by them. Content owners have quite a bit of clout. It remains to be seen how much of that content they can monetize by having the pipe. You have somewhat strange things going on in this front.

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In terms of the companies which are over 100 PE, we had a peak in the 2000 era. There were about 120 public companies that had over 100 PE. Today we are at about 80. It is not like the dotcom boom, but you have froth in a narrow segment of the market. If you look at the day the NASDAQ peaked in March 2000, it was the same day Berkshire saw its valuation cut in half. We had started Pabrai Funds in July 1999. In the first year we were in operation, we were up 70% and most of the indices had started their crashing and burning in that period. All the oxygen had been taken up by these dotcom companies at that time. People put a lot of money in that sector. The boring brick and mortar, vanilla companies and Berkshire and others got really cheap. This was a great time from my vantage point to find companies to invest in. If you were willing to sidestep the madness, then there was a lot of stuff available outside. We went after those and it and did quite well.

Today we find something very similar. We find extreme cheapness in many different parts of our portfolio and quite frankly some of the cheapness is puzzling. I don't understand why things are as cheap as they are. For example, I look at GM. GM is committed to putting all its extra cash back in the hands of the investors. They have a very aggressive buy back program. If they were to apply all their cash flows to buy backs, in about five years they would have bought back the entire company. You would still have a company with a $10-$12 billion earnings engine. Having that type of dynamic where the company goes in that direction and you still have that type of pricing is quite interesting. Our numbers in the near term don't look great, but I like what we own. In fact, I think we will do quite well with it long-term even though we aren't presently looking like geniuses.

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When you look at the Nifty Fifty of 2015, a lot of it is concentrated in the Top 100 names in the NASDAQ. There are 2200 stocks in the NASDAQ. The total value of all 2200 stocks is $7 trillion. The top 10 make up $2 trillion and the top 100 are $5 trillion. There is a huge portion of the value of the NASDAQ in these top 100 names. Many of the top 100 names have very frothy valuation. I wouldn't include Apple or Google in that list those are more sensibly valued. There are a lot of companies like the Amazons and the NetFlix that have a very high valuation.

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In 2000, the NASDAQ was at 5000. At that time you had a lot of froth, but the froth was quite widely dispersed. That bubble popped and the NASDAQ went from 5000 to 1200 in a couple of years. Today we also have froth in the NASDAQ, but it is more concentrated amongst these names. I don't know whether it will pop, whether it flat-lines or whether it will go up for a while. It is hard to tell how bubbles will play out. All I can say is that it's probably a sensible response to sidestep it. We just don't know how things will work out.

Ad: Cadillac Dare Greatly Commercial

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We have three funds. Fund 2 is our oldest fund. Fund 1, which started in 1999 merged into Fund 2 in 2000. It is a little over 16 years old and has done quite well. Since the beginning of PIF2 in 2000, it is worth three times better than the indices. If you look at it from the beginning in 1999 until now, PIF1 is worth 10.5 times the original investment, whereas the Dow is up less than one-fourth of that. PIF1 and PIF2 have done quite well. If you look at the numbers from a one, three, five year and life of fund, we are lagging in the one and three year numbers. The NASDAQ nowadays is on fire for some of the reasons I just mentioned but in the longer term we have done better.

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Fund 3 is our off-shore fund. If it were up to me, I would only have one fund, but we are required to put these investors in different buckets. There is a little over $200 million in the PIF3 off-shore fund which has the non-US investors, foundations, endowments and IRAs.

From the beginning in 2002 and a little over 13 years, PIF3 has grown over four times. The NASDAQ is the best performing index, which has increased less than three times over that period. Long-term, PIF3 has done better than the best index at a little over 3 percentage points. It has done even better versus the S&P and the Dow. As we get to the five year numbers, we are lagging the NASDAQ. All the numbers are versus the NASDAQ. I think that lag will correct itself over time. Presently in the near term we are not doing that well. One of the things about Pabrai Funds is that we have always said that we want to beat the indices, but you can't beat the indices by buying what is in the index. We have never tried to buy what is in the index and have gone off on our own path. Over time that works out but it also means that you are going to have periods when you underperform and have periods when you outperform. That's just the nature of the beast and when we zag, everyone else zigs. We are going to pay the price for doing that sometime in the near term.

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Fund 4 is our US fund for qualified investors. It is a little less than 12 years old. From the beginning, PIF4 has been lagging the NASDAQ. It is doing better now versus the other two funds, but it is slightly behind the NASDAQ in the life of fund numbers. The NASDAQ is doing better than us, at least for now. When we look at the life of fund numbers, we are lagging against the NASDAQ across the board on all four metrics - the one year, three year, five year and the life of fund. I believe this will correct itself over time.

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We have about $840 million in assets under management. Dhandho Holdings has approximately $200 million and the rest is Pabrai Funds.

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This slide is just an update for the last two months – looking at the July 1 to August 31 period. The US funds only report once a quarter, so all the numbers you saw for the US funds are through June 30th. I wanted to give you a sense of what happened in July and August. If you look at our PIF3 off-shore fund, year-to-date we are down nearly 14%. It is significantly below where the indices are. In the near-term in 2015, we don't have great numbers but I think that will again correct and reverse itself over time.

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In the past we have not talked about current holdings for very good reasons. This time however I am going to talk about two of our holdings because they have some unusual dynamics. There are two companies collectively that make up a little over a half of the pie, which is unusual for us. We never invested more than 10% of assets into a single stock. For example, for Fiat-Chrysler Automobiles, we invested $70 million in FCA in 2012. That position is now close to three times where it was when we invested. It is still quite undervalued and we have never sold something just to bring it into balance versus the rest of the portfolio. We are not willing to sell undervalued assets just for that reason alone.

Fiat is about a third of the pie, and it's been hard to get a handle on them because there are a few moving parts. They make about 4.8 million cars and out of those cars, 7,000 are Ferraris. They own 90% of Ferrari which is about to be spun out to the Fiat shareholders. I believe the shares we will get for Ferrari will exceed what we paid for the company in 2012. I think the spun off Ferrari shares will be $70-$100 million in value. When that spin off happens in about four months, the equity of the rest of the pie won't be affected much by it. We may end up with somewhere between $70-$120 million in Ferrari stock, and over time that number may go up because they are doing a few things to increase the value of Ferrari. In a few years, Ferrari alone may be worth more than the $200 million that we have for Fiat.

When you look at the rest of the company without Ferrari, there is a very wide range of things taking place. It would not surprise us if we ended up with a double, triple or more on the rest of the pie. There are some scenarios where we may end up with 25-30 times the original cost basis in the next few years. There is an extreme end of the range of valuations that could put our stake in FCA at $2 billion. This would be a 25-30 times return. With that dynamic we have no interest in selling any FCA shares. I am sharing this because every year we have redemptions from Pabrai Funds, and this year I want investors to know and understand what they might be leaving behind. I could be wrong, but we have a huge position in Fiat and we feel really good about that.

We also have a $90 million position in GM Warrants. These are unusual instruments. These were basically forced down GM’s throat as part of the bailout by the US Government. The US Government basically divested that interest and made it available to investors. The current GM market cap is under $50 billion right now and the CEO of GM, Mary Barra has publicly proclaimed the goal of making GM the most valued car company in the world. She may or may not get to that goal, but if she does we would have about $600 million worth of GM warrants. It would be a significant run from here. Even if she fell short of that goal by quite some margin, on a bad day it would be worth three times what it is worth today.

Fiat and GM are half of the pie. We have other things in the other half, which I prefer not to talk about. This however is a big portion of the portfolio. Most of my family’s net worth is in the funds and are invested in these assets, so I believe we will come out fine. I would like investors to know this and understand why we have this position. If you intend to leave, you would have a good understanding of why you are leaving.

I have covered these existing positions with some hesitation. I honestly don’t like to talk about positions because there is a commitment and consistency bias that creeps in and hopefully we will avoid that. We want to keep these positions and I believe we will do quite well with them.

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Our expense ratios right now are amongst the lowest across the entire mutual fund and hedge fund industries. We charge no management fees and only charge performance fees. Expenses such as our annual meeting, office rent, office staff and my salary do not get paid by the investors. The direct costs the investors pay are third-party costs - audit, accounting, tax and administration. As you can see, we are now down to 3 to 7 basis points on cost, and these are some of the lowest in the hedge fund and mutual fund business. I am very proud of this.

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John Bogle says that 85% of mutual funds typically lag the index. It is almost like the law of physics that they lag the index. If there were no frictional costs, then half the assets actively managed would beat the index and half the assets would not beat the index. Then when you add frictional costs, which are in many cases significant, that 50% shifts to somewhere between 70%-90%, depending on how big those costs are. You almost have a rule of physics that a vast majority of mutual funds are going to lag the underlying index. Even those that beat the index by more than 3% a year is down to something like 0.5% - 1 out of 200. I believe we will beat the indices long term, but I'm not quite sure by how much. This has always been our beacon and there is no reason for us to exist if we can't beat the indices.

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In terms of our value proposition, this is not a sales pitch because the funds are closed. For many years we have not taken any new investors in the US funds and only the offshore fund is open for investors. We have kept the offshore fund open only because we have one investor who is a large portion of the fund. If they decided to exit completely, then it would cause some changes for us. I would like the offshore fund to have more assets, simply to take their percentage down.

We have no management fees. We are not trying to attract assets, but if we had a 2 and 20 structure my fees would be $14 million a year.

The Pabrai Family is the second largest investor in the fund, so I am definitely eating my own cooking.

We have no performance fees until we get to 6% annualized. If you look at the history of Pabrai Funds over the last 16 years, we had close to zero fees collected since 2007 due to the financial crisis and draw down. Prior to 2007 we collected a huge amount of fees. Until we get up to high watermarks and 6% annualized we are not going to collect fees, which I think is a fair arrangement. It's a record that we have operated for more than eight years with close to zero fees. The good news is we don't have much of a cost structure. We have no analysts associated at Pabrai Funds and there is very little in terms of expenses. We can almost run forever without fees, though I hope that is not the case and I think all of you would love to pay fees. For those reasons I talked about, PIF3 is open and the others are closed.

We're going to play a commercial for you.

Ad: Chevy Happy Grad Commercial

Ad: Chrysler Kings and Queens Commercial

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I will go through some post mortems and talk about the two stocks we sold earlier this year. The first one is Bank of America which we bought in 2011. I was intrigued by Buffett's investment in Bank of America and I started to study it. We piggybacked on that almost right after. We last sold it towards the end of the first quarter. We had invested over $57 million and received proceeds of about $124 million. We had a 117% realized gain and 24% annualized return on the investment over that period. As you can see on our stock chart, it has done fairly well.

We have Sunil Puri in the audience who used to intern at Illinois National Bank. This bank was owned by Warren Buffett and it was the second purchase Berkshire made after National

Indemnity Company. They were forced to divest the bank because they had rules that didn't allow an insurance company to also own a bank. By 1980, Warren, much against his desire, was forced to sell the bank. From the late '60s till now, there isn't a banking analyst, in terms of commercial banks, better than Warren Buffett. Warren has made a lot of investment mistakes in his career but if you study him in certain industries, his track record shows a 1000 batting average. Commercial banking is one of these industries. In his 45 years in commercial banking, there has never been a loss on an investment. When Sunil was at Illinois National, a single branch bank, they never had a single dollar of loans outstanding that wasn't collected back. There were zero defaults in the period he owned the bank, which is why Warren loved the bank so much. At that time, he would show up once a month. Quite differently from his situation right now of being an arm's length to everything. From then on, Warren studied banking very closely and he made a number of investments which have been part of the Berkshire portfolio - Wells Fargo, M&T Bank, US Bank and a number of other banking investments.

There were other industries where Warren made investments. In retail, Warren Buffett had a terrible track record. In insurance, it wasn't that great because insurance is a tough business. In manufacturing it also wasn't that great of a record. But in media and commercial banking it was almost a 1,000 batting average. Overall, if you look at Warren in certain industries, he is probably amongst the best in the world. When he bought Bank of America, I studied why he bought it because it was a phone call that he initiated and not them calling him. Bank of America at that time was trading at about half book value. A well run bank should be trading at 1.4-1.8 times tangible book value. Wells Fargo actually trades even higher than that. Some of the best run Indian banks trade at 4-5 times book value. The question I had in my mind was how real the book value was because BofA was coming out of the financial crisis, their purchase of Countrywide and different lawsuits. It was a very fuzzy picture of what the entity looked like. One number that you can get very quickly about Bank of America is their PTPP (Pretax Pre-Provision) number. At the time we made the investment, the PTPP number for Bank of America was about $40 billion. They had a lot of provisions, but they had the ability to drag out the settlements and provisions.

In the late '80s we had the Exxon Valdez disaster in Alaska, and the litigation is still going on today. Exxon still has reserves on its books that have not been paid out, and the ability to stretch it out can be quite mindboggling. If you have a company that has a $40 billion earnings engine before provisions and taxes, it has some robust ability in terms of future earnings to be able to take care of quite a bit of the ugliness and the bad news. This was the first thing that was happening at the time. The second thing that happened after 2009 was the number of large banks and even small banks was cut in half, and most of the competitors were absorbed by other companies. If you look at the banking landscape in the US in 2006 and look at it today, it is like night and day. Most of the large banks such as Wells Fargo, Bank of America, Citi and Chase, saw a dramatic reduction in the number of competitors left standing, and it made their competitive position stronger. In the case of Bank of America, they picked up some crown jewel assets like Merrill Lynch for next to nothing.

The technology tailwinds help the large banks a lot more than they help the small banks. Let's take a step back – for example, life when we went from no ATMs to ATMs. ATMs gave banking a boost because you didn't need a live teller and it became cheaper to service a customer. When you go from ATMs to mobile banking it becomes even cheaper. Now there is no need for a machine for your customers because they are using their iPhone as a computer to do the processing. The IT demands put on the banks makes it very difficult for the small banks to invest and build technology with the same ease as a larger bank. When you have a bank such as Bank of America with a $40 billion pre-tax earnings, they have a very robust ability to invest in technology. Whereas when you have a small community bank which has maybe $100 million in assets, they are going to have a very hard time matching those technology investments. Not only did the number of banks decrease, the technology tailwinds disproportionately favored the larger banks. Also the tailwinds and mobile banking took down the need quite significantly for brick and mortar branches. All of the big banks are decreasing their total banking square footage, even as their assets are growing. It is a better business for us going forward and even though we sold it, we still have room to run and do well. We had other things we could have bought at the time and that is what I was focused on.

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Another investment we made around the same time was Citigroup. It was very similar to Wells Fargo, Chase and Bank of America. We bought it for about $31 a share and sold it for about $53. In this case, we didn't do as well as Bank of America. We made the same investment and we had a 60% gain over a 3.5 year holding period. We could have bought about 6-8 months later, and looking at the chart, theoretically we could have sold within 12 months of buying and captured most of that. It is still a reasonable result. It has a very similar thesis to Bank of America, with the exception that the two banks are a little bit different. Citi has an incredible international franchise in Asia and is very much part of the plumbing, just like Bank of America in the US is very much part of the banking plumbing. As Greece found out recently, you will go straight to the 17th century in terms of GDP if you don't have a functioning banking system. Therefore, these banks are as essential as the water flowing from your tap and they are part of the core plumbing. It was a similar type of deal where they were trading at half the book value and had a similar type of Pretax Pre-Provision engine. And in Citi's case, they have international franchises in Mexico, Southeast Asia, India and Europe. They have an incredible global footprint that would be almost impossible to replicate. Again the same thesis played out in both cases with the reduced competition.

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The next couple of slides is a cross section of our past holdings. As you look at these companies, you will see that we have made investments across the board. They have been in a wide range of industries at different times. For most of the existence of Pabrai Funds, I disliked the auto business. I never would have guessed that we would have our assets in the auto business, but that is just the way the wind blows. We are very opportunistic about how we look at things.

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Our number of service providers have gone up quite a bit since we have Dhandho Holdings and Pabrai Funds. I'd like to recognize some of the folks that we work with, and some of them are here. From UBS we have Ajay Desai and a few members of his team. Michael Liccar does our accounting, administration and tax. PriceWaterhouse does our audits. Grant Thornton in San Juan does our accounting and tax. BDO in San Juan does our Dhandho Holdings audit. For our investments in India, we use Kotak Mahindra India as our custodian. Dentons is our law firm in the US and Conyers Dill & Pearman is our law firm in the British Virgin Islands. Wintrust is a bank we use as an omnibus account. There are rules and laws that apply for our wires in and out of our UBS account so we have to use an intermediary bank. Armor Compliance helps us with our SEC filings.

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This is the Pabrai Funds team in Southern California. In the back row, we have Lynn to my left and Betsy on the right. The bottom row, we have Karen, Nickii and Julie. They all do a great job.

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This is the Dhandho Holdings team in San Juan. We had a large number of interns with us during the summer at our office in Puerto Rico. Most of them are from UCLA, MIT, Harvard and one of them from IIT. We filed a patent in the ETF space, and we are going to launch the first product early next year. We are quite excited about this. Most of this crew came on board for the summer. We made offers to the UCLA students and most of them will be joining us. I will know by the end of the month and most of them will be based in San Juan. Currently the Dhandho office in San Juan is down to four individuals holding the fort and it will increase again in December or January. I had a great time in the summer working with them and we have some very interesting things coming out in terms of products.

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I will go through an update on Dhandho Holdings. We raised $152 million in the first half of last year. We closed the Stonetrust acquisition in December of 2014. We have a number of folks from the Stonetrust management team that are here. Tim Dietrich is here with his team. We also have Aditya Varanasi. Aditya is the CEO of our new insurance venture we just started, which will do business insurance directly.

We acquired Stonetrust eight months ago and at the time we were restricted in terms of what we could do until we finished the acquisition. After the acquisition was complete, we made investments in the holding company. We invested about $50 million from our holding company investments in public stocks, and we are managing the Stonetrust surplus in float as well. The rest of the business is pretty much running the way it was. If you have questions for Tim or his team, we will see if they can answer them during Q&A.

We spent a lot of time looking at a number of different acquisitions after Stonetrust. Many of them even before the deal had closed. We came close on one but in the end, I found it to be a challenging environment to do deals. There is a lot of money swashing around and a lot of private equity funds. The one deal we liked ended up becoming an auction and at that moment we walked away. Our take has changed a little bit, and I am less interested in additional acquisitions. If something unusual shows up on the radar, we will look at it, but we are not putting forth a lot of outbound efforts on that front at this time.

We are using some of our own money to get it started and are hoping to launch this in Q2 2016. Once we have it up and running, then I will communicate more with the Pabrai Funds and Dhandho investors. At that time I will explain more about the product and why it makes sense for all of you to view it as part of your portfolio allocation. We are very excited about the product and especially with it being the first of 3 or 4 other products to come. I have been in the asset management business for 16 years and it's a great business with very high returns on equity. The Junoon ETF product is the product that could theoretically have tens of billions in the ETF and it will still be able to perform at the level it does. This is not the case with Pabrai Funds because it is limited in how much we can do. We think that we can do quite well with this product. Most of the benefits of the product will be accrued to the investors, but we will collect some fees for it. As we scale up, this can turn out to be an attractive little business. It would be a NewCo wholly owned by Dhandho that we are going to build up. Before we've spent the first couple of million on the ETF, we would either have something that's a winner or we would have decided it's not worth pursuing. So far everything I see is very much worth pursuing. The team from UCLA did a great job. We also have an office in India and we hired some IIT grads in India who are also joining this effort so it looks quite exciting.

We decided to defer our IPO in Dhandho. I polled the investors and we received about 35% of the units outstanding that responded to us. I think the other two thirds are happy doing whatever they are doing. Of the folks that responded to us, about 96% of the units agreed with our deferring the IPO, so we will push that out for two or three years. Some of the reasons why we are doing this is because we have the two very early stage businesses. We have the ETF business, and the other is a NewCo insurance venture which is writing small business insurance directly. Both of these business will take some time to take shape, and I don't think in a public offering we would get any credit for these seeds. We would in effect be diluting ourselves at a relatively low valuation. It would be very difficult for us or the market to put a value on them because we don't know where they are going. We don't know whether they will thrive or die early deaths. We would like to get these businesses further along so we can capture and monetize the value long-term.

In addition to that, in the first six months of this year, Stonetrust has reported an underwriting loss of $4 million which is quite significant on $60 million of capital. There are reasons why we believe that will reverse itself over time because all of it relates to an estimate of future payouts. It's not actual money out the door. The money is sitting in float and management believes over time we will get draw downs on the reserves. In an IPO situation it will be difficult for us to explain that to investors. I would rather take the company public when it is going to get a fair valuation. I am not looking for a ridiculous valuation but we should be fairly valued. I don't think that would happen today because of the two startups and the situation in Stonetrust.

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We have NewCo Insurance Company which is the digital insurance agency. Small business insurance today is a market which is served by independent insurance agents and on average are taking 15+ percent of the premiums. It lends itself to technology - it's cheaper and faster to have it done online. You can have straight through processing using computing horsepower and speed to give quotes to customers and bind them. This compares to a traditional model where the independent agent will meet with you, get all the data from you, go through a process of getting a number of companies to quote for that, and then take 15% of the pie. That would be like Progressive or Geico in the commercial space. This is very early stage and we have hired a CEO for this venture. He came out of a branding background from Frito-Lay. We are really excited and will have more to talk about this in next six months or a year as we get further long.

Most of you know we set up Dhandho Holdings as a Puerto Rico Corporation. Everyone in Dhandho, except me, is in San Juan, Puerto Rico and they love it. Aditya the CEO of our new insurance venture is based in Dallas. Both of these ventures have low capital downside. They are effort intensive to get off the ground, just like any start up would be.

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We also set up a subsidiary of Dhandho in India and we had that up and running in April. We have a wonderful person there, Reema Mukherjee, who I have known for many years. She is the Chief Operating Officer. There are a few different things that are planned for Dhandho India. The first is that Stonetrust uses some external consulting. Some of that could be moved to India at some cost savings, so we are looking at that. Our ETF venture would be based entirely between India and San Juan. We have hired two folks who are IIT grads in India and one of them has already started with us. This also gives us some cost advantage. These are the very early days, but we have started things going in India.

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This is the Dhandho team in India. Reema Mukherjee and Jyoti Diwan who are the first two who came on board with us in India.

We have a couple more ads, and then we will open to Q&A.

Ad: Chevy End of World Commercial

Ad: The All-New 2015 Chrysler 200 Commercial

Q&A

Q: Thank you, Mohnish, for all your hard work over the years. I'm thrilled to be an investor. My understanding of the automotive market is that consumers have stretched out their automotive replacement cycle over the last decade from 7 years to almost 11 years. People are keeping their cars longer. I know that Detroit on the whole has had a pretty good acouple of *years recently. But, do you see that there may be a built up, pent up demand, or that we may even see higher automotive sales as folks are forced to replace cars over the next couple years?*

A: On a steady state basis, the US has population growth unlike many other advanced countries. Our population goes up every year - we add one to three million people a year into the country. In general, over time the need for housing and cars would go up. If there are behavioral changes, for example, Uber becomes a big part of the equation where people no longer need to buy a car, then you will see some impact. But if you ignore behavior changes, you would over time see a gradual increase in the total number of automobiles in the US. On a steady state basis, we should be at somewhere between 15-18 million cars a year being sold.

We went through a period of several years where the actual sales were much below that. During the financial crisis, it went down to 10 million cars. There was a deficit for a while and then we also had the cash for clunkers program that took a lot of old cars out of the inventory in the USA. Right now we are at all-time record numbers of cars being sold in the US. The US has a run rate of approximately 17.5 million cars being sold/year. When you look at the deficit of the last few years versus where we are right now, it doesn't look that significant. You had a lot folks push out car purchases because they didn't have jobs and lot of them were living at home. Jobs have increased, the economy has done well, the population has gone up, and the number of cars sold has gone up. I don't see US auto demand dropping below 17 million for a while.

A shift towards SUVs and trucks is another change that has been taking place. This type of shift gives a significant tailwind to a company like Fiat Chrysler, because Jeep and Ram are a big portion of their pie. They get an unfair advantage on that front. GM gets a decent advantage but Fiat Chrysler in general does better. The net of this is that both these companies that we own, Fiat Chrysler and GM, have a dynamic in the US that you could be concerned about. But they are both global companies and in both cases, the sales outside the US are significantly above US sales.

You have to look at the business globally. They have challenges in some markets, and they have tailwinds in some markets. When you look at the picture across the board, Fiat Chrysler, for example, estimates that they will go from 5 million units to about 7 million units a year in the next two or three years. It is very significant for an auto company to have that sort of a change.

Automobiles are a terrible business with the dynamics of unions and high CapEx. But even a terrible business can be a great investment depending on when you invest and at what price you invest. This was a terrible industry which went through significant restructuring. GM had $7 billion a year just in retiree health care costs. Their entire profit was going into retiree health care costs. This was wiped out in the bankruptcy. They also have a situation today where low energy costs helped them and low cost for raw materials such as steel help them quite a bit. Their labor contracts which are now up for renegotiation are very attractive.

They are pretty much running on all fronts with all engines firing. They are optimizing their platforms, reducing their costs, and they have terrific management. I don't see anything that will take a leg down for these companies for some time, but the nature of the business is unpredictable. The companies in the U.S that have difficulty are the Hondas and Toyotas of the world because they don't have the SUVs and trucks.

Q: You mentioned earlier that a couple a years ago you would not have thought you would be invested heavily in the auto industry - industries like auto and steel manufacturing. You have highlighted that they are capital intensive as opposed to higher ROI businesses. Can you give some thought on how important is valuation or management? If it is valuation, why are some of these more attractive than some foreign automotive manufacturers?

A: I've mentioned that I always hated the auto business because of all the dynamics. But when I studied the business in some detail, I found that you can look at something like labor costs for example. Labor costs are about 5% of the price of a car. The labor content which people talk about so much is just 5% of the pie. In fact, if you look at a company like BMW, BMW manufactures its cars in Germany which is the highest labor cost environment in the world. And they have the highest margins of any automotive manufacturers.

When you look at the dynamics this tells us that GM and other companies that went bankrupt did not go bankrupt because of labor. Labor was a factor but it wasn't the defining factor. The defining factor was terrible product. At the end of the day, you have consumers to deal with and if you are not going to deliver great product, you are not going to get the price you need. You will be discounting while you still have the fixed costs in the business. All those dynamics take it in the reverse direction. A lot of that was fixed. The product quality of the domestic manufacturers improved.

For the first time ever in the history of the U.S. auto business. Toyota, Hyundai, Honda have real competition in every single product that they offer. In the '80s or '90s, they had no competition from domestic car companies in the compact or sub-compact car market. There was this dynamic along with the companies cleaning up their balance sheets because they went through the bankruptcies that made these companies attractive.

There are some international auto companies that are also very attractive. For example, Hyundai is trading at a big valuation, especially when you look at the Hyundai preferreds which is an interesting instrument to look at. One reason I shied away from looking at them now though, is that I did not want to increase our pregnancy with the autos. We are already deeply pregnant with the autos and I wasn't looking to add more autos to the repertoire even though that might be a mistake. There are opportunities outside the U.S. for international auto makers, but I would say that the dynamic we have with Fiat Chrysler and the dynamic we have in GM is very unique.

Q: I have question on Dhandho. You mentioned that Dhandho invested $30 million in Stonetrust. I am curious about 2 things - 1) how has that been in used to increase intrinsic value and 2) why is that not actually reducing underwriting losses?

A: One of the issues Stonetrust was facing before the acquisition was that they had been growing quite a bit. The company went from about $20 million to close to $70 million in premiums in a space of 2-3 years. They grew by entering different states and a lot of that growth was quite profitable, but their capital did not grow with the premium growth.

They are subject to ratings which are given by AM Best. Stonetrust currently has a B+ rating. AM Best expressed to them that they were uncomfortable with the rate of growth in premiums relative to the capital in the business. They suggested to Stonetrust that they might want to increase capital or AM Best would consider a downgrade. Stonetrust had about $24 million in capital supporting $70 million in premiums which is not even a 0.5 to 1 ratio. When we were looking at the investment, Stonetrust said one of the things that would be important to them as part of the acquisition is that Dhandho would come and put in more capital. The capital we put in to Stonetrust wasn't going to be used for anything in the business. It was to provide financial strength to the balance sheet and we were also allowed to make equity investments with the capital.

We didn't see a big negative or have an issue with putting in the capital because the capital would be sitting at the holding company otherwise. We also have another dynamic with Stonetrust and Dhandho which is PFIC compliance. This is the Passive Foreign Investment Corporation where you must have a certain number of active and passive assets. Putting in the capital made it easier for us to get the compliance on PFIC which is important to us.

The injection of the capital into Stonetrust has nothing to do with their underwriting loss going up or down. It has no impact because underwriting losses are coming from the dynamics of the business. It has nothing to do with the capital in the business. I wrote about it in some detail in the Letter to Investors. We have put up pretty significant reserves. It's always good for an insurance company to be conservative on reserving. If you are conservative on reserving, you have a lower tax bill because it's treated as an expense. To the extent that the actuaries allow you, you're better off having conservative underwriting, conservative reserving and getting drawdowns or take downs on those reserves over time. I believe that a lot of the $4 million will come back to us in the next few years as we run through the business, but time will tell.

Q: I've been an investor with you since 2002 and now I'm invested in Dhandho. I have a simple question regarding intent and ability to buy back between now and when you see Dhandho going IPO. Are you willing and able to do a stock buyback in case any of your investors wish to take advantage of that? There might be some investors or investor pools who have put in money and because of the change in time frame for going public, they might be looking for some sort of liquidity. Are you willing and able to do that?

A: One of the reasons why we wanted to go public was in case people want liquidity. So far no one has approached us and said that they have a need or desire to sell their shares or wish to no longer be an investor. If that were to happen, we've got a couple of levers. The first lever we would prefer is to go to some of the folks who want to invest in Dhandho, and see if they want to buy. In effect, transfer the shares from A to B. The second lever would be that the company could buy back itself. We could look at either one. We don't have too much capital in the business. When we launch some of the ETFs we may need to put $5-$15 million into each one to get them going. At the same time we are not looking to get rid of a lot of our capital. If it was $1-$3 million, then we could do either one. If it was more than that we would prefer to arrange for a third party to buy those shares. If someone did want to do that, they would get book value for their shares from other investors coming in or even from us. That is how you value it. For most people it would be unattractive unless they had pressing needs.

Q: I very much appreciate the information you provided on the multiples of Nifty-Fifty. One of the questions I have looking at your returns is - are you able to separate how the returns are driven in terms of what amount of the returns are driven from a change in the multiple and what percentage by a change in earnings?

A: I've historically not tracked that. What we have typically tried to do when we looked at a business is try to get a sense of what the business is worth today, and what the business is worth in the next 2-4 years. The worth comes up from our combination of book value and earnings. We looked at Fiat Chrysler, for example. Within Fiat Chrysler, they have Ferrari. Ferrari has historically produced about $500 million in EBIT but there are reasons why that $500 million is likely going to a billion or more from increasing their volume. In this case, the earnings become part of the equation but it just depends on the business.

We do want to look at the capital and the earnings - it's a combination. But I don't do the calculation on this. Typically at the time when we are buying businesses, they tend not to have tremendous earnings, but there tends to be something going on in there. At the time we made the Citi and Bank of America purchases, they had negative earnings but we didn't think that would persist long term. We didn't make that investment based on the multiple of earnings. We made that investment based on where the business was going and where it would end up in the few years.

Q: Thank you for the presentation and that's a great looking suit. The question I have is, when you made an investment in Google - what was it about the company that the market was mispricing it?

A: Google is a current portfolio position. We would prefer to talk about it when we no longer own it. I made an exception with 2 of our current companies because they are such a large portion of the pie. Our Google investment is a much smaller portion of the pie - we've got about 5% of assets into Google and we like the business. I prefer we talk about it once we don't own it.

Q: I had a question for Bob Scherich, CFO of Horsehead. I would just like to hear your thoughts on Horsehead's balance sheet and its ability to withstand the time it takes for the plant to ramp up. Also could you give some comments on non-core assets' ability to provide liquidity.

Bob: First of all thank you, Mohnish, for inviting me. I do want to make one prediction though - if you expect Horsehead to produce an exciting interesting inspirational video, you'll be waiting long time!

Horsehead is going through a very challenging transformation of the company, and we're de-risking the business significantly. The balance sheet is on the forefront of our minds - especially the debt capital that we have tried to use primarily for the investment in the plant. We need to refinance within the next couple years. We have concentrated investors in those notes and they seem to be very supportive. There is a lot of interest and they like the underlying assets that are there so, we have lots of opportunities in front of us.

We are concerned today with the commodity prices. For anything associated with energy or any commodity, pricing is going down significantly. We are highly dependent on the price of zinc and have hedged very effectively through the end of this year so we don't have concerns near term. But commodity prices can be very unpredictable and Buffett said it best back in 2009 - periods of irrationality can outlast liquidity. My primary job is to maintain liquidity. It is something that we give constant attention to. We can't predict what will happen with commodity prices but we will continue to take actions to make sure we maintain liquidity.

Q: Could the non-core assets be part of providing liquidity if needed in the future?

Bob: They could, but the non-core businesses that we have generate cash very effectively. We like their ability to add valuation. We have a lot of alternatives and we keep the focus on that.

Mohnish: Bob, I have a question for you since I caught you with the mike. You have this new plant and when it’s fully ramped up there is $90 to $110 million in additional EBIT coming out of the new plant. At current zinc prices, at what percent capacity does the plant break even?

Bob: The zinc price has moved down about 25% in the last 2 or 3 months. For cash flow breakeven we need to be close to 75% capacity at the current zinc price. Right now, we are hedged well above the current zinc price which is why we have a concern. We need to get the production levels up by the time we hit the unhedged portion.

Mohnish: And at what percent capacity of the plant do you break even company-wide?

Bob: At the current zinc price, probably in the 60% to 70%. With our old asset that we shut down, we would have been in a much different, unfavorable position.

Q: My question is more behavioral in nature. You talked early on about 30-40 year cycles between extreme exuberance. Given that the speed of information is increasing greatly and, in my opinion, people’s attention span is decreasing greatly, do you think the timing between those super cycles will decrease also?

A: CNBC Anchorman Ron Insana wrote a book, Trend Watching, where he wrote about bubbles. If you go through Ron’s book, it’s a tremendous book, it would blow your mind in terms of the frequency of bubbles and how common they are. They are happening all the time, all over the place, in different aspects and different geographies.

These dynamics that I pointed out is a sliver of what we’ve seen. For example, very recently there is what you saw in the Chinese market. Some of what I’ll say is probably coming from Munger, so if it’s politically incorrect I’ll blame Munger for the political incorrectness that I am about to embark on.

Munger believes that the Chinese are, on average, better at math than the rest of us mainly because of rice cultivation. Going back deep into history, you can look at what is required of a farmer to produce wheat or corn, versus what is required to produce rice. Rice is much more difficult to produce; it needs a lot more math skills and you have a lot of dynamics going on with water and different things that you have to do at different times to end up with a productive crop.

So again, it’s not me it’s Charlie. Charlie believes that over thousands of years of selection, you ended up with a population that is better than average with math versus the human population. One time I was talking to him and he was saying that some friends of his adopted a couple of Chinese girls from the middle of nowhere in China - deep in the Hinterlands. They came over here, and then they were admitted to Stanford. He asks - how did that happen?

You are randomly picking up kids who have been given up by parents which means they are not really kids of PhDs. They are coming over here and hitting the ball out of the park. The Chinese have a deep interest in math, and because of that math interest they have a much deeper than normal interest in gambling.
Ignore my political incorrectness, but the Chinese love to gamble. There are a lot of restrictions on how many people can go to Macau – one of the largest gambling centers in the world. There are also restrictions on when you can go, and now they are cracking down on corruption. This had some negative impact on Macau but the bottom line is that the Chinese love to gamble. We see this in Vegas as well - simply look at the number of Chinese restaurants in the high end casinos. The high end casinos are very clearly catering to the demographic that is naturally biased towards gambling. The gambling also moved in a major way into gambling on apartments and condos. The Chinese family would have one home they were living at, and then three more that they bought or put down deposits. This is what causes bubbles, and the only thing that saved them versus our housing prices was that a third of the money for the Chinese was equity.

The equity portion of these speculative bets being made by the general population is significant. If there is a downturn, the person speculating will face the brunt of the crisis. This compares to what happened to us - people just tossed the keys and ran away because they only had 2% down, zero down or negative down. That's why we have a different dynamic in the financial crisis. China doesn't have the same issues with the housing market that we have even though they have a similar speculative bubble. After it became somewhat clear in the last few quarters that housing isn't going to be going straight up, then this potential shifted to the stock market.

They couldn't go to Macau so they went to buying condos. Then they understood condos don't work so well, and they went to stocks. The Chinese stock market took off in a major way. Then the government had a misdirected policy of trying to prop up the market, and people believed they don't have anything at risk. Because if things fall, then they always have the government that will come in. But, that's been taken out.

The bottom line is we are going to see that population exercise its propensity to use its math skills quite frequently; it's just the nature of the beast. If you look at Ron Insana's book and you study all these different bubbles, you'll find it's common across the board. It is happening all the time because of human nature. With information and technology you may see it speed up, but you already have had lots of speed without even technology coming in. If you study Ron's book, you'll find that every three to six months there is a new bubble coming. It's very frequent, it's happening all the time.

Q: What are the three best investment books you recommend for a 14 year old?

A: Have you read any so far?

Q: I have read, The Little Book that Beats the Market.

A: The first one I recommend is a biography on Warren Buffett which is called Buffett, the Making of an American Capitalist, by Roger Lowenstein. It came out 22 or 23 years ago, but it's still very relevant and extremely well written. It's a great book to learn about business, investing and compounding.

The second one that would be terrific to read is Poor Charlie's Almanack. This book is a combination of Charlie Munger speeches. It also has a lot of graphics in the book and is quite entertaining to read.

The third book is the Berkshire Hathaway Letters to Shareholders. They are available on Amazon and there is a Kindle edition of this book for only $3. Or, you can go to the Berkshire website and it's free. The bound version is from 1965-2014, and it has all the letters from the last 50 years. There is a tremendous education in reading those.

Q: I was sitting here a year ago and you had Fiat commercials but you didn't talk much about Fiat. But I just want to thank you for helping my portfolio quite a bit with that idea. The audience should pay attention to your commercials because it may help their portfolio as well.

Sergio Marchionne has been going around trying to steer up the GM-Fiat Chrysler merger and there have been a lot of writings about it mostly from the journalists. People may be looking unfavorably to that. I feel like you are uniquely positioned to give us a view of this because you own both of these stocks, and you are a fund manager and not a journalist. What are the odds of the merger actually happening, and if it were to happen do you believe that it would be a tremendous value creation for both companies or not?

A: Normally I wouldn't answer because I don't usually talk about current holdings, but I have already talked about it because we own so much of it. Sergio is a poker player. He tends to spend most of his time on private jets flying between different continents - all the different parts of the Fiat empire. Typically when he has his management team with him on his private jet, they start with a poker game as the jet takes off. I think he is pretty much figuring out his managers based on how they play the game.

One of the first things that he did when he came in was get rid of the entire management team at Fiat. He went into the organization, picked up a bunch of 30 and 40 year olds and made them his vice-presidents. For the most part, they were the ones actually running the business, so he pretty much did a reset. The same way Lee Iacocca did with Chrysler a while back.

Sergio is a tremendous manager, and a very smart poker player. I haven't talk to Sergio about GM, but with GM, I would guess it's the beginnings of a poker game being played. At the highest level, if GM and Fiat would merge, they would have $10 billion in cost savings between the two companies relatively quickly – it may take 2-3 years. If you include an additional $10 billion to earnings, that alone will add $70+ billion in value. GM in terms of enterprise value is about $35 billion and Fiat has a market cap of $17 billion. That portion is significant. If it passes the anti-trust muster, the top three truck manufacturers would be reduced to two truck manufacturers which would also add more in terms of margin. Then you get different perspectives on labor negotiations, and the flexibility in where you put your manufacturing plants. What may be happening in Sergio's mind is that Sergio first takes Ferrari out of Fiat pricing. This may be way off, but I have seen the rhetoric coming from Sergio go up as the price of GM stock goes down.

The Agnelli family wants to hold onto Ferrari forever, and they will probably want to increase their stake in Ferrari. They own about 30% of Ferrari and I think that they would love to own 60% if they could. The first thing is that they take Ferrari on the side. Ferrari alone is about half the pie and over $200 million would be coming out of Ferrari. We still have the $200 million in a post Ferrari spin off. Fiat is at $15 dollars today and he could possibly get it to $20-$25 dollars in six months or a year. If at that point GM is sitting in the $30 range, then he could do a stock deal. This is what he would want to do - a stock deal with GM. The number gets staggering. There is a chance that if things play out the way he is trying to play his poker game, we may end up with a $2 billion position. We may get a 10x from here, but there are a lot of pieces that would have to come into play. We are not banking on 10x; that would be very nice but we are also very happy with 2x-3x.

We'll see how it plays out. But long live Sergio - he smokes the Italian brand of cigarettes nonstop when he is in Turin in Italy, and then he switches to Marlboros when he is Detroit.

Q: I want to know if you think it's prudent for individual value investors to use small leverage like 10% or something so that in an event of a market crash you don't get forced out of your position?

A: My suggestion would be the other way around - which is not to be fully invested. You are talking of being a 110% invested in effect and my suggestion would be that unless the market was sitting at something like the 2008 levels, it may not make sense to be 100% invested unless you found amazing businesses. Charlie Munger was asked a question a few years back at an annual meeting by a young guy. The guy asked "how do I get rich?" Implicit in the question was "how I do get rich fast?"

Munger's response was to consistently spend less than you earn. Even if you make only $30,000-$50,000 a year and you put away 5%-10% of the pie into an index fund like the S&P 500, over a lifetime even with modest returns, you would be stunned what number you'll have when you are 70 years old. It would be a huge number.

The tendency to want to get there faster, which is what the 110% would do, is a negative tendency; it's not a good idea. You might have a better argument for levering up when you have deep crashes. If you want to go to 10% leverage, do it after the 2008 crash; but even that is something I would not be willing to do.

Munger also says that you don't want to go back to Go. It's a game of Monopoly. He says I have been at Go, I know what it feels like to be at Go, and I don't want to go back to Go again. If you have a net worth, it doesn't make much sense to even take a low probability chance of losing a significant portion of it because markets can do very strange things in the short term.
My suggestion is never lever up at all.

Q: Is there a minimum ownership stake that you like see directors, officers and senior managers have in a given company to make sure that their interests are aligned with yours, and do you care if that ownership stake is based on options or direct purchases in the market the way that you make them?

A: It is preferred that people have put up their own money and bought large stakes, and that they are family controlled. Fiat, for example, has that right now. GM doesn't have the dynamic. It's a factor that I look at when we are making an investment. But we made lot of money in businesses where the management had little to no stake, and we made lot of money when management has a lot of stake. And we've also had losers in both cases. It's not a requirement, but if you were to say that I only want to invest in businesses where management has a large stake that they bought with their own money, that's not a bad criteria to have.

Q: I have a question on some of the previous investments. You had an investment in Berkshire which you disposed of a while back and then you had Chesapeake which you sold at the right time and it has come down quite a lot because of energy prices. Any thoughts on them or are you thinking about investing in those again. What are your thoughts on their valuation based on where they are today because they are significantly lower than where you wrote those off?

A: In Chesapeake, we made a mistake It's always nice to make a mistake and still make money so I am perfectly fine with that outcome. An "aha" moment came to me after we owned the stock. I always feel that you learn about the business only after you own it, not before you own it. You can do all the analysis you want but you only learn it after you own it. When you look at the real cash generated after everything these oil and gas companies spent on exploration and

CapEx, Chesapeake didn't really produce anything. The concept that Buffett and Munger have about owner earnings, which is earnings to take out of the business, didn't exist. That was a basic glaring error we made in our analysis of Chesapeake. Thankfully we were able to exit before the prices crashed. Having understood that and having understood the dynamic that a miner is nothing more than a liar next to a hole in the ground, I'm less interested than I used to be in oil and gas exploration companies and mining company unless I can see a dynamic with their very significant earnings. We have done well in the past investing in these assets in distress times, and that may still make sense in the future sometime. One of the things about the Horsehead investment which is so attractive is that they are going to end up with a mine that produces zinc, and basically never runs out of zinc.

Q: I am 24 years old and I am from Germany. I have recently graduated from with a Masters in finance and as a value investing student, I'm really curious about your process. Can you give us some insight into your process, which discount rates do you use and how do you basically value a company and what kind of results do you have.

A: When I describe the process, your opinion of me may drop considerably so. First of all, we believe in bowling. Do you go bowling? I know you go biking.

Q: I am a fanatic bike rider but I'm a really bad bowler.

A: Have you been to a bowling alley?

Q: A few times.

A: You can bowl in two ways. You can bowl with bumpers or you can bowl without bumpers. If your objective is to get the highest score in bowling which should you choose?

Q: With bumpers.

A: With bumpers, exactly. I like to bowl with bumpers too. Bowling with bumpers is basically being a shameless cloner. You buy stuff that some smart guy has already bought and put his money behind because you know they are much smarter. Someone was asking me today - should I clone ValueAct, an activist fund. That's bowling with bumpers; that sounds like a pretty good idea. Or if you buy what Warren Buffett buys, especially when it's banks or media, you'll probably do pretty well. Bowling with bumpers is better than bowling without bumpers. First thing to do before you get into valuation is to consider buying things that other great investors have bought. Right there you have taken away a lot risk because someone else has already bought it; you may still lose money but the odds have gone down.

The second piece is circle of confidence. Look at the ones that you believe are businesses you understand. If you understand the business, you understand what it is worth. If you do not understand the business, you are not going to know it's worth. If a business is in your circle of confidence, that by definition means that you know what is worth. Then it's simple math – divide that number by 2 and look at the stock price. If it is trading at or below half of what it's worth, it should be a good candidate. Now we are buying from a universe of people that we trust and who have already put a lot of money in it. Look at the top 3 or 4 positions owned by great investors - not the 38th position owned by great investors. Then within the top 3 or 4, look at the ones that you understand and the ones that you can figure out the value. When you are within your circle of confidence, you know the business, you know what is worth, and if it's trading for less than half, then you can pull the trigger.

Q: I have a question for Bob about Horsehead. I am curious about how long it took the other two similar plants in Japan and Namibia to ramp up to 100% capacity after commissioning.

Bob: The technology that we used is the same as in the plant that we are ramping up right now - the solvent extraction technology. This is the fourth installation. Only the Skorpion plant that Anglo built in Namibia was a full plant where they built the entire plant - green field site, both solvent extraction, and electrowinning - similar to what we have done. It took them about 2 years to ramp up. We now have on staff at the plant as our technical manager the person that started that plant up.

The other 2 installations were existing plants that used traditional methods of taking mine concentrates, and they already had an existing leach and electrowinning facility in place. They were simply adding additional capacity on the front end which was the solvent extraction piece. They were only doing a small portion of what we are doing. In their case, they ramped up to 70-80% of just the solvent extraction part within the 1st six months or so. Our challenge is that we have an entire plant as a green field site - a fairly large plant - and we have to work through the entire ramp up of a full plant as opposed to just doing a brown field expansion to an existing plant.

Q: Are the 2 plants currently running at a 100% successfully?

Bob: I am not sure if the two brown field expansions – the Akita plant in Japan and the Glencore Portovesme plant in Italy - run to a to full 100% of what they bolted on, but I believe they do. The Skorpion plant is at full capacity. It's about the same size as ours. It took them a couple years to get ramped up and they quickly became recognized as one of the lowest cost zinc producers in the world. This is the position we are looking at for ourselves once we are fully ramped up.

Q: When you said 2 years - does it mean from the time the plant starts operating until it reaches 100%? Your new plant that started operation in August last year?

Bob: That's right, we are in year 2 now.

Q: In that case, do you expect your new plant to get to the level in another year also?

Bob: We expect that we will continue to make progress. That is our internal view - that we will get there. But, we can't predict exactly.

Q: I know you expect to add an additional $90-$110 million EBITA after the full capacity is reached. What is your assumption for cost/ton and zinc prices to reach this number?

Bob: The $90 to $110 million is incremental EBITA from where we would have been if we had continued to run the old plant instead of investing in the new. It doesn't depend on the zinc price because the benefit that we get is really from the costs - labor efficiency and energy efficiency are dramatically better. We have already seen evidence of that lower cost structure even when we are operating at lower capacity utilization levels. The other thing to keep in mind is it's only a part of our business. We have our recycle business and we have other segments. It's not just stand alone dependent on the ramp up.

Q: I didn't explain my question clearly. I know you don't need to buy the raw material. That's why you have this new plant - you are using all the recycled materials. My real question is - what is your cost/ton assumption?

Bob: We think in terms of cost per pound of zinc when we think about the zinc price. Our cost of raw material coming in for making zinc is what goes through our recycling plants. That's our real core value because we get paid to take that material. We take it to our recycling plants, so we basically have a fixed cost. Getting to full production at the new plant allows us to take some of the cost out of recycling. We think we will be able to bring our zinc into the facility as a raw material at about $.30 -$.33/pound of zinc. When we get the new plant operational at full efficiency, we can get the conversion cost down to below $.30, but our target is $.30. That's before by-product credits which we would be able to achieve once we get that part of the plant to run itself. We would produce zinc at slightly over $.60/ pound and we would have $.05-$.06/pound of by-product credits. Then we would sell the output at $.06-$.08/pound over the commodity price. That's what drives the cost break even for us. We believe we can get the break even under $.50/pound in comparison to commodity prices.

Q: I was also asking about the price assumption because when you sell your finished products, it's related to the zinc price. You said you are going to have $.07-$.08 premium. I am wondering what is your price assumption when you are projecting the incremental $90-$110 EBITA?

Bob: Net of the by-product credits, we would expect to get into the mid $.50/pound and sell it at a $.06-.$08 premium to the commodity price.

Mohnish: One of things that may be a little confusing is that the $90-$110 million is not the EBITA of the plant; it is the incremental EBITA. Now they have a different process than the old plant. There is another way to look at this. Bob, is what was your conversion cost for the old plant?

Bob: That has gotten to about $.75-$.80 cents, about the current zinc price at full capacity.

Mohnish: Basically if you are running the old plant at current zinc prices it would break even.

Bob: That's right.

Mohnish: The new plant has a different dynamic and part of the different dynamic is because they are getting the additional metals. They are getting lead and silver. You are recovering these other metals as well, which adds to it. The difference is that $90-$110 incremental EBITA is not related to the commodity price. If for example the commodity price were at $1/pound then this plant would produce $.90-$1.10 plus another $.15-$.20 cents because of the increase in the commodity price.

Bob: That's right and before we built this plant when zinc was at roughly $1/pound, we were producing roughly $60 million of EBITA.

Mohnish: And if zinc is at $1/pound, EBITA would be at $150-$170 range.

Bob: That's the reasonable range.

Q: Thanks for having us. Thank you for your intellectual honesty and willingness to share your knowledge with us. In addition, thank you for your work with Dakshana Foundation. I know you are not going to be looking for mergers and acquisitions outside of Dhandho. I see that NewCo is being formed and is going to be fostered and grown within Dhandho for growth. We were planning on the IPO, which is obviously delayed for the next couple of years. What else are you looking at right now?

A: The idea is to be patient and opportunistic. It is difficult to tell where opportunity comes in. My general thought is to keep up with distress situations or things where there is a dislocation, and be more focused in that area. My first thrust was to look at insurance companies. We have one and we are incubating one. We have put a significant amount of effort in this, and I have found in the past few months that we are not going to get any type of a deal unless you have a dynamic that is causing some dislocation. We found pricing to be quite euphoric, so we backed off. Even if you look at a company like Berkshire, they have gone multi-year periods with no deals - but they are looking all the time. Unless we see something very obvious, we are happy to do nothing. The key is to just be patient and sit still.

We have two early stage businesses that keep us busy. In the case of the ETF business, there is some advantage to have capital. We can launch the ETF with our own capital to get it going. We may have more ETF's that follow. It will absorb some capital. We also have some public stocks which are vastly better investments than what we could find in the private markets. We are happy to do that as well. If we had done a public offering we would have picked up another $150 or $200 million in assets. This would put some pressure on us to do deals, which I prefer not to have. For now, the capital that we have and the different opportunities we have in front of us is a very good place to be. We will see where we can take these early stage businesses, see which way the wind blows, and we will take it from there.

Q: Can you talk about the transition? I know Dhandho is still new. I think in your career it was a bit unorthodox - replicating investments of others and having a unique investment style. Now you are moving into illiquid spaces, starting this company, having a whole team reporting to you and creating NewCo. How have you found this transition? Do you worry about having to deal more with people rather than the personal side of picking a stock and sitting with it? You don't have to worry about Fiat or harass the management of Fiat. You don't have to harass GM and if you don't like it one day, you push a button and it is gone - Bank of America is gone. I'm just curious if you have anything to share about this?

A: I was telling my wife the other day what a blissful existence I had before the idea of Dhandho came along and that all went out the door. I have thought about that quite a bit. I ran an operating business and at the peak it had 170 people. I enjoyed the very early stages of the business and getting it started. I also enjoyed the business each time it went through a transition and it changed paths. It is very clear to me that I enjoy running Pabrai Funds a lot more than operating a business. It was a shift that I made and it was a very good shift for me because I don't enjoy interacting with humans. I am happy on a typical day when I don't have any meetings, any phone calls, and in general any human interaction. The good news is on a typical day, week, or even a month, I rarely hear from Pabrai Funds investors. I can't even tell you when the last time was that I heard from a Pabrai Funds investor about anything.

Before going into Dhandho, I felt I had a huge amount of empty cycles and I also felt that I could do more than what I was doing. Some of those cycles got absorbed when we created our family foundation with Dakshana. The good news is that we have a tremendous team in India, so I don't have a whole lot to do there. Dhandho was of interest because it allowed the possibility of buying and dealing with asset classes beyond stocks. The original idea of Dhandho Holdings was to be a holding company which owned businesses and public equities, but did not touch those businesses. There were a decent number of people that tried to go down the path of the Buffett model of investing, even though it was few and far between. Buffett's approach to management is almost never talked about and certainly never replicated. This is a wide open area and what Warren Buffett brings to the table in terms of his approach to running a conglomerate is so different from the GEs and others of the world that it is worth studying and even worth replicating.

My thought was, we have one life and at some point it is going to come to an end. I have these empty cycles and a great model that no one wants to clone. Why don't we try and clone that? At the time it sounded like a great idea. I have discovered since then that I have more appreciation for the journey Warren has been on. It is not an easy journey. It's a difficult journey, but the journey also has some interesting rewards. Currently I have Pabrai Funds, Dakshana and Dhandho. I am very clear that I have no bandwidth for anything more. Between the three, I am fully absorbed. If I were to have only the first two, I would have the same dilemma - the empty cycles and not maximizing the potential for what I could do. Dhandho has some challenges, but also has some interesting rewards and upsides. One of the things I would like to work on, is getting to the point where my interface with the businesses is very limited. Tim Dietrich can tell you - we've had about nine months of Dhandho owning Stonetrust and we have no involvement in the day-to-day activities. I learn about the numbers and what is going on with the business the same time the external world learns about them. This model of delegation to the point of abdication is worth exploring and expanding. If we did more of the acquisitions, we could get to the situation where we are not deeply involved. With Stonetrust, we are not deeply involved in the woods of what is going on. Where we are deeply involved are the two very early stage start-ups which take a lot of horsepower to get off the ground. At some point I am hoping these two fronts have enough of their internal teams further along to where I can be a fifth wheel.

Even while all of this has been going on, there has been no change to the afternoon naps. We still have the three businesses plus the afternoon nap. I definitely want to get to the point where the degree of involvement I have in Dhandho with the meetings and calls goes lower than where it is today. It has gone up because of these early stage start-ups, but hopefully as we get further along we will get past that.

Q: The energy market has gone through a lot of change, needless to say in the last year. If I recall correctly, I think it was mentioned last year or in some reports that you owned Chesapeake and you sold out last year. Can you tell us why you bought it, why you sold it, and if it made profit or loss? Given where it is today and the challenges they are facing, do you consider it a success or a mistake?

A: We did make money on Chesapeake and it was covered in detail at our last annual meeting, but I will give you the Cliff notes version. Sometimes it is better to be lucky than good. We had a significant gain in our Chesapeake position - it was around a 60% gain on our full position of $60 million invested and we did well. It's kind of like driving along and just seeing a big explosion behind you and saying, "Oh, if I was just a few feet behind, it would have been me". We lucked out on Chesapeake.

One of the things I didn't pay much attention to at the time, but am more savvy about now, is Warren Buffett's talks about the concept of owner earnings. Owner earnings are basically earnings that can be taken out of the business. Earnings which the business doesn't need. The true dividends that are for the owners. One of the issues in the oil and gas space, but a little different in some of the majors, is that there are no owner earnings. Even for Chesapeake, they would say they have several billion of cash flows and all these things coming out, but then they also had several billion to be spent on wells and exploration. At the end of the day when you looked at the amount of cash that was available to an owner, it was zero or negative. That would probably be the case for a long time with a company like Chesapeake.

One of the underlying assumptions that I made when the investment was made is that it was very unlikely that oil would go below $80 or $100 a barrel. I viewed that as almost impossible to happen. We have seen that happen and it might go even lower. The real world always surprises you and we were fortunate that in the period that we owned Chesapeake, oil stayed at the level that we had assumed. Given where energy prices are today and the amount of innovation that is taking place in the fracking space, it would be hard for me to make a call on oil. I would just put it this way -it wouldn't surprise me if it stayed at levels like this for a long time. That is certainly within the realm of reason. If it stayed at present levels for a long time, then a lot of the oil and gas companies don't look so good.

In the end Chesapeake was a mistake, but a mistake where we made money and I am always happy to take that. We are not looking to go into the oil and gas space specifically for that reason, unless I see a dynamic where the owner earnings are truly there. There is the classic joke, "a miner is nothing more than a liar next to a hole in the ground", and so a lot of that applies. These guys in the oil and gas space and in the mining space are very excited about drilling holes. The owner earnings is a concept that doesn't come naturally to them.

Q: A few years ago after the financial crisis, one of things that you shared with us is that you didn't want to be in a position again where if a large wave of redemptions came your way you would be forced to sell good holdings to come up with those funds. We are getting close to the end of the year which is your normal opening for redemptions. How do you feel about your liquidity position? Are the funds in good shape to meet the redemptions that you might see coming down the road?

A: It is still early but we haven't seen a lot of activity so far. We track this even if someone makes an inquiry and asks what the redemption rules are. This would trigger us to see what the number would be if they pulled everything out. I just reviewed a spreadsheet the other day which had every inquiry that we have received of any kind as of September. If every one of those inquiries or actual redemption requests came in, we would be around $5 million in redemptions as of today. That will change because we still have another 6 or 7 weeks that people can submit a request. I don't see anything that tells me that we are going to see a significant surge in redemptions. I mention this because I received comments after the California meeting which seemed to allude that I made some comments because I am concerned about redemptions. I made the comments to provide the information if our positions were reversed. I am not concerned that we will have a huge flurry of redemptions and I just wanted to make sure that if people are redeeming, they will redeem with this knowledge of why we have what we have and why we are so concentrated. This is why I wanted to present it. The people who stay after others redeem should know that it would be very unlikely that we would lighten up our GM or Fiat positions. We will probably just keep those and look at other positions. We have plenty of liquidity and we have some tax loss selling, so I don't see any issues with very significant redemptions, nor do I see anything on the horizon there.

Q: I am looking across the three or four stories you shared with us. If you start with the end, we are clearly looking for digital disruption to work in our favor in commercial insurance. If you look at banking, you pointed out mobile as a real catalyst which is moving Wells Fargo, Bank of America, JPMC to taking more and more of the share and the profit. When you look at the car business, are you concerned about them getting digitally disrupted, given there is a clear investment happening in Google, Apple and other places to change the economics and dynamics of the car business. I am sure that has crossed your mind quite a bit because we are now serious owners in the car business.

A: There are two paths being taken by various entities on reducing or eliminating the role of a driver in a vehicle - self-driving cars. One path is the path where you keep adding more features and functions which reduce the role of a driver. For example, my Cadillac has adaptive cruise. When I set adaptive cruise, the speed varies with the car in the front and I don't have to take any action. It also has a heads up red light that comes on if I am about to crash into a vehicle, and it can also take it to the next step where it can actually apply the brake. You have a whole bunch of things that are going on where the degree of accidents that you have in human driven cars will likely go down because they are going to add more and more of these enhancements.

There was a Ted talk by the guy who runs the Google self-driving program. His perspective was that if you go down the path of taking a driver driven car and try to get it to the point where there is no driver, there would be a dead end you will hit before you can pull the driver out of the car. If you look at Google's new prototype car, it just has an on/off button. It doesn't have a steering wheel and the driver has no control of any kind in that car. The Ted talk speaker believes that you cannot take, for example, a Tesla and convert it into a car that never has a driver. He believes that technology will hit a point where you are going to dramatically reduce the role of a human, but you cannot take the human out. His view is that if you want to go completely driverless, you have to start with driverless and then keep building on that.

Google has a driverless car that has been driven around Mountain View a lot, and it has done well. They have had a few accidents and every time they had an accident, it is a human driven car making an error that has caused the accident. There are quirks that happen when the Google self-driven car comes to a four way stop sign. It has been designed to follow all the rules and it is not going to do a rolling stop and go. It is also looking for the other drivers to follow the rules. When it comes to a four way stop, it is looking for certain behavior patterns that are rational amongst the participants in the other three intersections. And they are humans - they are not rational. What ends up happening is that the Google car acts in a manner which appears to humans as very strange,and it gets rear-ended by the guy behind the Google car because it is expecting different behavior. These are software issues that they may or may not be able to fix. We will just see what happens.

They would have an easier time designing the self-driven car if there were no human driven cars on the road. If Google were told your spec is that there are no human cars on the road and go design it, that would be a relatively trivial job for them. The difficulty is that it will never go directly from A to B. You have a transition and you will have to manage that transition. They have only tested this in one geography, Mountain View, California and they have just started testing this in a second geography, which is in Austin, Texas. I don't know how much of this is public information, but some of it just leaks out. The Google self-driven car is on a trajectory different from the Teslas of the world. In their spec, they have very specifically laid out that the car is not to be on an interstate. It is to be a neighborhood car. Their focus is on a vehicle that you can put your kids in, it drops your kids off at school, and then it comes back. It goes to places and does certain things in well contained geographies. It can't go more than 40 or 50 miles an hour, and it has limitations with batteries and distance. All of those trajectories will change over time.

That is a very interesting question because I don't believe we will have our auto investments for more than two or three years. I also believe that markets are discounting mechanisms. If the markets believe that there is some major change coming, even in 2025 or 2027, it would start impacting valuations which is what I am concerned with. There are two different things - market perception and then there is reality.

Let us take a step back since you asked the question. In a world where cars are fully self-driven, you have major reconfiguration that takes place. For example, we wouldn't need garages. What would happen is if you need an SUV - you call up an SUV and the SUV shows up. If you needed a big car, small car, whatever type of car you want, it shows up when you want it. You get in it, you go where you want. It drops you there and then it goes to service someone else. The entire US fleet of automobiles, is around 250 million cars in the US. You would be in a situation where you didn't have garages and had people just using cars the way we use Uber - Uber with no drivers. You would get to the point where people just got a car when they needed it and it went away when they didn't need it. That 250 million fleet would probably go down pretty dramatically. However, we have rush hour and simultaneous needs, so it would temper the decline. Everyone needs cars at the same time. It would also completely reconfigure cities because you wouldn't need parking lots like the way we do now. The car would drop you off and then go park 20 minutes away somewhere. It would dramatically reduce highway congestion and there are a lot of things that would change.

This type of world may come, but it's probably more than a couple of decades away. It is quite a ways away. It would affect us it if that world came about suddenly. You would have a lot of regulations and issues. That world is only possible if you get the driver out 100%. If you get the driver out 98%, you don't have that world. If you need the driver only for the last three minutes of a ride or the first three minutes of a ride, again you don't get to that world. You really need the Google car with the driver completely out of the equation.

Then there are the quirks about human nature. For example, we do a lot of things in our cars and teenagers do a lot of things in their cars. There is a cultural aspect. For example, a lot of us go through drive-thrus, and then go sit in a parking lot and eat. They are just like me - they don't like human interaction. There are a whole bunch of quirks about the way humans operate. We may find that when you get to the point of telling them that you can always have transportation when and where you want it, this may not satisfy some of these other human needs. It may or may not, and we don't know what the behavior changes are at that point.

For example, you can have NetJets where you can call up a number and a jet comes to pick you up. There are still people who are not interested in that and they want their own jet. They want their own jet, done their own way. We don't know how much of that plays into the auto business as well. The bottom line is that these are all great changes for society, but probably not such great changes for capitalists. We don't see anything on the radar in the time frames that we are intending to hold these investments.

Q: I have seen a few of your case studies here - the seismic shifts in commercial banking that you deeply study and deeply invest. Also in the auto industry, same shifts. It seems like there is a lot of hype about seismic shifts in healthcare right now. I am wondering if that is what you are doing in your free time. Is that what you are studying?

A: I haven't studied healthcare in as much detail as some of the other places where we have our money invested. Healthcare is a morass. There is so much waste and inefficiency on a number of different fronts. The incentives are off. On the healthcare front, you could have a lot of different things that come in from a technology or even from a management perspective, which would change things. There are advantages and disadvantages to a single payer system. There are disadvantages to the system we have. So it is a bandaged, closed up, special interest driven system. Right now we don't have any investments in this space. We have had some in the past, but I don't have the same insights because we have our attention focused in other areas.

Q: Could you comment on what you feel the future is going to hold for natural resources and also perhaps comment on Horsehead?

A: We don't like to talk about our current holdings, so I will defer on Horsehead. The CFO of Horsehead Holdings attended the California meeting. He did get several questions and those will show up in our transcripts. I will defer on Horsehead until we have exited. We have a position and we must like it, because we own it. In regards to natural resources, a lot of things have come down quite a bit in price because of the concerns in China. In general if you are in that space, you are a low cost operator and you have some moats around your business. If you are a first or second quartile cost producer of iron ore or coal, or any of these basic commodities, you have been beaten down quite a bit. Your profits are down but you would still be profitable, assuming that your balance sheet is in good shape. I have looked at that space, especially since it has gotten more distressed. So far nothing has gotten us to the point of pulling the trigger, but we remain interested to see what might be possible.

Q: I was wondering if you spent any time thinking about platform companies like Precision Castparts (acquired by Berkshire), and Valeant. A lot of value investors are on both sides of these. You have Charlie at the Daily General Meeting critical of Valeant, but then you have Ackman and Sequoia that long it. What do you think about these types of companies?

A: Sure, which side are you on?

Q: Long Precision Castparts until Buffett stole it at a cheap price.

A: And Valeant?

Q: Too difficult to understand.

A: That is good. If it is too difficult to understand, we can just leave it alone.

I don't think so much in terms of platform companies. Valeant is an interesting company but I don't know it very well. I don't know of any situation where Munger has expressed an opinion and the opinion was wrong. There has been no past history of something like that. I was at the Daily Journal Meeting where he made those comments. Recently I was very intrigued by Valeant because you have some people who are long, and they are long very significantly. Sequoia Fund for example has some of the most thorough folks in terms of the quality of their research and the way they research things before it gets into their portfolio. They are very anal investors and are extremely good at what they do. My only fault with them is that they are so focused on quality that they sometimes overpay to get that quality. Valeant is 25%-30% of Sequoia's portfolio, which is huge. Normally they will make about a 3% bet. The same with Ackman and a whole bunch of other folks who have gone long.

Charlie Munger made a comment about ITT and Harold Geneen. I was curious about it because I have no skin in the game and I wanted to understand it more. I recently bought an old biography on Harold Geneen written by a person who had close access to him. When ITT realized Geneen was going to be critical, they shut off all his access. So far it reads like a thriller. I am about 80 pages into the book and it is a good read. I paid $0.02 cents on Amazon for it because there is no demand for such things. Valeant is something I would say falls into that same exact "too hard" pile and it is not cheap. I am curious to see how that saga unfolds, simply because we have these super smart people on both sides. If I were a betting man, I would bet with Charlie.

Q: I know that you have spoken a lot about Fiat Chrysler, but I would like to ask one quick question about it. It has become a crowded name in the merger, risk arbitrage space. I think Paulson has a pretty big position and obviously this has to do with the rumors about a GM merger, and Marchionne has been pretty overt about how he wants that to happen. I was just wondering if this were to happen, how you thought that would sort of play out because obviously traditional merger arb is - you short the company that it is acquiring, you are long in the company that is acquired. Tthey may be overpaying or whatever else. Do you think that there is any squeezing that might happen in the short-term and has that worried you at all?

A: I don't think there is anything in the price of GM or FCA that reflects any kind of imminence to any deal. Clearly GM has said they are not interested and clearly Sergio has said he is deeply interested. I don't think there is anything that is priced yet. I don't see anything in the pricing of either stock that would be affected by the rhetoric on that front. Someone like Sergio Marchionne is probably one of the most gifted managers and negotiators that I have come across. He is a poker player and there is a game of poker going on right now. It might go on for a while and so we will see.

Q: I am not in the investment community, but I am a real estate developer. I had some interesting talks with a lot of folks here beforehand and we find we are in the same boat - the more you learn, the more you realize how much you don't know. Unless you have the skill or expertise to bring to bear on the investment operation, should we stick to what we do the best - invest in the funds, invest in indexes, maybe even clone if you really want to get crazy. Should we leave it at that? Is there a danger or hazard to learning more and diving more into Buffett and other folks, because it gives you the pre-disposition to want to start to meddle and play around with it? Or is it important to leave it at that and just try to make yourself a better business person by learning from the investment community? I know a lot of us were curious about that.

A: Buffett says if you are a know-nothing investor, you are best off investing in indices. I think that is a great way to go. Or even slightly better than the index would be the Dhandho ETF that is about to come out. You might give that some consideration once we are able to describe more in detail what we have in store. Going from there to individual stocks or even the act of selecting fund managers, is a very difficult exercise. It's difficult to identify who will do well in the future in terms of active managers. The skill set needed to identify managers who do well in the future versus who have done well in the past is a very rare skill. It is a very unusual skill to try and figure that out. It is perfectly fine to study those, just like I am studying ITT, Geneen and Valeant - with no interest of ever doing anything in the space, but just to understand.

It is a pretty big leap from the index world to anything else. Unless you felt you had a really strong handle on whatever else you might be looking at, I would stick to the indices. There is no harm in learning but you don't need to convert learning into action. As long as you can learn without the action, you will be fine. When you do feel that you are ready to commit, it is not like you have to go all in. You will have the feeling that you know what you are doing. If you felt that you know what you are doing in terms of manager selection and you feel as good in terms of competence as your real estate expertise, then certainly you can go into manager selection. If you feel like cloning and doing individual stocks and have the confidence and expertise, then you can go down that path as well. But these are paths you have to be careful about. There is a small sliver of humanity that can do well on either.

Q: I have a question for Tim Dietrich of Stonetrust. What are the plans for Stonetrust? Are you going to continue in workers' comp and will you keep it in Louisiana or are you moving out of Louisiana?

Tim: Our plan is to remain in Louisiana. We are currently licensed in eight other states and operate in a total of five. We have just started the process of getting licensed in states we are currently not licensed in - Puerto Rico and Washington DC. We will eventually be licensed in all 50 states. We expect it to take 1-1.5 years to get all that done. We are looking to writing some other lines, our commercial lines and working with NewCo - developing a straight through processing with application and directly working with the policyholders. That is in the works. We are not sitting still. We are looking to move forward and be more innovative and more efficient in our operation.

Mohnish: One thing I would like to say about the NewCo Insurance venture is that there would be no chance that we would have any interest or even a shot at doing it, if Stonetrust wasn't a part of the equation. Having the domain knowledge and the expertise of the Stonetrust management team is very fundamental for us to be able to do anything in the insurance space as far as NewCo goes.

The second thing is that the Stonetrust management team has never taken a perspective of whether something is in the interest of Stonetrust or not. They go one level higher and have always taken the approach to whether it is in the interest of Dhandho or not - which is great. There is a cross pollination where they are looking to learn from some of the things that NewCo will do. NewCo is very heavily dependent on a lot of the domain knowledge. One of the reasons why I wanted to do Dhandho and acquire Stonetrust is because I had a deep interest in learning more about the insurance business. I was hoping that that learning would not come at a big price and that the learning would be either at a zero or negative cost. In the last 12 or 18 months, my knowledge of insurance has gone up 10 times from where it was before, but I feel that I still know nothing about insurance and there is a long ways to go.

One of the reasons why Buffett was able to run circles around the industry is because it is a very insular industry - kind of an internally bred industry and not many external folks coming in. This is why people like Ajit Jain, Warren Buffett or Charlie Munger coming in were able to do quite a bit of unusual things that most of the industry players could not do. As the degree of knowledge and expertise in insurance grows, there is a lot of opportunity in this space to a do a number of these things, but you also have to be very careful. It is an area where you could very easily get your head handed to you. For me, without having Stonetrust in the picture, there would be no chance. We wouldn't be able to do any of the things that we are doing. Every few days I will call Tim and I will say to him, "Tim, this is the village idiot on insurance calling". I will say, "The village idiot has the following concepts and where is the village idiot wrong"? This is how we have our conversations in terms of getting educated on the insurance business. We are in the early days of the journey and we will see where it goes. Like I said, we couldn't do much in terms of NewCo or anything else if we didn't have the very robust team that Stonetrust has - the IT expertise they have and the underwriting claims. It's a great team. We have something good in place that is healthy and can grow, but it can also help give shape to something else and we will see how that goes.

Q: Thank you for having all of us here and being very transparent with your responses to our questions. My question is more from a perspective of portfolio construction and thinking about risk. Buffett often talks about risk of permanent capital loss. Just thinking about your comments today about the auto sector, many years ago you said you may not want to be in auto, but now have the portfolios in auto. Once again my question is not about a specific position, but I can't remember the last time you tripled down on a losing position as well, which is again Horsehead. I am just curious, not about the position but more about how you are thinking about risk as it comes to these diverse investments in your portfolio?

A: First, just to clarify on tripling down on anything. We have never invested more than 10% of our assets in anything. For Horsehead, our total investment in Pabrai Funds at cost is $62 million and that hasn't changed in a while. We definitely care a lot about position sizing. John

Templeton used to say that even the best investment analyst will be wrong at least one out of three times. As I mentioned earlier, looking at the history of Warren Buffett and Charlie Munger, you'll see that they had lots of mistakes. The mistakes in the investing landscape is just par for the course. You will have them and there is no way to avoid them. You want to make sure that the impacts are limited.

One of the ways we limit the impact is that we don't put more than 10% of the assets into any one position. Other than that, we try to study these things as best as we can and the position sizing is a function of how well we understand the business. From the time we put our investment checklist in place, our permanent loss of capital investments has been very few and far between, and the error rate has come down. Usually the bigger error rate that never gets reported or even recorded is the mistakes of omission, which are the things that we didn't buy and we should have bought, or the things we bought in a small size and we should have bought in a larger size.

I suggest that you start as an index investor and then you see the transitions from there. You see which of those transitions are the ones that make sense. Whether the transition is to find managers or buy individual stocks. Then you take it from there. There is no substitute for making real investments and incurring real losses.

Recently, one of my daughters expressed an interest in learning the investment business and making investments. I suggested that she have a $10,000 TD Ameritrade account and make investment decisions that make sense to her. If she wanted to discuss them with me, she was free to do that. After the California meeting she told me that she just sold her Tesla position. I had no idea that she bought Tesla. She did say that she made a little profit on it. The bad news here is that the learning isn't going to be much because there is not going to be any red ink there. She said that she made a few hundred dollars on Tesla, but after my presentation she said she was done with Tesla. There is no substitute for running real money in a real account. We don't learn anything when we make money, but we do learn when we lose money and this is what we want to focus on.

Q: You talked earlier about how difficult the auto industry was and how you never wanted to own anything in it. You may want to answer this more generally, but when you established the positions, was that because you thought the auto industry had changed and was a better industry or because you had learned enough and gotten comfortable with it? Was it a little bit of both or was it just so cheap that your comfort was high enough, even if the industry hadn't changed?

A: Both the companies we invested in went through bankruptcy reorganization and they got rid of a lot of the ugly stuff about the business. Their union contracts were redone, their healthcare liabilities, which was around $7 billion a year, were gone, and a lot of other things changed. It is always interesting to look at companies after they have gone through a bankruptcy and their balance sheets get cleaned up.

I had a kind of "aha moment", when I looked at a company like BMW. They basically operate in the most expensive labor market in the world. The German labor wages are amongst the highest in the world. Their labor unions sit on your Board. But BMW has some of the highest margins in the auto business. BMW has margins that everyone else would love to have. When I studied the auto business I also realized that labor is a very small part of the cost equation. In a typical car, the labor content is about 5%-6% of the sticker price of the car. The notion that Detroit had a problem because of labor is not exactly true.

I believe Detroit had a problem not because of labor, but because they didn't care about the customer. They put out very poor quality products and they typically tried to make the ends meet in the end. They cut off a lot of the things, such as leather changing to vinyl. Clearly consumers responded to that by saying they would buy the Chevy, but they wanted it heavily discounted. They weren't going to pay the same amount for a Toyota as a Chevy. They were willing to pay a lot more for a Toyota than they would for a Chevy. Detroit pretty much hit themselves on their own and they destroyed the business.

This was an industry where General Motors at one point had around 70% of the market in the world with huge margins. They had no competitors and they owned the entire business. When the Japanese imports came in, the Honda Civics and such, there was no proper response from the American auto industry. They pretty much ignored the imports coming in. They stuck to their big gas guzzlers, and of course the imports that were coming in eventually became better. Initially the Japanese cars coming in were very crappy, but over time they got better in quality and got to the point where you had a Lexus. Then it was game over. Toyota, Honda and these other companies never faced real American competition with high quality American products in the compact or sub-compact space. That just never happened. After bankruptcy, Detroit got religion. Now, for the first time the Koreans and the Japanese have real competition in the United States, which they never had before. The labor is not a deciding factor anymore. They have new labor content. For the first time, both Toyota and Honda have to compete and they never had to compete before. I would say it was a lollapalooza of looking at a number of different factors in the auto business. They all came together to a point where the valuation never reflected any of it.

We have someone here from Detroit - Gopal with Ford. Would you like to say anything about it? Maybe you can give your perspective on what is happening with the auto industry. How do you think of the big three versus the Japanese players today? How do you think Ford competes with Toyota today?

Gopal: They compete very well. In fact the JD Power ratings of most American cars are in par with, or even better than the Japanese automakers.

Q: You were talking about kids and daughters and our daughter asked us a question as we were driving over here today. She said, when is Mohnish going to start a fund for the next generation of investors? She has been to your meetings since she was a little kid. She is now 24 and looking to invest her savings. I think there is a connection there and I'm sure that other families here with kids are asking the same question.

A: You can tell her that I am about to start a Nifty Fifty 2015 fund and then she can invest in that. I will put her in touch with Monsoon and maybe they can share notes. Sometimes in investing you are better off being old fashioned. You don't necessarily need to go by the next wiz-kids thing, but clearly you need to know about the trends. It is a question of price and understanding things. To some extent some of the things that is going to transform our lives and may even be great investments, might be in the area of joining a start-up. This might be the way to go and get an edge by putting your labor as part of the equation. I have always found in investing that you are better off not trying to follow the next hot trend. That is typically a fool's errand and I think we are seeing that play out of the Nifty Fifty 2015. My suggestion to her is "old is gold", and keep coming to these annual meetings and the Berkshire meeting, and that is probably the path.

Thank you for coming and I hope you enjoy dinner.