

Guy Spier in Conversation with Mohnish Pabrai

In 2014, MOI Global teamed up with Guy Spier and Mohnish Pabrai to produce a video of Guy visiting the offices of Pabrai Investment Funds in Irvine, California. Guy toured Mohnish's office and then sat down for a fascinating conversation between the two value superinvestors.

The transcript has been lightly edited and may contain errors.

Mohnish Pabrai: I thought we might start with something that happened at a Warren Buffett lunch. My wife, Harina, mentioned to Warren I thought a business like Ikea would be a perfect company for Berkshire Hathaway to acquire, to which he immediately replied, "Yes, I wrote to them and told them to give me a call if they decided to do something." Of course, then he explained the way Ikea was set up with the foundations and trusts, it was unlikely there would be any kind of transaction with Berkshire or anyone else.

Interestingly, I was recently re-reading Alice Schroeder's book *The Snowball*, where she does an exceptional job with the depth and the writing style. One of the things she talks about is Buffett's reading list. He reads American Banker and all these newspapers, but he also gets furniture publications to his office and skims those as well. Alice also mentions he's very close to Irv and Ron Blumkin, the Nebraska Furniture Mart (NFM) grandchildren of Mrs. B [ed. note: "Mrs. B" was the popular nickname of NFM founder Rose Blumkin], frequently meeting them for dinner and even taking a trip with them once a year.

The net-net of all this is that he has spent an enormous amount of time studying the furniture business, and he's talked to the Blumkins about what other companies would be good to acquire. Berkshire's had a number of acquisitions in the furniture space, including Jordan's and RC Willey. The issue is that investing is one of the broadest disciplines and the edge you can gain comes from a multidimensional way of looking at it. I came to look at Ikea as a fit because the nature of its business is so amazing, but Warren probably came at it more from the whole NFM experience, and the Blumkin brothers might have mentioned it directly to him.

The point is that someone like Warren Buffet had those unusual insights into the insurance business and then went into insurance in a big way. He had that insight into banks - Warren understands banks really well, and he used to own First Rockford. See's Candy, for example, was a big learning opportunity for Warren, and this experience led to the Coke investment, among others. One thing that fascinates me with investing is that when you go through growth, reach the next level and find something which clicks, you had the same data set because all the data's public, but it's the analytics that becomes superior. It gives you insights that maybe others don't have. We had some of that when we looked at the car business in the middle of 2012, and you had it when you looked at money center banks. To me, the interesting thing about investing is that one has to continue to not only scan the horizon but also go deep to find those rich veins.

Guy Spier: Do you think NFM was a successful acquisition? Warren knows the furniture business, and I believe if Berkshire owned Ikea, it might make up for all of these other furniture businesses, but my sense is that furniture businesses have not been a successful venture for Berkshire.

Pabrai: NFM has been a success and the reason is economics. Warren bought the business for about \$60-\$65 million and, at the time, the company had less than \$100 million a year in sales. Today, NFM

is more than ten times that size. Berkshire hasn't plowed any capital in. In fact, it has probably pulled out a lot of capital over the years. NFM is an exceptional business, the reason being its cost structure. It's a low-cost provider with low overheads, pulling in people from a several-hundred-mile radius, so the per square foot sales are probably 10x those of other Omaha competitors.

However, I agree with you about some of the others. Jordan's, for example, hasn't worked. That's the other part of the investing business - you can have a pretty healthy error rate and do fine. What I'm trying to say is that in aggregate, furniture retailing doesn't come across as an enormously lucrative thing to go into. I think it's worked out fairly well for Berkshire. The same with jewelry - it has made a number of investments that may not have done so well, but Borsheim's, a low-cost provider like NFM, did well for quite a while.

Spier: Helzberg Diamonds hasn't done so great, but even if Warren doesn't get to invest in Ikea, he did invest in Shaw Carpets, which is a duopoly. In a sense, he probably learned from furniture retail to be sure Shaw Carpet was the place in the value chain where it captured the most.

Pabrai: That's the interesting thing. If you consider something like carpets, a normal investor might think of it and move on, saying, "Okay, carpets - blah." When you drill down, though, you really start understanding. Take USG, which makes sheetrock. This drywall breaks and is easier to cut and crack than other drywalls, so contractors prefer it because of labor savings. Even something such as drywall can have a moat, and for me, the fascinating thing about the investing business is you don't need too many. If you can find one of these insights, looking around the curve every couple of years or so, that's quite a bit. In railroads, for example, Berkshire acquired Burlington Northern for \$40-odd billion, and today, I don't think it could be bought for \$100 billion. It's gushing cash and is the ultimate toll bridge because you're not going to build another railroad like this, so with every passing day, it's getting a deeper moat versus trucks.

Spier: In many of the interviews John does, there will be the question, "What is your process?" However, it seems to me those insights, those "aha" and "Eureka" moments, come when there isn't any process. You've told me you have these "aha" moments. You don't know when you're going to get them, and you suddenly realize you're on to something. It happened with the automobile business, but if someone were to ask you, "What exactly did you do? How did that happen," I don't think there's any answer Mohnish can give. Every "aha" moment probably happens in a different way.

Pabrai: I have said this several times and will say it again - I'm a shameless cloner. Let me explain what I mean by that. When it comes to the process of getting insights, I think Warren and Charlie Munger are light years smarter than I'll ever be, so I take a low-life shortcut, so to speak. I looked at and continue to look at what great investors are doing. For example, the automobile insight came from looking at the Manual of Ideas (MOI) and finding that GM was owned not only by Berkshire but was also the second-largest position of David Einhorn. I always hated the auto business for all the obvious reasons - unions, high CAPEX, consumer taste, etc. I hated American autos even more because of all the quality issues. My guess was that since Berkshire's position was not that large, it would have been the decision of one of the two investment managers. Given GM's distress, I thought it may have been Ted Wechsler because that's more his bent.

The question I had was why would Ted Wechsler and David Einhorn, who can clearly see all the problems in the auto business, want to make this bet on autos. Why would someone like Einhorn want to make such a large bet? The funny thing is that Einhorn's largest position at that time was Apple. Think about it: you have a big bet on Apple, and then your second bet is on General Motors. The two cannot be more different in terms of the nature of the business. For me, the starting point with autos was to simply try to answer the question, "Why would these smart guys want to do this?" I wanted to get an answer which made it clear to me, and as I drilled down to try to get it, it dawned on me it

wasn't stupid to be in autos. It was actually pretty smart because there had been a sea change, and that change was not fully appreciated or recognized by the market. Detroit had gone from being one of the worst to one of the best places on the planet to build a car. In fact, that US is now exporting lots of cars to other parts of the world because it's so competitive in terms of its manufacturing.

That insight did not come from just looking at a 13F, but without the 13F, the seed of the insight wouldn't have happened. For me, what has usually worked is something has given me a seed, and usually it will be looking at what the great investors are doing and then trying to understand why they're doing it. Sometimes, it could come from a position in my own portfolio. For example, in December 2008, when commodity stocks were collapsing, I bought into zinc recycler Horsehead Holdings. I made the investment because it was a net-net. It was a classic Ben Graham-type stock, trading really cheap, below net current assets. As they say, you really learn about a business after you own it. I'd bought Horsehead because I was buying a basket of commodities and this looked super cheap, but as I subsequently drilled down more and more into the business and tried to learn more about it, I was fascinated and saw that even though it was in the commodity business, it had an incredible moat. I wouldn't have been able to appreciate the finer points of the business if I hadn't made the investment as a net-net.

I would say the key is there has to be a seed somewhere. In the 1970s, Warren Buffett took Adam Smith around Omaha, pointing out all these great businesses. About 15 years later, when he appeared on Adam Smith's Money World program, he had bought most of them. The thing is, Warren had actually looked at his hometown and picked out the exceptional ones. That's another way to do it, and I've thought about that – look around in Irvine, for example, identify the great businesses here and take it from there. For me, cloning the 13Fs has been a good seed. What are your thoughts on it?

Spier: When I find myself looking at something like General Motors or Horsehead, I have a rising sense of nausea. I'll be looking at GM and thinking of the bankruptcy. I might even mention it to a friend and they'll say, "Are you nuts? This thing just went bankrupt," and my sense is it can have too much hair on it. You don't have that rising sense of nausea. You actually have a rising sense of excitement even as all of this hair comes out. One would need to overcome a huge amount of resistance just to want to start reading the agreement between the unions and the automobile company to see what's in it. I think you did. My reaction would be, "Oh my god, I'm going to read what's in the union?" You don't have this rising sense of nausea, do you?

Pabrai: Maybe this is wiring, but I do not find it exciting to look at Nestle or a Proctor & Gamble at 17 times earnings. I think it's a negative since these great franchises can turn out to be bargains just because of the amazing returns and growth they can generate. In some cases, they can go from being national to international. When I look at globally established brands and they're not under any kind of distress, the concern I have is how much money we can make off an investment and what insight I have that is so unique that 17 analysts following it for 17 years don't have it.

You miss some. For example, I've been a loyal customer of Amazon and Costco for a long time. I've always thought Amazon was an incredible business. In fact, it is an interesting case to talk about because there's a different way to analyze the business. Jeff Bezos is probably one of the all-time greatest business managers, an incredible visionary, leader, and CEO. If you compare Amazon to Wal-Mart, for example, Amazon has lines of business outside of retail, like web and hosting services. He dreams up new businesses for the company to go into. He's probably capable of dreaming those up every three hours, and the areas it can go into are wide open.

Amazon has about \$70-\$80 billion in revenues today. It is probably within the realm of reasonable probabilities that five or ten years from now, it could be a \$400-\$500 billion company. If it gets to something like \$500 billion and puts 3%-4% of that to the bottom line, so 4% net margins, it would be

a \$15-\$20 billion cash flow producer, one of the best on the planet. What is that worth? At \$500 billion, it may not even be maxed out because it still operates in a small number of countries. The flipside is that it can also falter, so this is a difficult one. If things don't hit me over the head with a 2x4, I tent to take a pass. With something like Amazon, the downside would dissuade me even though I can see the upside. I don't see the margin of safety.

Spier: Regarding Nestle and P&G, for the longest time, I did not fully understand how the latent desire to say something pleasing to my investors influenced my desire to look at those companies. In the last two or three years, what really freed me was the blatant rule of "I'm not going to feel obligated and, in general, not talk about what I own. What I own is my concern." The minute I did that, I was blown away by how many very smart people, people who have studied all the psychological and behavioral finance stuff, still failed to see it and understand that simply talking about your investments dirties up the thinking process. It has nothing to do with intelligence.

I think I've become better on the Nestle front, but there is a long way to go. An analogy with bridge might be appropriate: in bridge, it's not the quality of your hand but what you bid and how you play that hand. You can have a really bad hand but play it well and do really well. It would be the same as buying into a horrible-looking business, but if you play it well, you can end up with very high returns.

Pabrai: I think the Holy Grail is to identify hidden moats. It's not so much about cheap assets because if you found a 40-cent dollar and it gets valued at a dollar at some point, you've doubled your money in some period of time. But it's a whole different thing if you'd found a Chipotle when it was in three states and sensed there were high probabilities this would appeal to a much wider group of people. One of the first investments Pabrai Funds made, back in 1999, was in a bank in the Bay Area called Silicon Valley Bank. It is an unusual bank with a definitive moat, different from other banks. I thought this one had some legs to do things, plus it had other peculiarities that made it interesting.

Spier: With the two for-profit education companies in Brazil, what was really great, even better than maybe a hidden moat, was a moat you could see being constructed. In the flooring business, Warren talks about how he's excited even when his competitor acquires a business because it's consolidating the market. What often happens is that people will talk a lot about what they believe is a hidden moat, and it becomes common knowledge. XYZ Company has a great moat nobody understands, it's a high valuation and there's a whole dynamic there. For me, those ideas can shout so loud that it's hard to get away from them. Right now, we have Bitcoin. Not that it has a moat, but everybody wants to talk about Bitcoin, as not that long ago everybody wanted to talk about Netflix.

Pabrai: You've done well in identifying clearly visible moats and then hunting around the world for clones investors may not have appreciated. It's like looking at Moody's and saying, "What are the other credit rating agencies around the world?" because they all have the same dynamics in terms of the duopolies and pricing power. You did it with for-profit education in Brazil, right? You took for-profit education in the US and looked at it in other parts of the world.

Spier: Funny enough, for-profit education is now a better business outside the US, but there are many ways in which it doesn't work. There are some wonderful brands in Africa, but the valuations are too high. Actually, I haven't done this for maybe a year or two. Perhaps I should go and revisit it.

Pabrai: The same thing happened in India, where the subsidiaries of P&G and Unilever are publicly traded and have widely outperformed their parents. That would have been quite obvious because you would have seen the way Indians were going from unbranded to branded soap. The same thing with Indians not having bank accounts - it's going to go to having bank accounts. Many of these things are obvious, and if one has some conviction, then they can proceed.

Spier: Speaking of India, do you think there's any event which could derail its emerging growth?

Pabrai: India has already been derailed in terms of its growth for at least three or four years now. It was 9%-plus growth, and now it's sub-5% growth. A lot of it has to do with government policy, and there's a good chance the people in power will change in the next few months. If the new government chooses to focus on the economy, there is intense pent-up energy and ability to grow by some margin for a while.

Spier: My sense is that even though India is a dysfunctional place and has enormous difficulties, there's nothing that will derail it in the way Egypt has been derailed by its political difficulties. Is there any chance of India going through what Egypt did?

Pabrai: The odds of the core principle of democracy going away is small, in my opinion. In fact, I think it's the other way around. Even Egypt is on a path toward democracy although the path is not straight. Egypt is a different country and a better one, I think, than it was even five years ago.

Spier: In India, I'm less concerned about democracy, which I believe is pretty much embedded. I'm worried about communism and socialism and people feeling it's the government that's going to solve problems rather than the private sector.

Pabrai: I think we're getting past that because they can see what happens when you take such an approach.

Spier: I know there's a huge amount in your life that's been created through destruction. I've seen a number of times how you had something in Dakshana that you decided was a no-go even though it had good prospects, and you tore it apart. [ed.note: The Dakshana Foundation is a philanthropic organization founded by Mohnish Pabrai and his wife. It provides gifted low-income students with academic coaching to prepare them for the entrance exam to the Indian Institutes of Technology (IIT)]. A number of times in your life, you've had a business with hundreds of employees, pulled it out by the roots, put it somewhere else and hit the reset button. Every time I've hit the reset button, it's been incredible for me, and I've always felt like I did it too late.

Pabrai: It's been surprising to me, but every time I've failed at something, it's led to tremendous growth. In hindsight, those failures have been a blessing. What I've learned is that success doesn't teach us much. We just feel good about ourselves and think we're great when we succeed. I've found that failure has really been the driver of growth for me. I think I'm a much better investor today because of a whole bunch of different stumbles. Actually, I have always welcomed failure.

Spier: Let me tell you about a failure I noticed, something you were dealing with on the trip I took with you to Dakshana. You had an office in, I think, Gurgaon.

Pabrai: In Delhi, right.

Spier: You had staff, and I know you weren't happy with that setup. Now you have the Colonel. Maybe you can tell me the story of how he keeps wanting to retire. You've told him he can have an office wherever he likes.

Pabrai: In 2009, when you were visiting Dakshana with me, things were at a pretty low point in terms of net worth and where markets were at. It was a great time for making investments, which was wonderful, but one issue I was facing then was a severe drop-off in my net worth and our ability to fund Dakshana. I knew I had to dramatically cut back Dakshana's scope had and as I was looking at the changes to be made, it became clear to me that as we were to slim down, it was a great opportunity to improve Dakshana in a pretty dramatic way. That's what we did. We had to hunker

down, but in the process of doing so, we were able to sow the seeds of some great restructuring and growth.

At that time, one of my board members referred Colonel Sharma to me as a potential CEO, and it didn't hurt that he was willing to work for one rupee a year. The Colonel is in his 70s and still pretty fit and very energetic, but every few weeks or months, he tells me he wants to go off to some mountain resort. I always tell him, "You retire, you die. There's no point in thinking in those terms." I've told him he can go to any mountain resort he wants, and we'll put up an office five minutes from his house so he can show up for ten minutes or half an hour a day, whatever he wants, but to stay engaged. I think he would have a hard time himself pulling away from Dakshana because it draws you in.

Spier: It seems like you've found your Buffett manager there, and it's fascinating that somebody with all the professional qualifications to run a not-for-profit in India would not be the right person. You've found somebody who's working for Dakshana for free, and you don't care how much time he spends on the project. If it's five minutes a week, he's still the guy you want running it.

Pabrai: The Colonel used to handle 40,000 troops, and he's got a great team under him. He's groomed and trained his people well, which is why he keeps telling me he wants to retire because he says, "They really don't need me." The team under him is absolutely jamming all the time, but I still feel Dakshana needs him. We don't need a lot of time from the Colonel, but we do need him to be available from time to time and that, I would hope, continues endlessly.

It's very clear to me the non-profit world has a myriad of problems, among the biggest ones being that the people who run non-profits are typically people with great hearts but not great business heads. What you need in order to have an effective non-profit is a benevolent entrepreneur running it. If people haven't built businesses, they are missing some basic skills which I consider fundamental to running a great non-profit. Almost every non-profit is run by individuals who have never dealt with payroll.

At Dakshana, we had no interest in hiring people who had spent time in the non-profit world because I think having them unlearn what they thought was gospel would either be impossible or take a long time. It's better for us to start with a clean slate, so we haven't had people who come from the non-profit world. We also haven't had people from the education world. We've found that having people from different industries and disciplines has been a source of great strength for Dakshana because they don't know a certain way of doing things. We're able to come up with ways of doing things that are probably quite novel and unusual.

Spier: What I see is your and the Colonel's capacity to make tough decisions, decisions that would not by any stretch of the imagination appear to be benevolent because you're aiming at a goal. You are there helping high intelligent young people get into the IIT, but the decisions you make for the people who don't make it in are heartbreaking for me. It seems like both you and the Colonel are okay with that.

Pabrai: We're not okay with it, but any non-profit has to realize that the problems of the world are immense while the resources at our disposal are very limited, so we have to think about maximizing the good we can do. Even if you are the Gates Foundation, you cannot solve all the problems of the world. Dakshana is not even a thousandth of the Gates Foundation in terms of assets or funding, so our mandate is simply to try to be good stewards of the resources at our disposal and do the most good we can with those. I'm very proud of what Dakshana has accomplished on that front because very few non-profits think that way.

Spier: I know the Charles T. Munger Hall is being built. When are we getting the Warren E. Buffett?

Pabrai: We'll definitely get to that at some point. I'm working with the Indian government. The next one we're going to build will be in Hyderabad. The Charles T. Munger Hall will be a 360-capacity coaching center in Bangalore. I would really like to name the one in Hyderabad the Prem Watsa Hall because Prem is from Hyderabad and has been an incredible supporter. It would be wonderful to have his name in that city, but we've got many more of these coming up. Warren's name is definitely coming up.

Spier: Your Dakshana business card says "chief catalyst." You haven't called yourself chairman or CEO, and you're obviously the mind behind it. Do you think you could have done as good a job if you had been in India? There are definitely disadvantages to being in Southern California with the beneficiaries being in India, but there may be some incredible advantages. The distance helps to get your thinking clear.

Pabrai: It would be worse, actually. I have lived all my adult life outside of India. I have been in the United States more than 31 years. People may not fully appreciate it, but when I go to India for Dakshana, I'm basically a tourist. I think I have spent less than half an hour in our headquarters in Pune during all these trips. In fact, most of the times when I go to India, I never make it to Pune because I love meeting the kids in the schools or meeting the parents in their homes. You can say that my Dakshana-related trips to India are not directly operational. I just focus on things I happen to enjoy.

Of course, there is data and learning helpful to Dakshana that come out of those visits, but in my opinion, it's a perfect match. The folks running Dakshana in India are extremely good at it. I think they're vastly better at it than I would be, and they have rightfully stressed that my job is to make sure Dakshana never has a financial hiccup. I'm proud to say it's actually in the very best financial state it's ever been. We've got a good engine because it's a great match. The DNA of Dakshana – part American, part Indian – is a terrific DNA. The distance has allowed me to look at things in a more strategic way, and I think I've added plenty of value on the strategy and direction. I've added very little value on the nuts and bolts of running it on the ground in India.

Spier: That American/Indian combo slightly pains my heart because I feel like it should be a British/Indian thing.

Pabrai: Britain's in there, too, Guy, because even though your education took place in England and mine in India, they have lots of similarities, so it's deeply embedded as well.

Spier: In his book *One Man's View of the World*, Lee Kuan Yew talks about America being an amazing place to live, but he also talks about how he'd go to the UK if he wanted to live somewhere. I guess the Indian experience in the United States has been an amazing one. Of course, it's a broad experience. There have been amazing successes and also some people who have engaged in criminal behavior, but maybe you can give your take on having immigrated to the United States from India with your background and what it's done for you.

Pabrai: People say, "America is an idea," and it's an incredible idea. I'm so glad this idea exists, and I think it has a physical presence. I love America because so many of the things possible for Americans and immigrants in this country are not possible anywhere else in the world. I'll give you an example. I finished high school in Dubai and still have friends who live there. One of the things impacting your opportunity set is how big the country and the market are. You can be as smart as you want in Dubai, but you have limitations because of boundaries.

The United States has amazing advantages in terms of size. There are incredible natural resources and you overlay on top of those an incredible approach to developing human resources and an

incredible openness to anyone to come in and do their thing. A company like Google doesn't happen if you don't have migration from Russia. We have all these amazing advantages in the United States. I think there is no other country on the planet which can come close. In fact, I feel now that the United States is the real emerging market. People start looking in different nooks and crannies around the world for emerging markets and where the growth is going to come from, but I think America has so many intrinsic strengths that are getting more and more prominent. For example, the whole shale gas revolution is a huge tailwind for the United States, as is having all the leading universities. The country is still a massive importer of incredible talent (another huge tailwind), and if the government gets immigration fixed, those tailwinds will get even stronger. No other country has those advantages.

Spier: That's absolutely right, but I'd argue that those of us who live outside the United States can still participate in the life of the country. I invest on equal terms to any American investor when it comes to information and insights.

Pabrai: You are enriching the United States, that's the beauty of it.

Spier: By diverting capital from the global capital market into the United States, ensuring a lower cost of funds for American businesses. I think people all over the world are doing that. Going back to investing, why is it that so many smart people do things like, say, bet against a fixed exchange rate in Asia or continue to short stocks?

Pabrai: As Warren says, if you gave up 50 IQ points, you would actually do better. I think egos and too much intellectual power get in the way. Buffett's approach of "Don't invest in anything until it hits you like a 2x4 on the head" is blindingly obvious - do not invest in something which requires a 14-page thesis to explain why things will go your way; invest in something that requires four sentences.