



光华管理学院

Guanghua School of Management

**Distinguished Speaker Series
Lecture and Q&A with
Mohnish Pabrai**

“The Quest for 10-100 Baggers”

Value Investing Course (1st Ever in China)

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Mohnish: It's a true pleasure and honor to be invited to speak to the students and obviously Peking University amongst the best of the best. And I saw a few of the resumes and they look exceptional. We've got lots of horsepower in the room which is great. Behind me is a bust of Charlie Munger. Charlie will be overseeing the proceedings for the next couple of hours, so in case we go off track he'll get us right back on track.

The topic for today is the quest for 10 to 100-baggers. This term, 100-baggers, comes from Peter Lynch. It means making 100 times on your investment or making 10 times on your investments. If you say 10-baggers it's 10 times, 100-baggers is 100 times. I haven't given this talk before which is always a lot of fun for me because it's very boring if I have to repeat some talk that I've already given before. In some ways, you guys are guinea pigs but in other ways, I think it'll be exciting. And because I've not given the talk before, I'm not entirely sure of the timing, but I'm going to try to move this along because there's a lot of material. It'll feel like it's going pretty quickly but that's why we have the recording - so later you can watch it more at your leisure if you want to at certain parts. But also certainly during the Q&A we can go through things that you have an interest in.

I started my journey as a value investor 22 years ago, and I quite by accident heard about Warren Buffett for the first time. Unlike you, when I heard about him, I was 30 years old so I was much older. When I read about him I was really stunned. I haven't been to business school. I'm an engineer by training. All of you probably know a lot more about finance than I do. But I was really stunned with Warren Buffett's approach and the way he had been so successful. And the crux of his success, at least what I took away from what I read in 1994, was a quote by Albert Einstein which is, "Compounding is the 8th wonder of the world." Even though Einstein was a physicist, he actually figured out a few things about compounding. And obviously, in '94 when I had read about Buffett, he had been compounding at the rate of about 25%, 26% a year. And 26% is a magical number. I thought of the magical number then because if you compound money at 26%, it doubles in exactly three years. If you have \$1,000 and you compound at 26%, you're going to have \$2,000 in three years and so on. And if you go for 30 years that's 2 to the power of

10. And this group doesn't need me to tell you that 2 to the power of 10 is 1,024.

Throw away the 24 and it's 1,000 times your money. If you had \$1,000 and you compound it at 26%, 30 years later you would have \$1 million. If you had \$1 million and you compound it at 26%, 30 years later you'll have \$1 billion. That's basically the key to Buffett's success. I thought it was worth trying to do what Buffett did. Of course, there's no way that we're going to have another Warren Buffett. But I thought it was worth trying to compound at high rates. Gradually over five years, I switched from being a CEO of an engineering company to eventually being a hedge fund manager. The key nuance, or you can say mental model I used was very simple. I looked for companies that were selling for half or less than what they were worth in two or three years. So if I could find a dollar bill for 50 cents then what that meant is that if it got valued as a dollar in two years or three years I would be compounding at 26%, and if it happened in two years, it would be even higher. It'd be like 35%, 36%. So I said it's worth trying to seeing if we can find these 50 cent dollars because 26% sounds high. I didn't think it was that hard to find things that are half off in an auction driven market, and I thought it was worth trying because the rewards are so high. That's what I embarked on doing. I said, "Okay, let's try to find these dollar bills for 50 cents." And then you just sit back and wait for two years or three years. Markets are a weighing machine in the long term and they'll get reweighed accordingly. And for the most part, if I look at my performance from '95 until let's say 2014, it's done about the 26% approximately. The last two years I'm down about one-third, so we were taken down a little bit. But we think in the next few years we'll make it up. We'll see how it goes. I'll report to you next year when I'm with you in-person.

It's been 21 years since I started doing this. And I had a million dollars in '95 and I wanted to try to see if that million in 30 years could convert to a billion. I said, "Okay basically, we have the million, I don't really need it for anything. I'm going to try put it in this Buffett engine of compounding and I want to see what happens to it." The good news is that even if I miss by 90%, it's still a big number. Even if I miss by 95% it's still a big number - they're all acceptable numbers. It sounded like a good game to play. When I first set up my first set of stocks I bought in 1995, I had one year of experience reading about Buffett. I didn't have a lot of experience. I hadn't gone to business school. If I found a company, I would make a 10% bet. So in my portfolio of a million stocks, basically \$1 million got divided into 10 stocks. I bought 10 stocks and at that time I had an interest in making investments in the Indian market. There were some companies I had noticed in the Indian stock market that looked very compelling. It was very complicated at that time in '94, '95 to invest in India, especially as a U.S. resident. And for example, 21 years ago they

didn't have Demat, so if you bought shares, they gave you physical stock certificates.

Also the Indian government said that if I brought in dollars and I bought Indian stocks, I'd be able to take the money back without taxes back in dollars. The country had a lot of exchange controls, so I didn't actually believe them. I was a little skeptical that a country that would have all these exchange controls would honor these things that they were saying. I was skeptical, so what I did is out of the million dollars I only allocated \$30,000 to India. And the \$30,000 I allocated to four stocks. I had to physically go to Mumbai. I opened a broker's account, opened a bank account and then I bought these stocks. Then a few weeks later I got these physical stock certificates in California and they were almost falling apart. They looked like they almost were worthless, they looked so beat up.

One stock I bought which was half of the \$30,000, or \$15,000, was an IT services company, Satyam Computers. That was the business I was in. The three others - one was a broker to whom I bought the stocks and two were courier companies kind of like FedEx or DHL because India had a very bad postal system. I thought that as the economy grew these companies that were basically doing what the postal system should be doing but are doing it in private ways like FedEx and DHL and UPS would also grow. And I thought these were all very long term plays. When I got these certificates I said, "Okay, I'm going to stick them in my drawer and not look at them for 10 years - just let them be. I bought Satyam Computers for ₹45 and after 5 years it was trading at ₹7,000. It was up 130 or 140 times what I paid for it. I had been tracking it a little bit, but about 1999, which was about four years after I bought it, I said, "Let me just study this business again because I know the business but this is ridiculous." I noticed that the multiple it was trading at, was trading at more than 100 times earnings. It was just ridiculously overpriced. One of the reasons it was priced that way was because they had spun off a dot-com company which they still owned a piece of. And the market at that time was in a major bubble for all these dot-coms. This company which was just a system integration IT company spun out a subsidiary which was doing some nifty things on the web. And the market gave that spun out company a huge valuation and because of that, this company got a big valuation.

I thought this was complete bubble territory and I was also concerned with the \$15,000, and the exchange rate had moved against me. The \$15,000 was worth over \$1.5 million. I had started with \$1 million. I will tell you about the remaining \$985,000 in a second but \$15,000 of the portfolio was sitting at \$1.5 million. And I was concerned whether the Indian government would allow me to take the money back, whether I

could even sell the stock, and whether the shares were fake or real. I had a lot of questions. I said, "You know what? We're going to test this out." I contacted the broker, and I said, "I'm ready to sell these shares." I sent them the shares, and they sold the shares. I sold within 5% of the all-time high of that company, and they put the money in my Indian bank account. The next day I asked them to wire it to the U.S., and they wired it. Everything went flawlessly, exactly as the government had promised - no issues. I was blown away. I said, "Wow, no taxes?" I gave them \$15,000. Five years later they're giving me \$1.5 million with no questions asked. What a country!

The other stocks that I had were all old economy stocks. They hadn't done much, so the remaining \$15,000 maybe was worth \$20,000 or \$25,000. It had not moved much. In fact, everything else was going down in price at that time except the frenzy for the dot-coms. Even Berkshire Hathaway hit an all-time low at that time. In 2001 I decided to completely exit my Indian positions and I sold all the remaining three. One of them was down 50%, but the other two we made a little bit of money. Basically, for the remaining \$15,000, I got about \$20,000 back.. The result in India was obviously more than acceptable. \$30,000 in, \$1.5 million out is perfectly fine. With the other \$970,000 that I had, there was one company I had which went up 100x. I had \$100,000 in a U.S. company, CMGI which went up 100x. So that one company became \$10 million.

Now I had \$10 million in that one company, I had the \$1.5 million in the one Indian company, and the rest of the portfolio I'd done okay. At that time from '95 to 2000, the U.S. markets had gone up 25% a year. It had moved up, but nothing like these other companies. In 5 years, I had around \$13/14 million out of the million dollars. I said, "Mohnish, forget about 26%, we've just blown it out of the park. Very well done. Good job." I was very happy. It was a fantastic job. Especially for never having even attended a single class at Peking University. Just winging it on my own, if you will. Recently I went back, and when I went to sell these other stocks, the other premium stocks, they told me one particular stock certificate was fake. There was a very small amount of shares but they said it was a fake certificate and the broker said, "We're not responsible for fake certificates." I didn't really care, because it was a small amount. I just kept that one certificate in my desk. Recently I looked at it again and I said, "No, it doesn't look fake to me." I sent it again to a broker in India to sell and I asked them, "Can you sell these 100 shares of this company?" I had held this one company, Bluedart which is the FedEx of India for 21 years. And I held it for 21 years by accident because that one little piece didn't get sold because of this fake thing. But I kept getting these dividend checks all this time. Bluedart was ultimately a 60x.

I'd invested \$7,700 in Bluedart, and if I had kept those shares I would have had about half a million. Then I went back and said, "let me check all the four stocks in India, what happened to the other three if I had not touched them?" Because they were designed to not be touched, I was stupid, I sold it after six years. So what ended up happening is that Bluedart was 60x. There was another one, Kotak Mahindra, which was my broker, that was up 50x. And the third one which was Skypack, which was a competitor to Bluedart, went down to half - that didn't do anything. But what ended up happening in the portfolio of 14 stocks in 1995 is that 4 out of the 14 all eventually went up more than 50 times. And in one of them, I had a serious position - a 10% position - which completely altered my net worth.

And then I started thinking that this is not good that I ended up with these companies in my portfolio and I never recognize how great they were. I recognized it in two cases. In both those cases, I cashed out the 100x. Both because of the bubble. Not because valuations went up. They probably should have been worth 10x or 15x but not 100x. But to be over we cannot collect more than we should have, which is fine. These other ones, these were real businesses, like the FedEx of India, the Goldman Sachs of India. These were businesses I should not have sold, and I sold them. I started thinking, "How often has this happened in my portfolio? How often has it happened where we've had these companies I was smart enough to buy them but not smart enough to hold them. And why is that happening?" The is the subject of the talk today. The best way to learn is to teach, so I have to admit that one of the reasons I wanted to do this talk and this lecture is because I'm trying to learn. Whether or not any of you guys learn anything from me, I am definitely going to learn from this talk. I'm 52 years old, and hopefully, I have another 30 or 40 years left In the next 30 or 40 years when these 100-baggers show up in my portfolio, and they're guaranteed to show up, I hope I am at least smart enough to figure out that some of them are 50 baggers or 100 baggers and I should hold on to them and not sell them.

So what I did then I said, "Okay, how do we identify these 100-baggers?" And what I discovered is that if I just looked at the examples in my own portfolio and obvious examples around me, there are basically around six... Sorry, there are about five different categories that these 10 to 100-baggers fall into. Now, it could be more than five, but five is the one I was able to come up with before it was time for this lecture. If I come up with more I'll update you next year. But we at least have five very distinct kinds of companies which should give us clues that these are businesses that we want to hold onto. The first category of companies that has the potential for 10 to 100-baggers are businesses that have huge tailwinds. Tailwinds means they just have all the factors moving in their favor, they have very deep moats, they have very long runways,

they have very high return on equity, they typically don't need any debt, and the most important condition, an idiot can run these companies. Like Warren Buffett says, "Invest in businesses that an idiot can run because one day an idiot will run them." So which are the companies that a complete moron, stupid idiot can run? These are the businesses like See's Candy, Coca-Cola, Moody's, Visa, Mastercard, American Express.

These are the types of businesses that are deep in the moats. In fact, if you look at a company like Coca-Cola they have more than 100-year history. And in the 100 plus year history for several decades the company was poorly managed. And you have a company in China, Maotai. Maybe some of you even consume the product. I think Maotai has great management, but with due respect to Maotai, an idiot can run that company. You do not need anything between your ears. You can put me in charge of Maotai and I can run it. Even a person like me can run that company. That is an unbelievable fantastic business. There's a good friend of mine, you might have heard of him, his name is Guy Spier and he lives in Zurich. I think he's going to try to also speak to you next year - maybe we'll both come together. We'll see if we can do back-to-back lectures. Guy has a mental model he uses. His mental model which he has used for more than 15 years is that he identifies a company like Moody's or S&P as a great business. or let's say if he identifies Coca-Cola as a great business, or let's say the Coca-Cola bottlers are the great business. What he does then, is that he looks around the world for Coca-Cola bottlers in other countries. If he finds out that being a Coca-Cola bottler is great in Tennessee, in the U.S. then he wants to find the same business in Brazil. He wants to find the bottler in China, the bottler in India. He wants to go around the world looking for the coke bottler and find which one is being undervalued. Then he wants to invest in it because the economics of these coke bottlers no matter where in the world they are is about the same, they're all great businesses.

One of the businesses which is the ultimate deep moat business is Moody's. They do the debt rating, and even in the financial crisis when they gave all bad and flawed and garbage debt ratings it still did not destroy the company. This is a great business that an idiot can run. For Moody's, Guy said to himself, "What are the credit rating agencies all around the world which has the same business model like Moody's?" Because Moody's is a model where they'll hire an analyst, they'll pay him maybe \$100,000. For each analyst that they pay \$100,000 they're probably collecting \$4 million in fees. It's just a great business. It's just the economics are fantastic. He found a company in 2001 in India which was very small, but was the number one credit rating agency in India exactly like Moody's was in the U.S. He found that S&P 500 owned 10% of the company. S&P had done a lot of due diligence and they bought a 10% stake in the company. That company was called CRISIL.

Guy Spier at that time was managing about \$30/40 million. He made a small investment in CRISIL. It went up - it doubled or tripled in two, three years and then he bought a little bit more. Then another year or two later he sold it all. He had made four times his money. Sometimes I like to pour salt on the wounds of Guy Spier. Sometimes I want to have fun with him. I spoke to him last night when I was preparing the talk. I said, "Hey Guy, that CRISIL position that you owned which you sold. If you had not sold..." (It went up 130x after he sold.) He's the kind of guy who doesn't even trade that much, he just buys and holds. So I said, "Hey, by the way, that CRISIL you sold back then, why'd you sell it?" He said, "Mohnish, don't remind me that's the dumbest thing I did." Because basically, if he had kept CRISIL he manages \$160 million. The CRISIL position would've exceeded the entire portfolio he has today. One decision and what was so hard about that decision? Well, it wasn't hard. I already told you an idiot can run Moody's, just like an idiot can run Coca-Cola. And idiots have run it and they've not been able to destroy these businesses.

The first thing to do when you run into businesses that idiots are running or can run and they still continue doing business, is buy those companies. If they have these characteristics then forget the P/E ratio. Just buy and hold forever, because there are very, very few businesses on the planet like this. I can almost bet that 10 or 20 years from now, Maotai looks very different. It's hard to tell the path it takes, but it looks like a great business. That's the first one, the businesses that idiots can run. The second is exactly like the first except these cannot be run by idiots. These are businesses which are exactly like the first kind. They have huge tailwinds, they have deep moats, they have ultra-long runways, they have high ROE, they don't need any debt but they need great management, and they do have great management. These are businesses like Amazon, Costco, GEICO, Amorepacific, Kotak Mahindra bank - the one I bought in India which went up 60 times or something. Bluedart, which is the FedEx replica I bought in India. Satyam the IT company, then Restaurant Brands which is the one that owns Burger King and Tim Hortons. McDonalds, Yum brands, Domino's Pizza. These are all great businesses but they do need solid management on top of them to make sure that they can keep those franchises. But these businesses have economics that are just phenomenal, just great economics.

So that's the second type of business you want to keep and look for in your portfolio. And you get these massive runs as we saw with Bluedart and others in India. The third kind is the ones which have shown up the most in my portfolio. I have never had the good fortune of having the first kind of business which is huge tailwinds and idiots for management, I've never had that. If I ever get that in my portfolio we're never going to

sell those, we're going to keep those forever. The third one is when the market gets confused between risk and uncertainty. I will go through some examples from my own portfolio in the past. In some cases I was able to capture the upside, in other cases, I was too stupid and I missed the upside. I made some money but I didn't make a lot of money. The businesses I'm going to talk about are not businesses you may have heard of but that's the nature of this game. The ones that are going to be 100-baggers are not going to be the biggest names around that you've heard of. In 2005 I invested in a steel company which was based in Canada. They were created in the U.S. called Ipsco. Ipsco made two types of steel. They made plate steel and they made tubular steel. Pipelines, and drilling for drilling oil wells. They made these specialized steel, they are in pipe form or plate form. The company had the following characteristics when I invested in it: the market cap was \$2.5 billion; they had \$900 million of extra cash on the balance sheet; and the company had contracts on the book. There were these pipelines that were going to buy their steel for the next couple of years.

They had a two-year backlog where they knew that their earnings for the next two years were going to be \$650 million each year. So you had a \$2.5 billion market cap, and you had \$2.2 billion between cash they already had and cash that was coming in the next two years. You would collect about 90% of the market cap in cash in two years, and after two years you still had all the plants and equipment and people and all the know-how - everything was still there. But after two years there was no visibility into earnings, and we know the steel business can go up and down.

The way I looked at it I said, "You know what? What we're going to do is I'm going to make a bet, I'm going to put 10% of my assets into this. I'm going to just sit there for two years and if it doesn't work we probably get back 90% or the company's completely gone. But I don't think it's completely gone. I think it's a real business." What happened is a year later they made the \$650 million, and that year later they had visibility for one more year. Now they said that they would make \$650 million for the third year. Now they had three years of \$650 million which was almost \$2 billion plus the \$900 million. Now we were above my purchase price. The stock that I bought at \$45 was sitting at \$70 a year later. I said, "Well, we were above what we paid, but we still don't know what the business does after three years. Why don't we just wait for another couple of years, see what happens?"

In 2007 I waited one more year and by now the stock had gone to maybe \$100, \$105. And they got a buyout offer. Another company came and bought them for \$160 a share. When the deal was announced, at \$157 I sold the stock. We ended up with almost a 4x in about two and a half

years. And we captured the entire 4x. This was a situation where it's a highly, highly cyclical business and markets hate uncertainty. It's a highly uncertain business, but the risk for this business was very low. It is what I call very low risk and very high uncertainty. When you find a combination of low risk and high uncertainty, that combination is usually going to give you a high reward because markets are not very good at pricing in uncertainty. They hate uncertainty. We get some benefit from that and in fact, there's a business like this in my portfolio currently. I don't talk much about my portfolio but I'll just make an exception because I love you guys so much. I own a company called Fiat Chrysler, which is based partially in Italy and partially in Detroit.

Fiat Chrysler's very similar to Ipsco - the stock is around \$6 . The management of the company says that in the year 2018, their earnings are going to be around \$5. If the management is correct about the future prospects of the business then basically the business has been priced at 1.2 times earnings for one year. My answer to that is, "Okay, we'll hold the stock to 2018." They have \$130 billion in sales of cars. They just started manufacturing Jeep in China. The Chinese love their Jeeps. Raise your hand if you think Chinese love Jeeps. All right, at least a few Chinese love their Jeeps. That's great. Their Jeep sales are going up 5x in the next three years in China. I happen to think that what they're saying makes sense. The market thinks it doesn't make sense.

Just like Ipsco we put the stock in the portfolio and forget about it. And I'll wake up in January 2019 and see what happened. If you invite me back in 2019, I'll tell you what happened to Fiat. And between us girls, we may end up with five times our money if it trades at five times earnings, or seven times our money if it trades at seven times earnings.

There's another company, Tesoro Petroleum. This is one which we did not capture but we should have Ipsco is in the steel business. Tesoro is in the oil refining business. They have oil refineries in the United States. In the United States, in the last 30 years, not even one new oil refinery has been built because of NIMBY. You guys know what NIMBY is? Not In My Backyard. Nobody wants the oil refinery near them. In the entire U.S. for anyone who wants to build an oil refinery, they never get the permits.

The oil refineries that we've had for 30 years are the same ones we have today. They keep trying to tweak the oil refineries in the U.S. to get more and more capacity, but they are not able to build new ones. The oil refining business in the U.S. actually is a pretty good business, and Tesoro had a bunch of oil refineries. The reason it's pretty good is because all the different states have different requirements for how the gasoline or petroleum is to be produced, and the amount of emissions. You need different refineries for different states to meet the standards,

which makes it difficult for other competitors to come in. Even though oil refining maybe a commodity business, it's not really a commodity business because it's got these local aspects to it.

What happened with Tesoro is that there was another merger taking place with two large oil refiners. In order to make that merger happen, they were forced to sell one of the oil refineries to make the budget. Tesoro bought that refinery, they leveraged the balance sheet to buy the refinery, and after they leveraged the balance sheet the crack spread which is the spread that refiners get to make oil into gasoline. The crack spread narrowed to almost nothing, so their profits went to next to nothing. At the same time they had a huge amount of debt. The markets looked at the debt and they saw a lot of uncertainty because it is very hard to predict the crack spread. Just like the uncertainty of steel prices, the refining margins are always uncertain. And markets project present circumstances to infinity. The market said, "Hey, the crack spread is small. It'll always be small. They have all this debt. They will not be able to pay their debt." What happens if they don't pay the debt? Well, what happens if they don't pay the debt is they have many refineries. They can just sell a refinery, they don't need to go bankrupt they can just sell some assets, and they can get out of the jam on their end.

I looked at the company, the balance sheet, the debt, and so on. The stock was at \$7.5 - it had gone down a lot. It used to be at almost \$30. It gone down to 25% of the price so I bought 10% of assets at \$7.5. Three months after I bought the stock it was trading at \$1.33. The 10% of assets I put in just this alone took my portfolio down by 8%. This one position. One of the things that always happens to me, only happens to me, it doesn't happen to you, is that every stock I buy goes down first. It always goes down. I don't know why it doesn't go down before I buy, but they all go down after I buy. Somehow it knows.

Bruce Berkowitz is a fund manager, and he calls it premature accumulation. I always have premature accumulation. Anyway, \$7.50 went down to \$1.33. We're used to that, we're not going to sell anything. We sit there and then a few months later the crack spread widens and they're paying down debt, and the stocks at \$15. And I said, "Hallelujah!" From \$1.33 to \$15, 10 times from \$7.50 to \$15 double less than three, still on track for 26%, we are out of here. Or like Arnold Schwarzenegger would say, "Hasta la vista, baby." I sold the stock and moved on. What I didn't realize is Tesoro had a phenomenal manager, Bruce Smith. Just a kickass manager. And he was a master at extracting value from these refineries. He bought pipelines and refineries when the financial crisis took place. If I had kept Tesoro from the bottom tick of \$1.33, it went up 200 times until today. From the time I bought, it went up about 40 times. I only captured a double. and the rest of the ride I completely missed.

This guy was a master at buying these assets, extracting more value, getting more assets. They spun off a pipeline company. He de-levered the balance sheet. It's done really well.

That was an example of a low risk, high uncertainty business where I already knew in the period I owned the stock that I was dealing with an exceptional manager because in the conference calls I was in love with Bruce Smith. He was just a great guy, he was doing all the great things. But we missed that 40x, and there was a chance to get 200x. Then we were going to go to another one which is a shipping company, all these wonderful businesses - steel business, refining business, shipping... And you thought you can only make the money on Alibaba and Baidu. No, you can make the money without Alibaba and Baidu. You can make it in other places.

For example, Frontline was a shipping company and this company focused on transporting crude oil. They had something known as VLCCs, Very Large Crude Carriers that they owned. I haven't looked at the shipping business lately but this was an investment I made in around 2002. There were about 400 VLCCs in the world and Frontline was the largest amongst all of them. They had about 70 of them in their fleet. Seventy out of 400 were owned by Frontline. And this is the ultimate high uncertainty business. The VLCCs are chartered two different ways. Either they are time charters or they're daily charters. The entire Frontline fleet of 70 ships was on daily charters. The daily charter rate for these ships can vary from \$5,000 a day to \$300,000 a day. It is a huge variance and at that time in 2002, once the rates went below \$12,000 or \$13,000 they were not making any money; they were losing money. Once the rates went over \$30,000 or \$40,000 they were super, super abnormal profits, exponential profits. But you didn't know what would happen the next day because every day these prices fluctuate. There's a particular nuance in the shipping business that I understood. I understood this because a friend of mine in the real estate business had explained this to me. He said when you build these large office towers in the U.S. it takes three to five years to get the permits and actually build these 20, 30, 40 story buildings. In China, it's probably much faster.

When office space is very tight and fully occupied, all the real estate developers rush out to build new buildings. They all rush out to build new buildings at the same time. And the banks finance all of them at the same time because everything looks great. It's a boom business. They can see 100% occupancy, and then five years later all these buildings come on the market at the same time. And then what happens is that the occupancy and the rents collapse at the same time. In these high-end office buildings you have this boom and bust cycle of very high occupancy and then low occupancy, then high occupancy and low

occupancy, it just keeps going back and forth because the property developers just think whatever's happening right now is the way it's going to be forever. The people who are in the shipping business are even worse than the property developers. They believe everything that's happening right now is the way it's going to be forever.

When these VLCC's are trading at \$200,000, \$250,000 a day they all go to the Korean shipyards and place a huge number of orders for ships. And they say, "Build me the ships." Like the building, it takes two, three years or four years to build a ship. By the time the ships are built, all these ships get delivered at the same time and those rates collapse. Then they go scrambling again or they got a bunch of bankruptcies. The business goes through these ups and downs. One of the things that happens is that when rates go to \$5,000 a day or \$10,000 a day, scrapping those ships increases a lot because they're losing money. What they do is they take their old ships and just scrap them so they make some money. The size of the fleet goes down at the time when the rates are low. As the fleet size goes down it sets up the conditions for rates to go up. Then when the capacity goes down and the rates start going up, you cannot bring in more capacity because it takes three years to build a ship. The only thing that can happen is price goes exponential.

I bought Frontline at a point when these prices were \$5,000 or \$10,000 a day and the stock had collapsed and it was trading at about \$6 a share. Just like with Tesoro, a few weeks after I bought it, it was trading at \$4 a share - lost one-third. Not as bad as Tesoro but one-third is gone. Then it went from \$6 to \$9 in a short time. I wanted to just capture that spread. It was above the liquidation value. I sold the company. Because of the very high uncertainty in rates, if I had held the stock throughout this company, , even with all the recent collapse in shipping, would've been a 30, 35 times investment, from \$6 to \$160.

Another company which I just wanted to talk about is Teck Cominco. This is again, low-risk high uncertainty. During the financial crisis, commodity prices collapsed in 2008. They went to nothing. Teck Cominco is like the IBM of mining. They have huge reserves of metallurgical coal and huge reserves of iron ore, and lots of trading with China. But they had done an acquisition just before the financial crisis, a large acquisition. They had taken a bridge loan to close that acquisition. Then the financial crisis happened, they couldn't refinance, all the prices collapsed, and this stock went from \$50 to \$4. It dropped by more than 90% in seven weeks.

When I looked at the company, it's again, like the refineries. They had all these different mines and assets all over the world. Some of them were the lowest cost mines you could imagine and the banks did not want to

take over this company. The banks don't want to be in the shipping business. The banks were probably going to do what I would call "extend and protect" - they would take some fees and penalties from them, but they would extend their loans. In fact, China came in as an investor in Teck Cominco, and in a few months the stock was up seven times and I sold. We bought at \$4 or \$5, we sold at \$30. And then it kept going - it went to \$50. We didn't capture all of it, but we captured most of it. That was the third criteria, which is the low-risk high uncertainty.

The fourth criteria is what I call bankruptcies, reorganizations, public LBOs, and special situations. How many of you have heard of Sam Zell? Raise your hand if you've heard of Sam Zell. At least one person, the professor. I think you should extend an invitation. You should extend an invitation to Sam to come speak to your class. Sam is called the grave dancer. He dances on the graves of companies that are left for dead. If you get a chance to invest with Sam, generally speaking, it's going to go really well. Warren Buffett, Sam Zell, and the Pritzker's - these are some of the very best people on the U.S. tax code. They know U.S. tax code better than anyone else. Way better than Donald Trump. They really know the tax code. And I don't think Sam Zell has ever sent much of a tax bill to U.S. government because he's just so efficient with the way he runs his tax affairs.

This story is an interesting story, but it goes back about 26 years. In 1990, there was an insurer called Mission Insurance that went bankrupt. When this insurer went bankrupt, they had \$630 million in Net Operating Losses. These net operating losses in the company have a lot of value if you can bring that shell company into a company that has profits because you can shield \$630 million of profits because of that loss. Sam was able to buy that company for around \$30 million because it had nothing other than the losses. He bought the \$630 million of losses for \$30 million about seven or eight years after the bankruptcy. This was in '98 or '99. Then there's another investor, Martin Whitman from Third Avenue, who also bought some of the shares in Mission Insurance. And then the two of them went looking for a profitable business that they could join with these operating losses so that they would suddenly have no taxes on the business.

They found a barge shipping company on the Mississippi River, like Mark Twain on the Mississippi River. They found a barge company which used to send goods up and down the Mississippi and it was profitable so they said, "Okay, we'll buy the barge company, and now the barge company's not going to pay any taxes because we've got these NOLs, and that's how we'll make our money." Then what happened right after they bought the barge company? The barge business went to hell. The rates collapsed and the barge company went bankrupt. Now they had

bankruptcy to the power of bankruptcy. I don't know whether you teach them, Professor, how to calculate bankruptcy to the power of bankruptcy, but it's not good. They have two bankruptcies now instead of one. Instead of having \$630 million in NOLs, they now had \$800 million in NOLs - even higher. Then they went looking for another company that they could buy so they could take both these things and pair it together. They found a company called Danielson Holding that was trading at \$1 a share. And then they found a waste to energy recycler.

This company is a plant where you put garbage in on one end and you get electricity on the other end. It's a German process. There's a bunch of these plants in the U.S. which convert waste materials, garbage, into electricity. The economics of this purchase was that this company had two billion in assets, it had two billion in debt, and they bought it for \$30 million. It was very highly leveraged but it had this energy business, and they thought that they could tie it in. So they tied it in but then they needed some capital, so they started to do a rights issue. That's when I found them. The stock was at \$1. By the time that I was able to invest in them, it was at \$9, so it had already gone up nine times. Then they did two rights issues, they bought another company and in about 13 months I had a double and I sold. If I had kept the position, it was about 40x from that dollar price they had and about 4x from where I had bought. As you can see we have all these companies that are in these weird places. They're not great businesses but they do really well.

The final and fifth model I want to talk about is upside without downside. I also call this playing the bubble. In the late '90s, the dot-com boom was on in a big way, and everyone thought it's going to be transformational, it's going to change everything. Companies like Pets.com, etc., had huge valuations. Even Amazon was a huge valuation, Yahoo - all these companies. I had spent some time in technology. I knew that the internet was important but I could not tell which company would make it, which company would not make it. I was definitely not interested in buying anything which was even trading at 10 times earnings. I like to buy things at three times earnings, or even better, like Fiat, one times earnings. I was uninterested in buying these businesses, but there was a bank in Silicon Valley called Silicon Valley Bank, a really good bank. It was a normal bank except that they had one thing. In the Silicon Valley what happens is that if you are a landscaper or a gardener for Google, they'll give you stock options. If you are a chef for Google, you'll get stock options. If you are a waiter in a restaurant, they'll give you stock options. Stock options is like breathing in Silicon Valley.

This company, Silicon Valley Bank, besides getting all their loan terms whenever they made loans to all these dot-com companies, they always got warrants. The companies didn't care. They gave them warrants.

Every time they would do some loan or some deal, they would get these warrants from these dot-coms, and they never disclosed how many warrants they had, what warrants they had, what the strike prices were. There was no disclosure. They only said that "We just get warrants." There was an unknown element to what these warrants were worth, but the bank itself was trading at a very low valuation, just slightly above book value. It was a very well run bank, even now it's in existence, has done well over the years. So I said, "Okay, this is the way to play the bubble." Buy Silicon Valley Bank and if those warrants turn out to be useless or worthless, we don't lose any money. We still have the bank. And if they turn out to be something, then we have a huge, huge run. We made about two and a half times our money in two and a half years on the stock. If I had held it a little bit more, another year, I would have made five times the money because then they disclosed the warrants just as the '99, 2000 bubble was peaking, and then they started selling those warrants. They monetized them which worked great.

The other company, which was the first company in my portfolio that went up 100x, was a company called CMGI. They were an incubator of internet businesses. I bought them just slightly above book value because at that time people didn't fully understand what that the business was doing. They just kept taking stakes in dozens and dozens of internet companies, and then they had a whole basket of them. Then the markets fell in love with these kinds of companies so they took it to the stratosphere. Our \$100,000 became \$10 million. I sold almost nearly at the top.

This is something that comes into play when you have bubbled. It's probably not the most elegant way to make money, but sometimes you can get these upside without downside situations. Those are the five models. We have the huge tailwinds with the idiots who can run the company and the company does well. The second is a huge tailwind, but you cannot have idiots, you need smart people running it like Amazon and GEICO. The third is markets getting confused between risk and uncertainty. We talked about Ipsco and Tesoro, Frontline, and Teck Cominco on that. The next one was the grave dancer, Sam Zell. Bankruptcy, reorganizations, public LBOs, busted LBOs, special situations. Those can all work out quite well as well. Then you finally have the upside without downside which has happened only once to me. They have the most mega bubble that I had in 22 years in the late '90s with the dot-coms. Most of you were still, I think, maybe not even in kindergarten, but maybe just in kindergarten. With that, we can talk about what you want to talk about.

Professor: Thank you very much. I feel excited to quit my professor job and to go into investing. Many 100-baggers in Chinese market I truly

believe. I just don't have time. Okay, now I open the floor to the students to ask questions. This is a very valuable opportunity. So if you have a question, just press the button, push, for the speaker in front of you. If the light goes bright then you are on, all right?

Woman: Okay, can you hear me?

Mohnish: Yeah, sure.

Woman: Yeah, first of all, thank you very much for your insightful speech. The question I want to ask here is that, what do you think is the core competence of Wayne Weser? And how do Wayne Weser actually differentiate from the huge Wayne Weser group? Thank you.

Mohnish: That's a great question. The number one skill set that an investor needs to have is extreme patience. If I look at a company like Bluedart, which was the FedEx of India, I held the company for six years and it didn't do anything for six years and I sold it. It had its run in the next 15 years, and there was no good reason to sell it. So the number one skill set is patience. If you are the kind of person who loves to watch paint dry, then this is the business for you. If you are a hyperactive person who's already looking for action, this is not the business for you. In many ways, the investment business is a strange business. It's a business that is best for people who are what I would call, gentlemen or gentlewomen of leisure. People that have some other activity which is their primary focus and investing is a secondary focus so that they don't have a compelling reason to act.

Usually, investors hurt themselves every time they trade. Charlie Munger says "You don't make money when you buy a stock and you don't make money when you sell a stock. You make money by waiting." What some of the things I talked about today show us is the huge advantages that that you learn about a business once you own it.

If you do analysis of a business before you own it, you may know something about it, but you're really going to know more about it after you own it. That's when you have an opportunity to perhaps understand which ones have truly multi-bagger possibilities and other ones that you should not touch and just let them play out for a long period. Patience is very important and that's what separates people. One of the things about stock markets is that they are deceptive. If you look at the market or the board which shows all the stock prices, you see them changing all the time. All the lights are changing and flashing. All the signals are telling you to be active. It gives you all the signals to do something, and what you have to actually do is ignore all that. One of the rules I follow, for example, is I do not submit any orders when the markets are open.

Anytime I'm trying to buy or sell something, I usually send it after midnight to my broker to execute the next day because there are no price changes taking place. There's nothing taking place; everything is calm. Then during the time when the markets are open, it's very rare that I will trade. I avoid that. You can setup some tricks to help you because everything is designed to make you be active. Your broker does not make any money if you don't buy and sell stocks. If you just buy one company and keep it forever, then no one will earn any money. It's good for you, it's not good for them. All the signals are the wrong signals. Patience is the number one thing.

Man: So my question is, among the five categories that you mention, what's your proportion like? In your portfolio, how much do you put in these five categories and what are the reasons for the same?

Mohnish: Charlie Munger says that each of us has a very limited quota of stocks that may have the potential to make us rich. There are very few times that we're going to end up with things in our portfolio that have truly got the potential to make us very rich. And usually, it is not apparent before you make the investment. Usually, it will become apparent maybe after you own the business for some time. It takes some time. I can think of many examples when I invested in the business. I thought "I'll get a double and move on", but then I start to learn more about the business. It's the wrong way to think about it by saying I want to put 10% in number one or 20% in number two or whatever. This is an opportunistic business. You need to be very flexible. Like I said, the number one skill set is patience. This means that there could be a long time before anything shows up, or it could be that five of them show up in one week.

For example, during the financial crisis in December 2008 and January, February 2009, there were so many ideas coming at me that I had literally had less than one or two days to process each one. Normally, I will have weeks, even months to process an idea. It's not a good idea to do this top-down. I have never done it top-down. You need to be a bargain hunter. You go into a bazaar and you're just looking for what looks exciting or cheap. And I'll give you the example of the difference between Ben Graham and Charlie Munger.

Ben Graham will go into a supermarket and he'll look for what is the most heavily discounted item, deeply on sale, and then he'll buy that and come out. Charlie Munger will go into a supermarket and look for the things that he loves, and then he keeps going back every day until what he loves has dropped in price, and that's when he buys it. The Munger approach, in my opinion, is more superior to the Graham approach, but

the Munger approach requires patience and it requires you to understand what you truly like. Then you wait for the right opportunity. It is a very good exercise to make a list of assets that you truly think are remarkable assets. Also make a list of at what prices those assets will be interesting or exciting for you. When you have that list then you just sit back and wait for the world to come to you. As opposed to taking my list and trying to go top-down.

The second thing about top down that doesn't work is it's very unpredictable when these things are available and when they're not available, and what is within your circle of confidence and what is not. Like the professor said, there are 100-baggers in every market. Definitely, in China, you've got a huge number of 100-baggers at any given time. The problem is most of us do not have the ability to see it because we either don't have the circle of confidence or we don't have enough knowledge of what the business is. This is a business where you want to be a student, you want to learn. You want to keep educating yourself and every once in a while, there'll be a business that'll show up in your portfolio. Right now I can think of at least three or four companies in my portfolio that could end up being huge home runs. I cannot tell you which one. I don't know which one, but I'm willing to be patient and let them play out. Even if one of them is a 10X, it's worth letting that play out because they're so rare. That's how I would suggest going about it.

Man 2: Thanks for a great talk, Mr. Pabrai. You spoke about the cyclical nature of the shipping industry. So when freight rates are high, ship owners essentially order a lot of ships and once they arrive, freight rates go down. Do you think that ship owners are going to learn from their mistakes, or is this going to be a problem that we keep on seeing in that industry?

Mohnish: The ship owners will never learn. The property developers will never learn. Humans with our genetic makeup aren't going to change in 5 years or 10 years or 50 years. We vacillate between fear and greed. As long as there are humans driving action in industries like shipping, you're going to see that vacillation. There's a really, really good book, a work of fiction. It's called, "A Shipping Man". I forget the name of the author, but if you Google it you can find it. The guy was an investment banker in the shipping business who wrote "The Shipping Man". It's a really funny book because it talks about the Greeks, it talks about the Norwegians, it talks about all this cast of characters, including the Americans in this business. It's funny as hell and it really teaches you the business while entertaining you.

Frontline, one of the companies I invested in, is run by a guy named,

John Fredrickson, a Norwegian guy. There is a character in the book who I think is a clone of Fredrickson, which is why I found the book kind of funny. I haven't looked at the shipping business in a lot of detail lately, but it's a challenged business right now. That means there's probably opportunity in that business. But I would also say to tread carefully.

Man 3: My question is. Out of the five strategies you mention require deep research in the business model, and to how much extent you rely on the open data source to the public? And do you have any unique or special channels for information to help you to make the decision?

Mohnish: All my data sources are open because I am a very lazy investor. I never meet management. I never talk to management. I never travel to see any plans or anything. I've never done that for any investments and the results still work out. We are not looking for superior information. What we're looking for is superior analytics on commonly known information. For example, I mention the boom and bust of the shipping industry, and the gentleman asked me, "Is that going to change?" Number one, it's never going to change because we have humans involved, and humans are housed on the emotions. And secondly we have market participants. We have two advantages against market participants. One is we have analytics which can help us because we have some understandings that maybe markets are missing. And the second is that we have patience. So, most investors don't have multiyear horizons.

I want to buy a stock at 10 and two weeks later I want to sell it at 12. Then I want to buy something else at 12 and sell it at 15, and I want to keep doing that. Well, good luck. If that worked, they'd be Warren Buffett, because the compounding rate would blow Buffett's compounding rate. Clearly, we still have Warren Buffett in place so therefore that approach doesn't work. If you have the patience and if you have the interest to really dig deep, then what you're going to find is if it's commonly held information or known information, you may come up with insights that others have not. This is what Charlie Munger talks about the latticework of mental models. You look at things through a different lens to try to see what can be different. I would say that when my friend, Guy Spier, uses the mental model saying that if Moody's are the great business in the U.S. what other businesses are like that in the other parts of the world? That's a great model because you may be able to find a business in another part of the world where people have not realized what a great business they have.

That's why these things get to where they are. For example, all my life, or at least all my investing life, I hated the automobile industry because it's a high cap-X, it's unionized. You've also got consumer taste and you've got a lot of things which are not good about the business. I spent

about six weeks studying the business and I actually realized that many of my underlying assumptions were wrong. The reason the auto company had problems were for different reasons than what people think why they have problems. I did not have access to any data that is not publicly known, but I synthesized it from many different sources to come up with some insights, and those insights were helpful. If you are a curious person, and if you are a person who's very deeply interested in business and how business works and understanding different business or industries, then you can do quite well.

Man 4: Right, okay. I have a question that's related. So can you tell us a little bit about your lifestyle? How much time you spend on thinking about investment every day? Because the size of your asset and your management very easily place you into one of the top 10 active stock funds from China. And I know many of those fund managers they're life is under pressure and very busy and a lot of overwork. It's not a good lifestyle for those fund managers who are managing a similar size of what you manage. So how is the lifestyle different?

Mohnish: I should not advertise this, but it's the best lifestyle you could possibly have. I maybe have three or four ideas in a year. Sometimes we don't have any in a year and sometimes we have many more than that, so it varies. If you follow the Buffett-Munger model, which I do, your life is going to be fantastic. Here's what happens in the Buffett-Munger model. Number one, I have no staff. There are no analysts, there are no associates. If you send me your resume I'll be excited to read it, but I can't help you with a job because there are no job openings because we've never had a job opening. One part of the Buffett model is that you do not delegate your investment research. Warren Buffett even today when he buys IBM or whatever he buys, he does all the work himself. He doesn't have anyone under him doing any of the work. There's no one building spreadsheets for him or anything like that. And that's the same thing at Pabrai Funds.

I have a few part time admin assistants who are great. They help run all the back office things. But even then we don't have much going on. In a typical month, I don't get any phone calls or any emails from my investors. And I have about 400 families who have invested with me. These families basically got selected because I have some very strange rules with how I operate. For example, before people invest, I don't meet them and I don't do phone calls with them. The only people who can invest are people who willing to do reading of their own. We can give them access to our website, they can read various things. If it makes sense to them, they can invest. That doesn't work for most people, but for the people it works for, since they invested the money without talking to me, they're really not looking to have a lot of conversations

even after that. And what I tell my investors is that we have a couple of annual meetings every year where they can come and they can ask any questions they want. They come from all over the world. I have investors from everywhere, and they show up at the annual meetings. In effect, we are open for business two days a year and it's a lot of fun to meet them and talk to them.

If you don't have any staff you don't have any HR problems, and you have any issues. And what is the reason that Buffett and Munger don't have analysts? The reason they don't have analysts is that the investment business is a very strange business. You need your brain at unpredictable times and the rest of the time you don't need your brain. If I hired a super smart analyst, someone in the audience here because I think each person here is exceptional, that person would want to do something constructive with their lives. They would either look to me to tell them what to research or if I don't give them any direction I'll say, "Listen, just go look and tell me when you find some great stock." Let's say I just tell them that. "Listen, you work on your own and just figure out when you have a great stock idea and bring it to me." Let's say I did that, for example.

Well, what would happen is because we have different circles of confidence, 95% of the time whatever they will come up with I would say "no" to because 95% of the time what I come up with I say "no" to myself. Since I would have liked this person when I hired them, I would feel really bad about saying no all the time because it would just be unpleasant. And so, eventually, I would give up and say, "Okay, I'll buy the stock that you want even though I'm not sure about it." And then you've just destroyed the model. What you have to do if you bring in people is you have to give them your own pools of capital, so they have full autonomy to do whatever they want and they don't come and ask you what to do. That's what Warren Buffett has done with Ted Weschler and Todd Combs. He'd just give them each \$9 billion. They do whatever they want; they don't talk to him. That works. When I look at investment operations like you mentioned a bunch of operations in China, I look for violations of the model.

Moses came up with the 10 Commandments. We have commandments in investing as well. They come from the guy with the bust behind me and they come from Warren Buffett and they come from Ben Graham. They have rewritten the commandments and so one should follow those commandments. When I look at an investment operation, the first question I ask is, "How many violations are there?" And the first place I look for violations is in team size. I can almost guarantee that the investment managers you are talking about who seem to be stressed out are not operating with a team size of one. Do they have more than one

person on the team?

Man 4: Much more than one. The whole team.

Mohnish: Like how many? Five, 10?

Man 4: Different firms have different structures. The employer analyst, they also have assistants, and all sort of things.

Mohnish: All that is hocus-pocus. There's no need for any of that. The bottom line is, what is a model? The model is buy things at half off. And you have 5,000 stocks in the U.S. and you have several thousand outside the U.S. in China, wherever. And we are bargain hunters. Why do you need a team to find bargains? You don't. And we didn't talk about it in this talk, but the simplest way to find bargains is to be a cloner. I am what you would call a shameless cloner. I meet Li Lu who's 100X smarter than me, I say, "Li Lu, can we meet for lunch?" And every once in a while I'll ask him, "Li Lu, what do you own?" And in a moment of weakness he'll tell me what he owns, and then I just go buy it and I'm done. I don't even need to pay Li Lu; it's great. And probably a better analyst than anyone I would hire. In the U.S. we also have 13F filings where every quarter people have to file what they own.

Just figure out who the smart people are, look at what they're buying, and reverse engineer them. You don't need an analyst, it's actually fun. Many times by the time I get to the office half the trading day is over. In California the stock market opens at 6:30 in the morning. At 6:30 in the morning, I can assure you I am drooling on my pillow. I am fast asleep. If I'm not going to sleep 'til 2:00 in the morning, I'm not getting up at 6:30. Tomorrow morning, I will wake up around 9:00 a.m. I may wake up at 9:30 a.m. There's no alarm, I'll wake up whenever I wake up. And there's no meetings because there's no staff. And there's nothing on the calendar because that's what Warren Buffett told me. "Keep your calendar empty." And I have no idea what I'm going to do tomorrow, no idea, but I know it'll be an exciting day because I have so many books to read. I've at least 30 books on my desk that I want to get to so I'll pick some book if that's of interest. If some company shows up, I'll read about the company. If I want to watch a movie with my wife, we'll do that.

The key to life is find CRISIL. That's the Moody's of India, and then just go to sleep for 20 years. That's it. The purpose of this talk is for me to understand that to become even less active is to not even wake up at 9:30 in the morning, but to wake up at 2:00 in the afternoon. Who cares? Because we found CRISIL and then the guys at CRISIL will make all the money for us, so we don't need to do anything. Warren Buffett says that it is not a good idea to get married for money. Usually, if you marry

someone because they're rich that's a bad thing. Usually, it doesn't work out very well. It's a terrible idea to marry for money if you're already rich - that's terrible. The fund managers you're talking about - I would guess that they are very wealthy. Are they wealthy? Are they rich?

Man 4: A bit. Especially for the younger generation...young managers. When they get promoted, go up hierarchy and they become pretty good.

Mohnish: For the young managers it's very simple. If you believe in the power of compounding, then a small amount of money on the side can get you to independence relatively quickly. The key is that you spend less than you earn, you put something away, and then that little something can become more and more, and eventually what you want to do is you want to be your own boss. Forget trying to chase the corporate dream, forget all of that. One should only be in this business if you love this business. In my opinion, the way to love this business are with some rules. Number one, no staff. Number two, no trading during office hours. Number three, don't even go to work when the market is open. Just be a gentleman of leisure or a gentlewoman of leisure, and that's it. I was very lucky that I never worked in the investment business. I didn't even understand the investment business, I stumbled upon it.

And because I never worked anywhere, the only models I had were Warren and Charlie. I just looked at how did Warren run his partnership? I set up the partnership the same way. How do they run their life? " If you look at Warren Buffett's calendar, it's completely empty. So let's keep it empty and let's do things that are fun. The reason I'm doing this talk is because it's fun. Number one, it's fun, it has to be fun. Number two, I want to get better at the multi-baggers, so I'm using you guys to pound into my brain to be even more patient. To be patient for 20 years. I never have the stock except that one stock by accident for 20 years. I want to hold something for 20 years and get 100X on it. I want to do that. It might show up when I'm 60, and we'll hold it 'til we're 80 and I hope that happens.

Man 3: I have another question on your opinion, on the differences between a value investor and a strategic investor. And we noticed that many Chinese companies took equity of overseas companies to help them go into China, like the China Fusan [SP] took equity of Climate, [SP] the very big tourist and hotel group and help Chinese customers have access to those hotels. And China ... acquire many good fuel companies in Hollywood. Of course, they would make a lot of money in China, in China's film industry. Often, or typically, we assume that a better investor is an outsider of the business. They don't want to do anything to help the business, so what's your opinion on being a better investor or being a strategic investor that you think you will get information on the

action of the strategic investor and go behind with them, follow their equity taking?

Mohnish: That's a really good question and a question I've never thought about before, so it's a good question to ask because at least I can think about it and I'll mumble some answer right now. But maybe I'll think about it some more and next year I might have a better answer. Buffett says that I'm a better investor because I'm a businessman, and I'm a better businessman because I'm an investor. There's clearly an interplay and advantage on those. One of the things that happens with entrepreneurs or CEOs who are running specific businesses is they have two things going on. One is usually their circle of competence is limited to that business. If they are in the hotel business, they understand the hotel business. If they're in the shipping business, they understand the shipping business. And that confidence can be an advantage because if they understand the movie business in China, they probably have a better shot at understanding the movie business in the U.S. than a person who is not in the business at all. The domain knowledge is a huge advantage.

The disadvantage normally that strategic investors have is they may not understand, or they may not have a good understanding, of value investing. For example, a lot of companies buy back their own stock. If you're in the hotel business it means you understand the hotel business which should mean that you should understand when it is undervalued and when it is overvalued. Most company CEOs are not really good at understanding when their businesses are under and over-valued. One of the reasons they don't understand that is because if you are going to be a great leader, you have to be an optimist and you have to be a builder. You always see the grass is green on the other side. Value investors are always skeptical. They are always looking for what is wrong. One of the reasons I sold all these companies much sooner than I should have is because I'm always skeptical of what might go wrong, for example.

They are different skill sets. If you have some data which tells you that the CEO of the film company in China is a good capital allocator, then that can be a huge tailwind. The thing you have to evaluate is if they are a good capital allocator then they're rare. For example, obviously Warren Buffett is really good at buying companies, John Malone is really good at buying companies, Sam Zell is really good at buying companies. But lots of the Japanese came into the U.S. markets in the 1980s and they bought all kinds of real estate, trophy real estate all over the country, and they grossly overpaid for it because they looked at their experience in Japan where these properties are much more valuable because they were in a bubble. They misunderstood what proper valuations were and they didn't do well. Even though they understand real estate in their own country.

It's a good idea to follow the strategic investors into other markets if you can figure out whether or not they are value guys, if they understand value. For example, the deal for Starwood. I forget the name of the Chinese company or the insurance company that was chasing Starwood. Starwood is a very prime asset. It's a great asset, but I don't know enough to know whether that would or would not have been a good deal for them. They were clearly paying up significantly more than what the market had priced that company. You'd have to have an understanding of how those people think and whether they think correctly.

Professor: Any other questions? Okay, all right, well it's almost two hours. We'll leave 20 minutes for internal discussion to absorb what you said today. It's a great lecture, we have it recorded. Myself will have to listen to it again. It's really motivating, make me think about a change of career.

Mohnish: And I enjoyed it very much as well and I look forward to seeing you guys in person next year. So even if you're not in the class, maybe you can ask the professor to let you in.

Professor: Yeah, everybody's welcome from this class when you come next year. They will still be here, most of them. They're not graduating. And also, we have a recording of this lecture we'll send to you and all you tell us the editor that you're using so we can ask him or her to edit this lecture according to my instruction. So I'll put it on the YouTube or China's version.