

FAIRHOLME CAPITAL MANAGEMENT, L.L.C.

Fairholme Capital Management Public Conference Call

Bruce Berkowitz

Moderator: Fred Fraenkel

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EDITED FOR CLARITY AND ACCURACY

Operator: Good morning. My name is Julie and I will be your conference operator today. At this time, I'd like to welcome everyone to the Fairholme Capital Management Public Conference Call.

Bruce Berkowitz, the firm's founder and Chief Investment Officer, will be answering questions submitted in advance by callers. Moderating the call today is Fred Fraenkel, Fairholme's President and Chief Research Officer.

All lines may be muted to prevent background noise from compromising sound quality. After the call, a transcript will be made available on our site at: www.fairholmefunds.com

Fred Fraenkel: Good morning. It's Fred Fraenkel. Let me start by saying that we're very pleased by the number of questions we received and how thoughtful they are. Bruce, we're looking forward to your responses.

Bruce Berkowitz: Thanks, Fred. And I'd like to say good morning to everyone. Good morning to our shareholders and to all others listening to the call.

Before we begin, I'd like to have a quick review of the Fairholme Funds (the "Funds") and our strategies. We continue to do what we promised: focus on best ideas, invest in companies whose security prices are below what we believe to be underlying values. Today, fund positions have large gaps between price and value, maybe as large as at any time that I've seen. And the two will eventually meet.

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Day-to-day market prices can tell you as much, if not more, about market buyers and sellers than about underlying values. Over my career, it is clear that an understanding of psychology has been as important as a degree in accounting.

On any given day, price is a perception of long-term value – at times, right...sometimes, very wrong. And this is when Fairholme buys, when we believe securities are priced far below their values with a large margin of safety.

However, there is no free lunch. Buying hated companies requires patience and courage of conviction based on independent thought and verification, and based on trying to kill our most cherished ideas. And we will look wrong until markets believe we are right.

We are confident answering if we will be right; however, given the human condition, we are much less comfortable answering when the crowd will agree with us. But we do believe patience pays.

Fred, we've got an awful lot to cover today and not a lot of time so let's move right to the questions.

Fred Fraenkel: OK, Bruce. Before we get into the company specifics, let's start out with a few general questions. People wanted to know: are your personal investments still in Fairholme? They also want to know: are Fairholme employees adding to or subtracting from their investments in the Funds?

Bruce Berkowitz: Yes, I'm still invested 100% in Fairholme and Fairholme ideas, and employees are adding every year.

Fred Fraenkel: Some investors want to know if you're ever going to hedge positions as the market gets more expensive.

Bruce Berkowitz: We do not short. It's just not in our DNA to hedge equity positions. We sell securities when prices are within a fair value range or if we need to reduce concentrations due to performance. Our hedge is basically the knowledge that we have about the securities and the cash we maintain.

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Fred Fraenkel: Well, more than one shareholder also asked: what have you learned from living through big inflows and big outflows. Do you believe that the current shareholders are more long-term focused?

Bruce Berkowitz: We've stayed the course under pressure. However, sadly, not all shareholders have had the courage required at bottoms. We hope our current shareholders share the same long-term focus we do. Most have been battle tested, and they recognize that staying with the fund for five years or more makes for better performance. We know it's not easy to stay the course – to ignore the crowd – when we look wrong. But why should it be easy? By definition, it should not be, or everyone would do it. This is the price our shareholders pay for long-term success.

Fred Fraenkel: The next question is about our investment process. Is Fairholme a one-man shop, or are others involved in the investment process?

Bruce Berkowitz: Well, I am the sole asset allocator. We do have a skilled research team of six analysts who support me with a parallel research process, verifying my work. I'm challenged by them, and I'm also challenged by many outside professionals. We are also growing [individuals] internally and, I may add, developing succession plans. But I'm planning to be around for quite a bit of time, at least the next 20 years.

Fred Fraenkel: Many investors understand that your belief in the fundamental analysis system of Graham and Dodd is central and they want to know: why does Mr. Market disagree with your values of long-held holdings like St. Joe, Sears, and Bank of America?

Bruce Berkowitz: Fairholme buys fallen angels. That's what we do. We buy securities that are priced to fail when thousands of hours of research and history tell us underlying values should be greater and there's little chance of financial death. But, as I said, we can't know. We just do not know when others will agree with our analysis. Patience and courage are needed, and Ben Graham was right when he said that, in the short term, Mr. Market represents a voting machine, and in the long term he represents a weighing machine. We avoid predicting and, instead, put our efforts into valuing. We believe that in the long term, our estimates of values will be realized. And we have proven over many years that our estimates have turned out to be relatively good over the course of the period of our investments.

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Fred Fraenkel: More than one shareholder, Bruce, has asked us about risk. How do you define risk, and do you do anything to dampen volatility?

Bruce Berkowitz: Fred, I define risk as the chance of permanent capital loss adjusted for inflation. Volatility, I believe to be just price changes based on market perceptions of risk. Risk does not equal volatility. And to think the two are the same, it just fails at the extremes. But I understand that volatility is used as a short cut for analyzing risk.

We seek volatility. We need volatility to prosper. We need false perceptions. We need fact and perceptions to be 180 degrees opposite. This creates a margin of safety because, eventually, the two measures meet: perception and reality. Prices rise to value, a gain. Value declines to the price, no loss. Price and value converge. Timing is always uncertain. Buying cheap, half-off, relative to value, is the number one determinant of success.

Fred Fraenkel: People have also focused on performance and they've raised the fact that The Fairholme Fund ("FAIRX") has lagged – even though that's been the short term. They want to know: why shouldn't they just buy the S&P Index?

Bruce Berkowitz: Well, Fred, it's my belief that a dollar buys much more in the Fairholme Funds than in an S&P 500 Index. When you look through to the companies in our portfolio and in the Index – their net assets, their profit potential, capital employed – our history has been to buy more value than the S&P. And that is why, over the long term, since inception, we have done better than the S&P. We believe that we can still produce such results.

And after periods of underperformance, when investors have questioned our sanity, our outperformance has reasserted itself. We have tried to show all possible five-year periods to prove this point.

Fred Fraenkel: The last valuation question was from someone who was focused on the fact that the S&P's price-to-book value ratio's up about 30% over the last five years, and yet the FAIRX price-to-book value is down slightly. Why do you think this is?

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Bruce Berkowitz: I was asked a similar question when I once visited the U.S. Treasury: why did we find, at the time, AIG so interesting when no one else did, while its price was so far below book value and declining? The only answers I could give at the time were: ignorance, investor fear of compounding a past mistake, and fatigue.

And I, frankly, don't have a better answer at this juncture. We constantly measure price-to-book value and we continue to believe a hugely discounted book value shows great potential.

Fred Fraenkel: Well, thinking about that anecdote on AIG, let's move to questions about companies and let's start with AIG. A number of investors have asked about our concentration in AIG, and there's a corollary question. Don't we have any other better ideas to invest in?

Bruce Berkowitz: We have an extremely focused position in AIG. And one reason is that the company has doubled in price. But AIG still sells at an enormous discount to book value. We must be patient in trying to achieve expected profits and underlying values. We monitor the company's progress constantly and if we're satisfied with that progress, we will hold. It just makes no sense to sell a company [priced] dramatically below what we consider to be a runoff value.

Fred Fraenkel: Also on AIG: could the Hank Greenberg litigation against the government end up costing AIG billions of dollars?

Bruce Berkowitz: We've turned to our attorneys on the matter and done our work. AIG cannot be responsible for willful misconduct or gross negligence of the government. If the government loses the case, then the court has determined that the government's actions constituted a taking. A violation of the United States Constitution by an agency of the United States Government – that certainly strikes me as willful misconduct. This issue does not keep me up at night.

Fred Fraenkel: OK. Moving on to AIG fundamentals: do you think that AIG can do better before interest rates rise?

Bruce Berkowitz: Yes. AIG and Bank of America can do much better before interest rates rise. They still have significant efficiency gains. Their expense ratio should

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dramatically decline with diminishing legacy issues. But they will need increasing interest rates to reach their full profit potential.

Fred Fraenkel: Finishing up on AIG, one investor wants to know if we've ever seen other examples of a large-cap stock selling so far below tangible book value five years into a bull market.

Bruce Berkowitz: Well, when you read the history books, there are quite a few, especially after the Great Depression. And then you see that these companies outperform for many years, and that's what we expect with our financials that have suffered through the Great Recession.

Fred Fraenkel: Thanks. Let's move on to Fannie and Freddie. Most of the questions were actually submitted on Fannie and Freddie. Shareholders really want to understand these companies. Can you explain why these companies are important?

Bruce Berkowitz: There's a lot to cover. The companies are essential. They have no substitutes. And they haven't cost taxpayers a penny. When it comes to funding our nation's housing market, Fannie and Freddie are mission critical. They buy loans that banks and other lenders originate so those banks and lenders have the funds to issue new loans, enabling more people across the country to buy, refinance, or rent a home.

Put simply, if you own a home, Fannie and Freddie have helped you. If you have a mortgage, Fannie and Freddie have helped you. If you rent a home, Fannie and Freddie have helped you.

Since 2009, Fannie and Freddie have provided seven trillion dollars – yes, trillion with a capital “T” – in liquidity to support America's mortgage market. This financing has enabled seven million families to buy a home, 21 million mortgage refis, and 4.5 million families to rent.

Fannie and Freddie ensure the 30-year fixed rate mortgage, the most affordable mortgage in the world, with predictable monthly payment and protection from interest rate swings. Fannie and Freddie help people buy or rent a home, or refinance an existing mortgage *even* during the toughest of economic times.

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For decades, these two companies [have] stepped up during the financial downturns, [and] they ensure stability, accessibility, and affordability in our housing market. It is this crucial, counter-cyclical role that makes the companies indispensable. Look no further than the recent books by our last two Treasury secretaries, Hank Paulson and Tim Geithner, to understand how these companies support our national economy in times of crisis.

To paraphrase them: if you want to stimulate the national economy in tough times, start with the housing sector. It's roughly 23% of GDP. There's nobody better to prime that pump than Fannie Mae and Freddie Mac.

Fred Fraenkel: Please discuss their current financial condition, as well.

Bruce Berkowitz: Since 2011, we've been telling our shareholders that the companies are incredibly valuable. They have enormous value in runoff, and significantly more value as ongoing businesses. The companies should earn around \$21 billion a year for the foreseeable future, more if they are no longer held captive in conservatorship.

The U.S. Treasury has recouped \$36 billion more than it disbursed to Fannie and Freddie during the crisis – three times more than it made from all other financial programs combined.

Fred Fraenkel: So what's the problem? Why are the companies priced for failure?

Bruce Berkowitz: This is, I think, where an analogy would be very helpful for all shareholders to understand. So, Fred, imagine you're a farmer growing food for decades. The economy has its ups and downs, but you've managed to keep the farm going. As time progressed, you expanded your farm business, started planting new crops. You're asked to try new crops.

Before long, after some time, a drought comes. You may not have enough money to withstand the drought, especially if [there is] unusual weather that lasts for years and years. So, luckily, a wealthy neighbor offers to invest in your farm to ensure your recovery. He negotiates a tough deal: you agree to pay the neighbor 10% interest on his investment each year, and you must give him 80% ownership in your farm for free. I suppose that drastic times call for drastic measures, and you accept the offer.

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A few years go by. All of a sudden water is again plentiful, the farm is recovering with hearty crops. With hindsight, you did not need the neighbor's investment. Predictions of death and destruction were overblown. No matter, you're a man of your word; a deal's a deal. You keep to it.

Eventually, your neighbor visits. He notices that your harvests are now bountiful, and anticipated profits are enormous. And just then, at the very point when you've come back, and it's crystal clear, the neighbor now says that he's changing the terms of the deal. Instead of paying him 10% interest each year, he now demands that you pay him 100% interest, all your net profits, in perpetuity.

That's right. Every dime you make on that farm will now land in his pocket without any chance for you to repay. It seems farfetched, but this is precisely what has happened to Fannie Mae and Freddie Mac at the hands of the U.S. Treasury.

Some call it expropriation. Others call it a de facto nationalization. Either way, it's illegal and it's unfathomable. This is America. We're not in Venezuela, it's not the Soviet Union.

Fred Fraenkel: On that point, could you give our shareholders an update on the ongoing litigation?

Bruce Berkowitz: Well, Fred, we've had our ups and downs, but we are making considerable progress in the Court of Federal Claims. The judge will decline the Justice Department's motion to stay the case despite the government's purposeful delays. Discovery is ongoing. Our lawyers have reviewed 400,000 pages of documents.

The depositions will soon begin. We'd like to be able to share more information with our owners regarding the case, and our owners do deserve to know all the facts. But the government has convinced the court that all of the materials produced in discovery could quote, unquote, "roil the national economy," and therefore, must be shielded by a protective order.

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While our lawyers get to review this information, we, as the plaintiff, and our shareholders, do not see anything. This raises an obvious question: what is the government hiding? If their actions were lawful, then they should show all to support their case.

In fact, the judge has expressed skepticism about the government's defense that the U.S. Treasury did not directly affect and control FHFA (the Federal Housing Finance Agency) as conservator of Fannie and Freddie, that they did not illegally change the terms of the deal by imposing a so-called "net worth sweep."

But when I attended court a few months back, the judge remarked, "What I have heard so far tends to suggest that FHFA is – I don't want to say joined at the hip with Treasury – but it doesn't sound like it's necessarily an independent entity that has no connection to the government." Well, your Honor, that is exactly right.

In the D.C. Circuit Court we filed a notice of appeal. Judge Royce Lamberth dismissed our suit against FHFA and the U.S. Department of Treasury. He opined that he lacked the authority to even review the government's action. We believe this is a fundamentally flawed interpretation of the statute. After all, why would Congress write a 260-page law specifying and limiting the conservator's powers if no court has the jurisdiction to enforce it? The judge is either wrong in his interpretation of the law, or the law is unconstitutional.

Ultimately, we believe [that] where there's no remedy, there's no law. And the highest court in the land seems to agree with us. Recent comments by several Supreme Court justices in *Mach Mining v. EEOC*, challenged the government's similar attempt to evade judicial scrutiny in a separate case. The government's claim: your Honor, we think this is a matter that is entrusted to the agency that is not for court review.

This was met with skepticism. Chief Justice Roberts noted, "I am very troubled by the idea that the government can do something, and we can't even look at whether they've complied with the law." Justice Scalia echoed those concerns: he found it "extraordinary" that the government wanted to be exempted from litigation. Justice Breyer weighed in, too: "In my mind, of course, there should be judicial review." So we do have reason to be optimistic as these cases proceed.

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Fred Fraenkel: Well, Bruce, can you discuss who's involved on behalf of the government?

Bruce Berkowitz: It's a long list. In our recent annual letter for The Fairholme Fund, we included examples from one Treasury privilege log that was recently produced. Now, a privilege log spells out documents that the Treasury is unwilling to share even under a protective order. It states the authors, the recipients, the topic, the date, and the reason [they assert] privilege for each communication.

And we expect thousands of such communications to be listed. The common theme of what we have seen among almost all of the cast of characters is their connection to the United States Treasury Department. Senior employees at Treasury who were directly involved [include]: Tim Geithner, the Secretary of the Treasury; Neal Wolin, the Deputy Secretary; Mary Miller, the Under Secretary; Tim Bowler, the Deputy Assistant Secretary; Michael Stegman, the Counselor to the Secretary; and others. All discussing and designing the illegal net worth sweep.

Then there's Ed DeMarco, the FHFA conservator who signed the Third Amendment in August of 2012. He previously served at the Treasury and ran the Office of Financial Institutions Policy. His responsibilities at Treasury included Fannie Mae and Freddie Mac.

DeMarco's senior adviser at FHFA, Mario Ugoletti, was a long-serving Treasury employee who had also run the Office of Financial Institutions Policy [and whose responsibilities] included Fannie Mae and Freddie Mac. Ugoletti noted in his court affidavit that he had primary responsibility at FHFA for negotiating and administering the [Preferred Stock Purchase] Agreement, the very agreement that he had helped draft when he worked at Treasury before he departed for FHFA. Can he really be considered independent? Can you really consider negotiating with your former employees and colleagues about documents you helped draft to be independent or arm's length? If that is not a serious conflict of interest, I don't know what is.

And we have Gene Sperling, one of the principal architects of the Third Amendment. He served as Counselor to Treasury Secretary Tim Geithner until he moved over to the

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White House as Director of the National Economic Council. From that perch, Sperling was able to push the unlawful policy amendment through with the help of Brian Deese, now the President's Senior Advisor in the West Wing of the White House.

We find it interesting that of all the financial advisory firms in America, Treasury hired Moody's to analyze the GSEs [Government Sponsored Enterprises]. This is the same Moody's that showed poor judgment in the crisis and is currently under investigation by the Department of Justice. [It is] the same Moody's that testified as an "independent expert" to Congress on the financial crisis, Fannie Mae, and Freddie Mac.

Clearly, senior Treasury officials exchanged [numerous] e-mails about the relationship between Treasury and FHFA as conservator. But they ask, and they say, "What relationship?" The government has said in court that there is no relationship. This is going to be very interesting correspondence to review when a little bit of daylight shines on these documents.

According to recent Congressional testimony, Mel Watt, our conservator at FHFA, claims that he's unable to end his *own* conservatorship. In the history of conservatorships, this is a first. Think about it: a federal conservator unable to end his *own* conservatorship – that he administers – without the consent of the Treasury Department. That's his sworn testimony to Congress. And to think that the Treasury has asserted in our court case that it has not directed our conservator's actions. Time and time again, the cover-up is always worse than the crime.

Fred Fraenkel: Everyone's also always talking about the legislative action that needs to be taken on Fannie and Freddie. What about Congress?

Bruce Berkowitz: Well, the Republicans are currently focused on FHFA's failure to allow Fannie and Freddie to rebuild capital. They expect FHFA to promote safety and soundness given its role as regulator, and to protect the taxpayer. They're increasingly concerned that FHFA's actions as directed by Treasury are exposing taxpayers even more, rather than protecting the taxpayers. Meanwhile, Democrats are rightfully concerned about mortgage accessibility and the ability to lower- and middle-income families to afford a home.

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All the while, the administration appears schizophrenic, talking out of both sides of their mouth. HUD [U.S. Department of Housing and Urban Development] Secretary Castro seeks to remove the “stigma” associated with homeownership and is concerned about the difficulties of lower- and middle-income Americans to access mortgage credit. Yet Treasury, across the street from HUD, holds Fannie and Freddie captive in a perpetual conservatorship, creating market uncertainty that makes it harder for Americans to afford a home.

Now the good news. As you may be able to tell, there are many, many individuals involved in this matter. Many third-party consultants. More answers are emerging every day, and we truly believe that the truth will shine. Just last month two individuals who worked on the relevant legislation authored a white paper explaining how the government’s actions were illegal and entirely inconsistent with legislative intent.

I’ve said it before, I’ll say it again: at Fairholme we believe in America, we don’t bet against America. Fannie and Freddie are two of the most valuable companies that we have in America. We own them, we own them at cheap prices, and we look forward to staying invested in them for a very long period of time.

Fred Fraenkel: Thanks, Bruce. And speaking of America, shareholders would like an update on Bank of America and, specifically, what they want to know is: what’s the return on equity that’s necessary to get Bank of America’s stock price moving back towards its book value?

Bruce Berkowitz: From the beginning, I’ve believed that a 10% return on equity that is distributable to owners by dividends or buybacks would very clearly show the power of Bank of America’s franchises. This is a very possible outcome. In fact, Wells Fargo achieves a much greater return at 15% return on equity. And I believe that as Bank of America moves more toward Wells Fargo, we shall see those types of returns.

Fred Fraenkel: St. Joe is next. People want to know: how much of the available cash that’s been generated is going to be necessary to finance the active retirement communities?

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Bruce Berkowitz: Fred, before we go on to Joe, let me just make another point about Bank of America. Everyone's worried about where interest rates are and how the banks are going to perform at current interest rates, and then with rising interest rates. It's quite possible – and it's quite probable – that Bank of America will do well in this interest rate environment.

There is still dramatic improvement to be had in efficiency ratios, especially from the ending of what I would call the Countrywide disaster. Bank of America is able to achieve a reasonable return in the current structure. But higher rates will allow much higher returns on equity, and I think that will be a big boost to the financial sector over a two- to three-year period when we start to see rates increasing. Sorry for that digression.

Fred Fraenkel: Thanks for that. Now to St. Joe. People are just trying to figure out how much of the cash is going to be needed to finance the active retirement community.

Bruce Berkowitz: Well, there is a huge demographic out there of baby boomers retiring over the next 15 years. There is a huge opportunity to serve them, and the necessary investment is being determined as we speak. And it will be based on the highest and best use of land, which surrounds the new international airport in the Gulf of Mexico, in a state with no [income] tax and a very low cost of living.

Fred Fraenkel: That's easy to focus on. What circumstances would occur that would lead to your exit from Joe?

Bruce Berkowitz: There's nothing new here. I've always had and I've stated three objectives: (1) To decimate the fixed expenses at St. Joe, get our fixed expenses toward zero; that mission has been accomplished. (2) To build a fortress balance sheet for any environment; we're done. (3) And within that necessary structure, we now search for a leader to move forward, to create worthwhile returns, to allocate capital. I hope my exit as chairman of the board parallels the start of a new CEO. When exactly that's going to happen, I do not know, but the company is well on the way to achieving my third and final goal for the company.

Fred Fraenkel: Let's move on to Sears. Several investors asked questions that can be summed up, I think, into one question. Is the Sears investment worth the opportunity cost we've all endured?

Bruce Berkowitz: [The] question is asked of me every week, and my answer remains, "Yes." It's given Fairholme shareholders the ability to own much more at cheaper prices in an improving economy. The real estate within Sears is a unique position. It's a once-in-a-lifetime opportunity you cannot re-create. I really don't understand the market's ignorance as to the values within Sears. But, then again, I keep [reminding] myself that, yes, most people once thought that the world was flat.

So the misunderstanding and the misperception [regarding] Sears could last quite a bit of time – it already has lasted quite a bit of time – but there's just so much value that we've calculated, that we are as optimistic on the investment as ever.

Fred Fraenkel: I think a lot of our investors understand that there is a lot of real estate value in Sears, but they ask questions about whether the retail losses will eat up the whole value of the real estate.

Bruce Berkowitz: Well, that involves two parts. One is the loss and then one is the value of the real estate. And the simple answer is "no." Retail losses will not eat up the value at Sears. The retail losses will stop with either success or failure. Of that, we're highly confident and, in fact, the company in the last quarter stated that the trends are turning for the better.

What people need to understand is that there are many valuable assets within Sears, even beyond real estate. For example: Lands' End. A casual observer must ask: "How could it be possible that after the spinoff of Lands' End, the [market capitalization] of that company could have approached the [market capitalization] of all of Sears?" It's just a misunderstanding of the pieces, and there are many, many pieces as we've described in our annual letter.

And we believe that Eddie Lampert is not misguided, he's not a narcissist. Personally, I'm impressed with his behavior. He's taken the time to optimize assets as a majority owner.

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Now, the second part of the question is the losses, and we do believe that the losses will diminish. [They diminish] with the filling in of the pension fund, with the lowering of the dual spend on marketing, and with efficiencies that will come from closing of unprofitable stores and overhead associated with it.

The other side of the equation that we focus on is the biggest value asset, which is the property. We [go] property by property, we've hired professional surveyors, we have our in-house evaluations, we've used sampling and statistical techniques, competitor analysis with Simon, GGP, Macerich, Westfield, talked to national chains [to learn] what their demand is for space at malls, and we've also reviewed commercial transactions, public financings, SEC docs, tax rolls, planning departments, and the history of Sears and the history of the development of malls in the United States.

We've asked ourselves: what would a reasonable mall owner or developer pay for properties of Sears Holdings? And I believe our analysis over the past few years has not proven wrong or too optimistic. And, on purpose, we exclude from our analysis development potential of adjacent acreage, air rights, and other characteristics that can make the property much more valuable than what we have [marked] down.

Fred Fraenkel: One of the most interesting announcements by Sears in the last few quarters is about the possibility of a REIT [Real Estate Investment Trust] that would be made up of some of their real estate portfolio. Can you explain the opportunity of the Sears REIT idea?

Bruce Berkowitz: Fred, I can't explain it because there's been no disclosure yet. But I can only guess until we see a filing. It's my belief that if 10% to 15% of the Sears property portfolio is sold to a REIT, it will give investors a good chance to better understand the value of the properties, the liquidity of the company, other net assets, tax matters, and the extent of development plans that we have found in various cities and towns in the United States.

It will clearly, I believe, remove some of the uncertainty. Sears is a very complex sum of the parts. It may be the largest [commercial retail] real estate portfolio in the United States. We understand it's not easy to get your arms around such [a] sizable [portfolio] –

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[approximately] 200 million square feet, larger than Simon [Property Group]. And while most people think our comparisons with Simon or GGP are far from apples-to-apples comparisons, I believe once people do the work, they'll see it's a lot closer than they think.

Fred Fraenkel: Some investors are still asking us, though: what is our exit strategy and how long it will take?

Bruce Berkowitz: Well, our exit strategy is consistent. It's the same for all of our investments. No difference. We exit when the investment reaches our intrinsic value target. We exit when we can prove to ourselves that we're just plain wrong and we're constantly trying to do that. Or we can exit if we need the capital for better ideas. So with those three criteria, we're constantly rank ordering all of our positions to assess whether or not to hold onto the positions that we have.

Fred Fraenkel: Our last Sears question is from one investor asking whether you're so dug in on Sears that nothing could change your mind.

Bruce Berkowitz: The answer is no, for a few reasons. We are unable to show a negative return on the investment under any scenario. Every real estate expert we've hired cannot disprove our value. And we have a guy running the place who may not be as popular as he once was, but whom we find to have an excellent long-term paper trail. He continues to walk the talk. He's not perfect, but who is? And we are very happy to be invested in Sears for the long term. We are extremely excited about the Sears position.

Fred Fraenkel: We're coming near to the end of our time, but can you spend a few minutes on Leucadia. The questions we received focused on whether there's still significant upside in Leucadia. Isn't most of the effort now focused on Jefferies under the new management?

Bruce Berkowitz: Well, Jefferies did weather the financial crisis without government assistance. And their top executives do have their family net worth in the company, which we like. Like Leucadia, the new team continues to make opportunistic investments, such as with Harbinger and FXCM. We think there are going to be other opportunities. Most importantly, the company is priced below its book value. And I

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continue to believe, [as with] Bank of America, [as with] AIG, [that] it is not unreasonable to expect a normal 10% return.

And we're going to wait and we're going to see them achieve those returns. The only negative I have on Leucadia, of course, is that their valuable assets walk out the door every day in the elevator. So it does have a bit of the expenses of a sports team, which always is of concern. But Jefferies does it better than most. Leucadia, like Fairholme, has had a lumpy but above average return over long periods of time, and that's where we are.

Fred Fraenkel: Bruce, I think we've covered a lot of material and I think that gives us all a lot to digest. We appreciate your candid responses.

Bruce Berkowitz: Yes. Well, I thank you. I thank everybody on the phone. If any of my answers to these questions seem vague to you, or you disagree, or you basically think I'm full of it, then I'd appreciate if you e-mail me.

We do appreciate when people can point out to us when we are wrong and this is what we try to do every day. So please do e-mail, the same way questions were e-mailed [ask@fairholme.net], and we look forward to responding to those questions. Thank you very much for your time. We wish you all a very good day.

Operator: Thank you again for participating. This concludes Fairholme's public conference call.

Past performance is not a guarantee of future results.

The opinions of Mr. Berkowitz expressed herein should not be considered a guarantee of future events or future results, or investment advice. Any references to past performance should not be construed as an indicator of future performance. Any projections, market outlooks or estimates that may be included in this material are forward looking statements and based upon certain assumptions. Other events that were not taken into account may occur, and may significantly affect the returns or performance of the Funds. Any assumptions should not be construed to be indicative of the actual events which will occur.

Each Fund's investment objective, risks, charges and expenses must be considered carefully before investing. The prospectus contains this and other important information about investing in the Funds, and it may be obtained by calling 866-202-2263, or visiting www.fairholmefunds.com. Please read it carefully before investing.

Mutual fund investing involves risk. Principal loss is possible. The Fairholme Fund is non-diversified, which means that The Fairholme Fund invests in a smaller number of securities when compared to more diversified funds. Therefore, The Fairholme Fund is exposed to greater individual stock volatility than a diversified fund. The Fairholme Fund also invests in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods. The Fairholme Fund may also invest in "special situations" to achieve its objectives. These strategies may involve greater risks than other fund strategies.

Portfolio holdings are subject to risk and may change at any time. Any questions you have regarding the latest month-end performance can be obtained by calling shareholder services at 1-866-202-2263.

Fairholme Distributors, LLC (02/15)

Please see the last page of this transcript for important disclaimers and for a list of the Fairholme Fund's top holdings.

MANAGED BY BRUCE BERKOWITZ

Long-term capital growth through a focused portfolio of equity and equity-like securities acquired at prices well below underlying intrinsic values.

Growth of \$10 (Since Inception)⁽²⁾

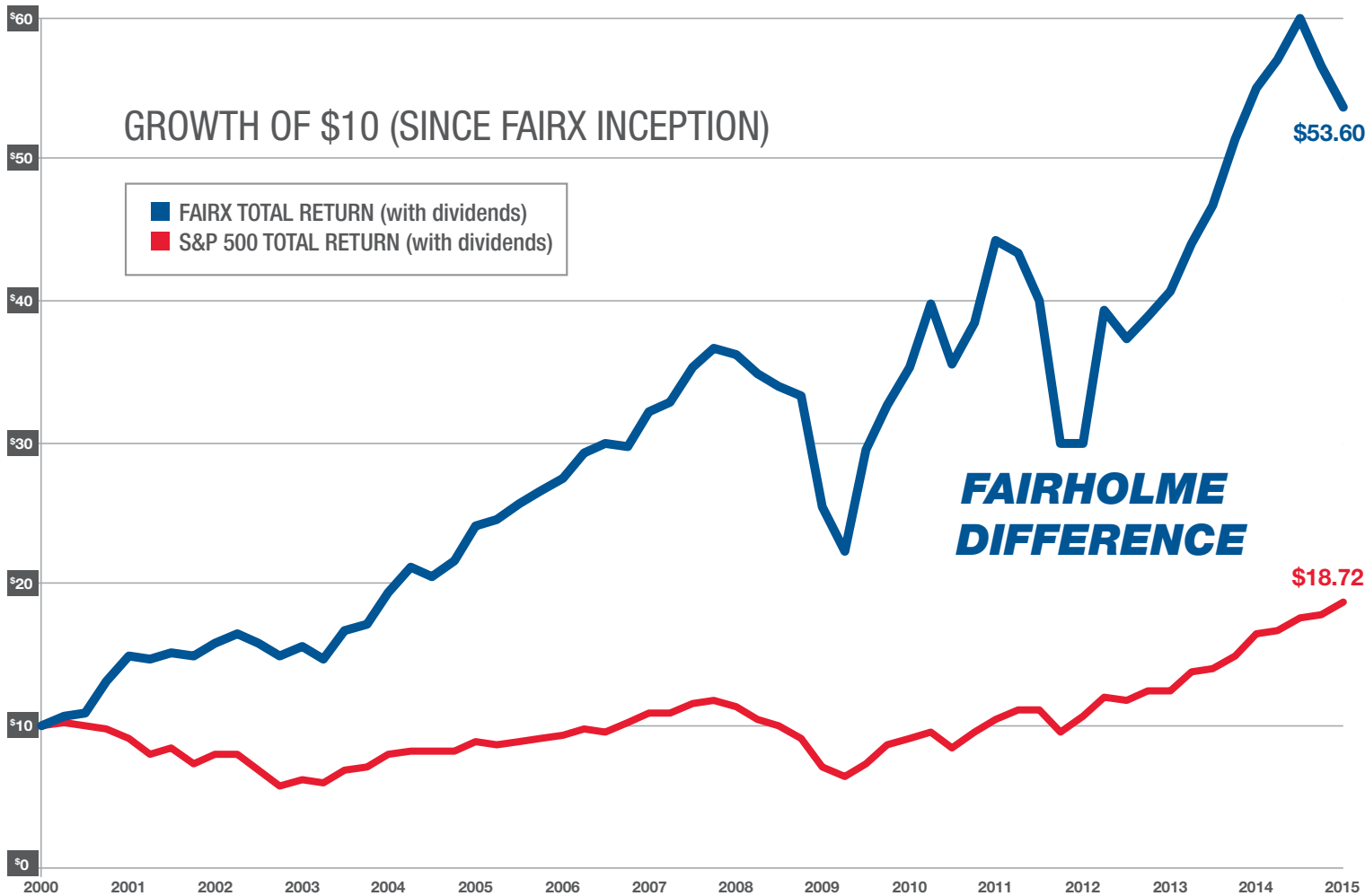
| | |
|-----------------------------------|----------------|
| Net Asset Value | \$35.08 |
| Distribution Value | \$13.22 |
| Reinvestment Value ⁽³⁾ | \$5.30 |
| Total Value | \$53.60 |

60-Month Rolling Returns

| | FAIRX | S&P 500 |
|---|--|--|
| Best | +185.26% <small>(3/2009-2/2014)</small> | +181.57% <small>(3/2009-2/2014)</small> |
| Average | +72.30% | +31.48% |
| Worst | -6.89% <small>(1/2007-12/2011)</small> | -29.05% <small>(3/2004-2/2009)</small> |
| Percentage of Positive Periods ⁽⁴⁾ | 97% | 78% |



Fund Manager of the Decade (1)
Domestic Equity



The chart above covers the period from inception of the Fund (December 29, 1999) to December 31, 2014. Performance information quoted above represents past performance and does not guarantee future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance information quoted above. Performance figures assume reinvestment of dividends and capital gains, but do not reflect a 2.00% redemption fee on shares redeemed within 60 days of purchase. Most recent month-end performance and answers to any questions you may have can be obtained by calling **Shareholder Services at 1.866.202.2263**. The S&P 500 Index is a broad based measurement of changes in the stock market, is used for comparative purposes only, and is not meant to be indicative of the Fund's performance, asset composition or volatility. Given the wide scope of securities held by S&P 500, it should be inherently less volatile. Our results may differ markedly from those of the S&P 500 in either up or down market trends. The performance of the S&P 500 is shown with all dividends reinvested into the index and does not reflect any reduction in performance for the effects of transaction costs or management fees. Investors cannot invest directly in an index. The expense ratio of the Fairholme Fund is 1.02%. The expense ratio includes acquired fund fees and expenses which are incurred indirectly by the Fairholme Fund as a result of investments in securities issued by one or more investment companies, including money market funds.

| CUMULATIVE RETURN | FAIRX | S&P 500 |
|--------------------------|--------------|--------------------|
| 1-Year | -2.72% | +13.69% |
| 3-Year | +79.06% | +74.60% |
| 5-Year | +51.84% | +105.14% |
| 10-Year | +121.32% | +109.47% |
| Since Inception | +435.95% | +87.22% |

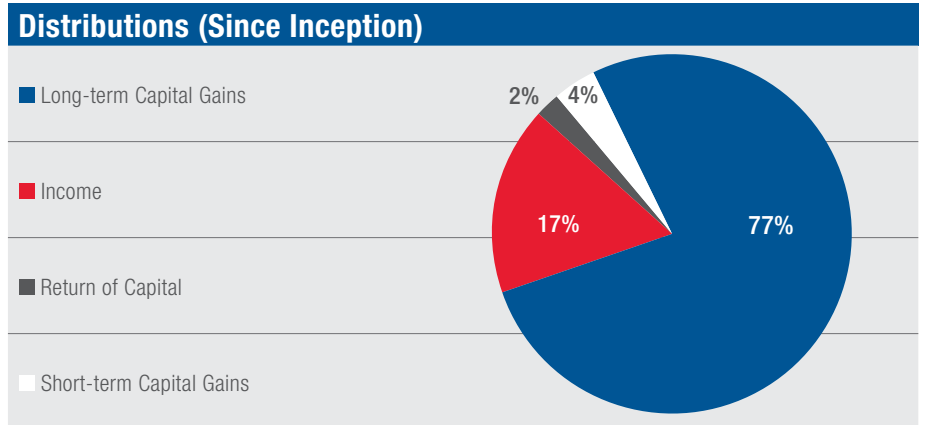
| ANNUAL RETURN | FAIRX | S&P 500 |
|----------------------|--------------|--------------------|
| 1-Year | -2.72% | +13.69% |
| 3-Year | +21.43% | +20.41% |
| 5-Year | +8.71% | +15.45% |
| 10-Year | +8.27% | +7.67% |
| Since Inception | +11.83% | +4.27% |

| Assets | \$ Millions |
|-------------------------------------|-------------|
| Net Assets | \$6,558 |
| Cash and Equivalents ⁽⁵⁾ | \$85 |
| Distributions Paid Since Inception | \$3,050 |
| Employee Ownership | \$200 |

| Time to Cash ⁽⁶⁾ | % FAIRX |
|-----------------------------|---------|
| 4-Days | 25% |
| 11-Days | 50% |
| 22-Days | 75% |

| Top Holdings ⁽⁷⁾ | % FAIRX |
|-------------------------------------|---------|
| AIG | 49.1% |
| Bank of America | 22.3% |
| Sears Holdings | 7.1% |
| St. Joe | 6.5% |
| Fannie Mae | 4.5% |
| Leucadia National | 3.6% |
| Freddie Mac | 3.5% |
| Cash and Equivalents ⁽⁵⁾ | 1.3% |

| Our Philosophy | |
|-----------------|---------------------------------------|
| Focus | Best ideas. |
| Strategy | Multi-cap value. |
| Return | Expect better than the S&P 500 Index. |
| Risk | Market prices may be volatile. |
| Horizon | 5+ Years. |



- (1) The Fund Manager of the Decade award (2000-2009) recognizes fund managers who have achieved superior risk adjusted results over the past 10 years and have an established record of serving shareholders well. Morningstar takes into consideration the fund's performance over the past ten years, including the fund manager's strategy, approach to risk, size of the fund, and stewardship. Award winners are selected based on Morningstar's proprietary research and in-depth evaluation.
- (2) This chart assumes that distributions have been reinvested and does not include the effect of taxes.
- (3) This figure represents the appreciation of the reinvested distributions since inception.
- (4) This figure represents the percentage of 60-month rolling periods with returns greater than 0% since the inception of The Fairholme Fund.
- (5) Cash and Equivalents include investable cash and money market funds.
- (6) The time to cash is calculated by determining the amount of days it would take to raise a given percentage of cash in the Fund based on selling 25% of average daily volume for the preceding three-month period.
- (7) Percentages of FAIRX were calculated aggregating all securities held of a particular issuer.

Investing in the Fairholme Fund involves risk including loss of principal. The Fund is non-diversified, meaning it invests in a small number of securities and therefore is exposed to greater individual issuer volatility than a diversified fund. The Fund may focus on issuers undergoing reorganization or other special situations, which may entail greater risk. Any debt securities held by the Fund are subject to credit risk, and some of them may be rated below investment grade, meaning they have greater credit risk. Debt securities usually fall in value when interest rates rise. The Fund may hold foreign securities, which are subject to potential loss from currency fluctuations, limited liquidity, tax regulation, and social instability. Investments in small- and medium-sized companies by the Fund could be more volatile than securities issued by large companies because smaller companies have limited markets and financial resources. The composition of the Fund's portfolio holdings and sector weighting are subject to change and should not be considered recommendations to buy or sell any securities. Current and future portfolio holdings are subject to risk.

| Contacts | | |
|---|---|---|
| <p>SHAREHOLDER SERVICES Fairholme Funds, Inc. 4400 Computer Drive Westborough, MA 01581-1722</p> | <p>MANAGER Fairholme Capital Management, LLC 4400 Biscayne Boulevard Miami, FL 33137</p> | <p>INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM Deloitte & Touche LLP 1700 Market Street Philadelphia, PA 19103</p> |
| <p>CUSTODIAN The Bank of New York Mellon 1 Wall Street New York, NY 10286</p> | <p>DISTRIBUTOR Fairholme Distributors, LLC 899 Cassatt Road Berwyn, PA 19312</p> | <p>LEGAL Seward & Kissel, LLP 901 K Street NW Washington, DC 20001</p> |

The Fund's investment objectives, risks, charges, and expenses should be considered carefully before investing. The prospectus contains this and other important information about the Fairholme Fund, and it may be obtained by calling Shareholder Services at 1.866.202.2263 or visiting our website www.fairholmefunds.com. Read it carefully before investing.