

# CASE STUDY I

**FAIRHOLME**

*Ignore the crowd.*

This presentation uses Bank of America as a case study to illustrate Fairholme Capital Management's investment strategy for the Fairholme Fund. In this presentation, we show Fairholme Fund shareholders why we "Ignore the crowd" with regard to our portfolio positions that are currently out of favor in the market.

However, nothing in this presentation should be taken as a recommendation to anyone to buy, hold, or sell certain securities or any other investment mentioned herein. Our opinion of a company's prospects should not be considered a guarantee of future events. **Investors are reminded that there can be no assurance that past performance will continue, and that a mutual fund's current and future portfolio holdings always are subject to risk.** As with all mutual funds, investing in the Fairholme Fund involves risk including potential loss of principal. Opinions expressed are those of the author and/or Fairholme Capital Management, L.L.C. and should not be considered a forecast of future events, a guarantee of future results, nor investment advice.

The Fairholme Fund's holdings and sector weightings are subject to change. As of February 29, 2012, Bank of America securities comprised 8.0% of the Fairholme Fund's total net assets. The Fairholme Fund's portfolio holdings are generally disclosed as required by law or regulation on a quarterly basis through reports to shareholders or filings with the SEC within 60 days after quarter end. A complete list of the Fairholme Fund's top ten holdings is available on our website at [www.fairholmefunds.com](http://www.fairholmefunds.com).

The Fairholme Fund is non-diversified, which means that it invests in a smaller number of securities when compared to more diversified funds. Therefore, the Fairholme Fund is exposed to greater individual security volatility than diversified funds. The Fairholme Fund can invest in foreign securities which may 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. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Lower-rated and non-rated securities present greater loss to principal than higher-rated securities.

***The Fairholme 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 may be obtained by calling shareholder services at (866) 202-2263 or by visiting our website at [www.fairholmefunds.com](http://www.fairholmefunds.com). Read it carefully before investing.***

# CURRENT INVESTMENT OPPORTUNITY

*We have identified a public company:*

- ✓ Trades at less than one-third book value\*
- ✓ Core businesses generating 1% return on assets and 10% return on equity\*
- ✓ The company is building a balance sheet that President and CEO, Brian Moynihan, described as “Fortress<sup>1</sup>”.
- ✓ Largest U.S. retail deposit market share and serves one in every two U.S. households
- ✓ Operates in all 50 states and serves clients in over 100 countries
- ✓ Essential to global economic security

*...Sound interesting?*

**...We certainly think so,  
and we are not alone.**



***“Bank of America is a strong, well-led company...I am impressed with the profit-generating abilities of this franchise, and that they are acting aggressively to put their challenges behind them.”***

Warren E. Buffett  
Chairman and CEO, Berkshire Hathaway  
August 25, 2011

# Investment Thesis for Bank of America (BAC)

## *Reasonable Expectations*

**1%** Return on Assets\* = **10%** Return on Owner's Equity\* = **20%** Implied Annual Return on Investment\*



This is a reasonable after-tax profit in current market conditions<sup>1</sup>.

This is a reasonable return even at heightened capital ratios expected this cycle<sup>2</sup>.

This is a reasonable return when you buy stock at less than half book value.

<sup>1</sup>: Historical return on assets of Large Money Center Banks has ranged from 0.75% to 1.5%. The current environment is not ideal, and so a 1% return is patently reasonable.

<sup>2</sup>: Large Money Center Banks are required to maintain capital ratios and balance sheet leverage, which given a 1% return on assets, would equate to approximately a 10% return on owner's equity.

\* See last page for definitions of terms.

# Bank of America: A 200-Year History

*Extensive Reach, Extraordinary Breadth*



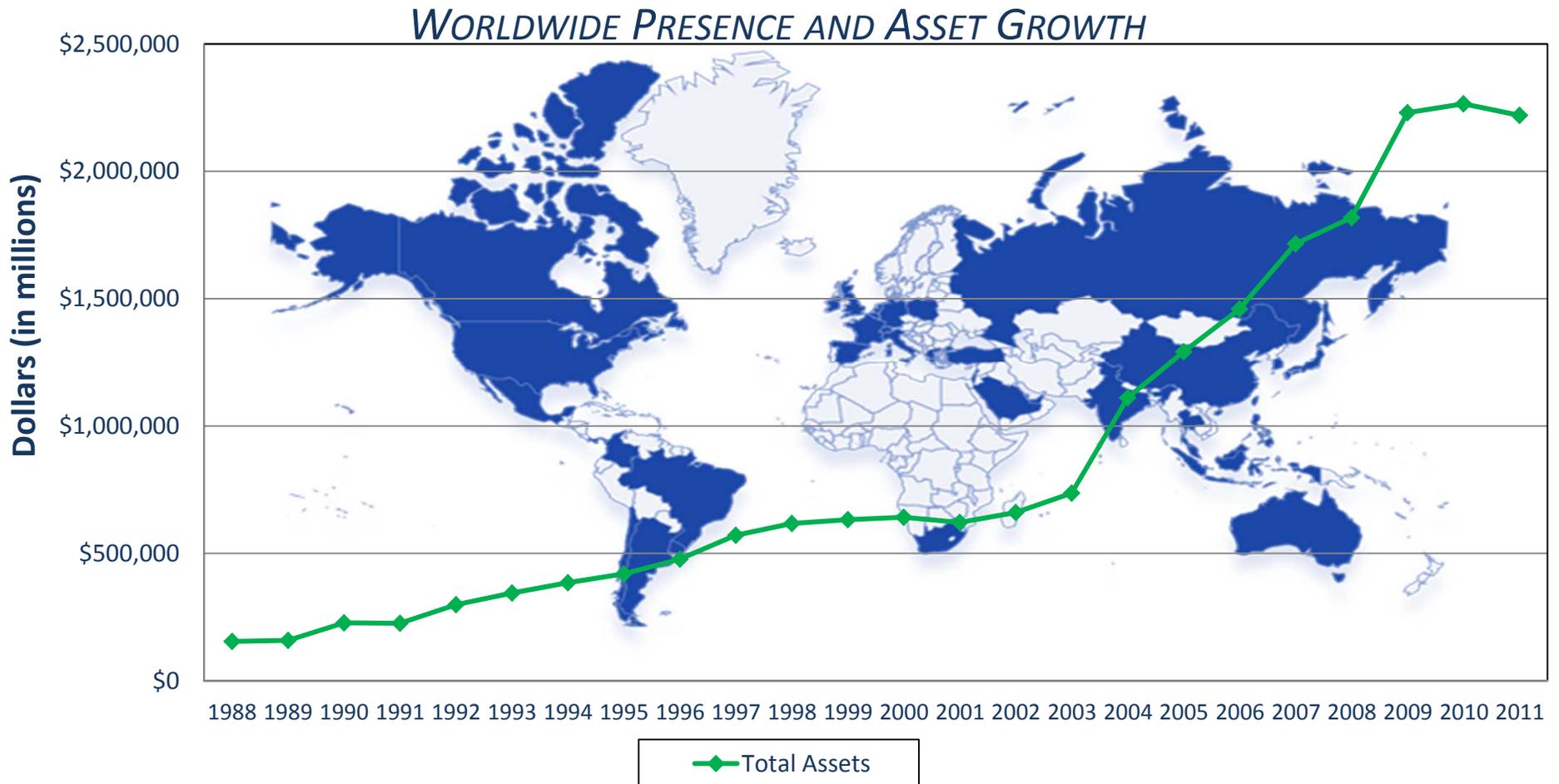
\* Bank of America was created through numerous mergers and acquisitions over the last two centuries, some of which are depicted above.

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# Bank of America's Global Franchise

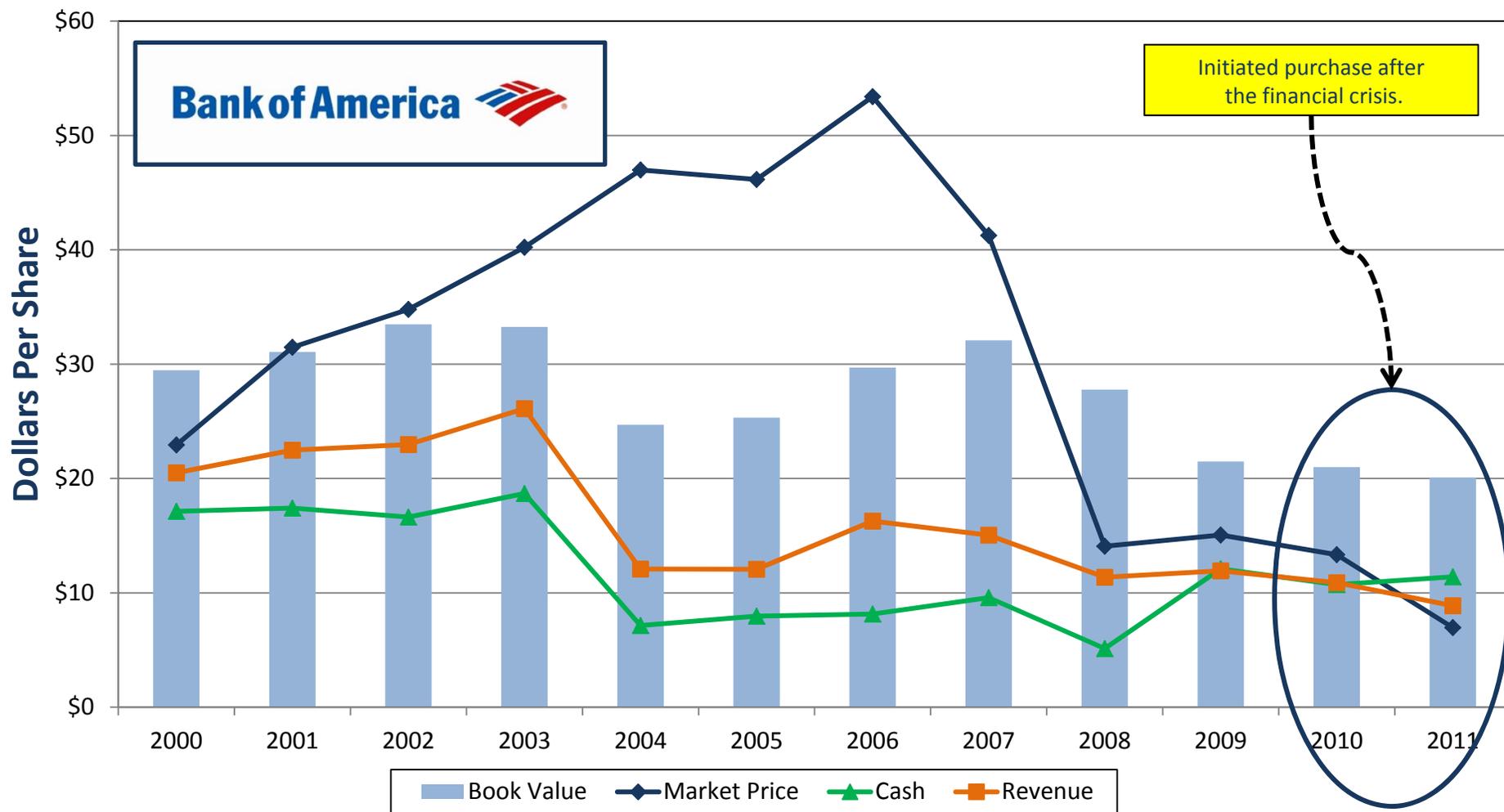
- ✓ 5,702 Branches, 17,817 ATMs, and 58 million consumer and small business relationships
- ✓ 17,300 Financial Advisors serve clients in over 100 countries



\* Bank of America conducts global operations in the blue-shaded geographic areas denoted above.

# Investing in our Circle of Competence\*

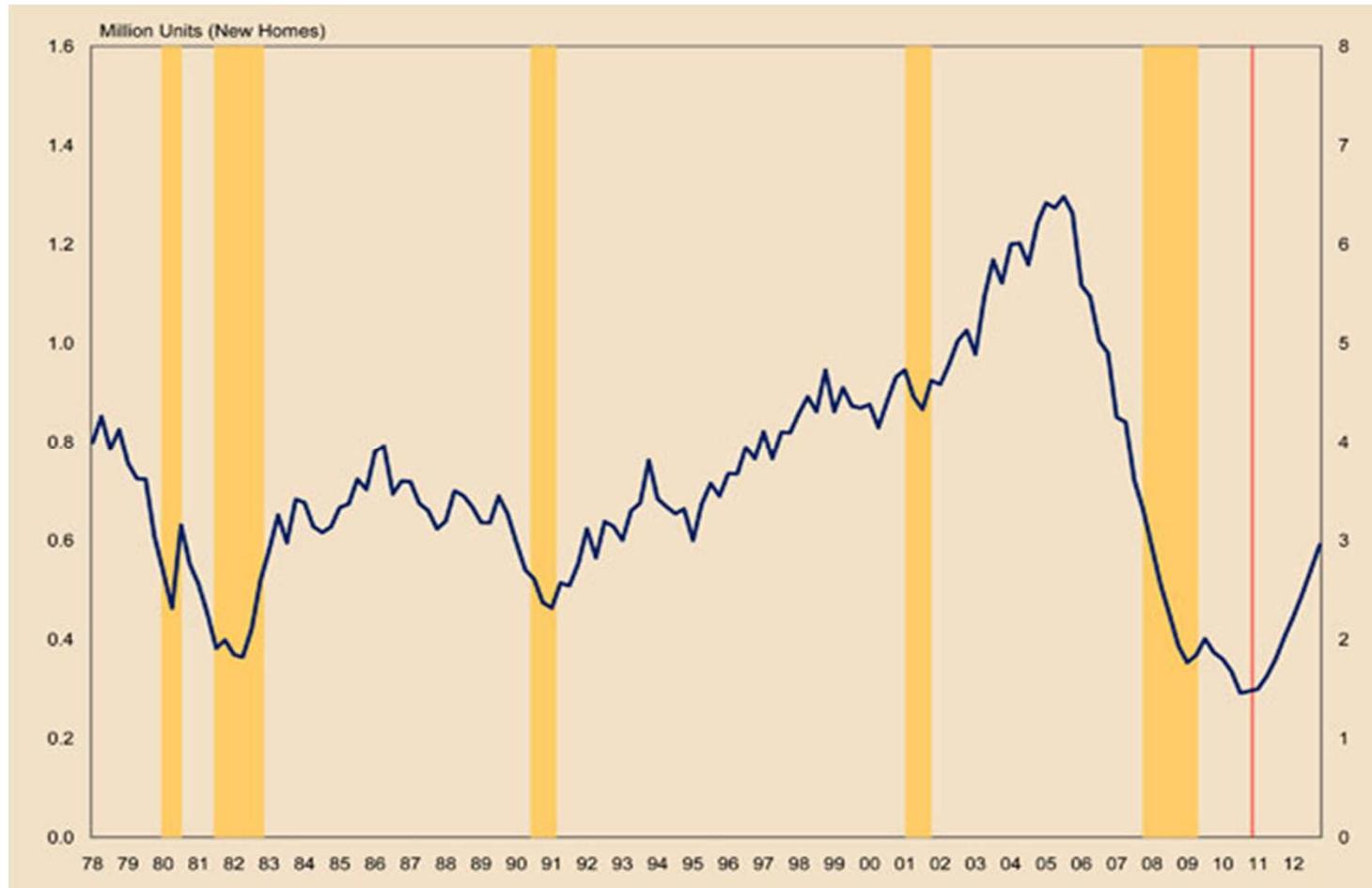
- ✓ Experienced with financial companies
- ✓ Improved fundamentals
- ✓ Favorable earnings power
- ✓ Available at attractive prices



\* Bruce Berkowitz has been investing in financial stocks for over 20 years. See Mr. Berkowitz's interview in Outstanding Investors Digest dated 11/25/1992, which can be found on [www.fairholmfunds.com](http://www.fairholmfunds.com).

# U.S. Housing Market is Stabilizing

*New Single-Family Home Sales Trending Upward*



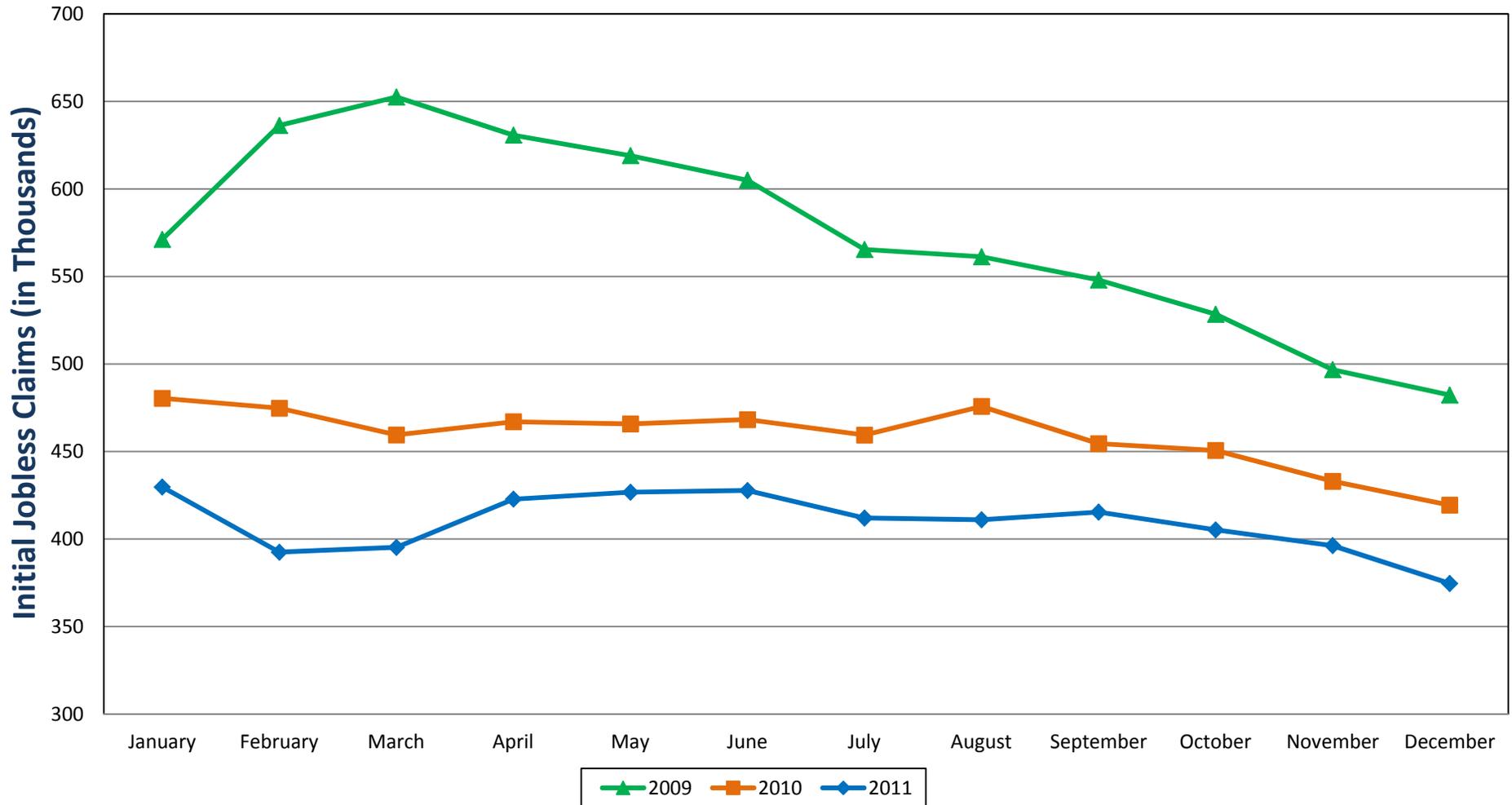
Source: National Association of Home Builders

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# U.S. Job Market is Strengthening

*Initial Jobless Claims Trending Lower*



# Financial Sector Fundamentals Are Improving

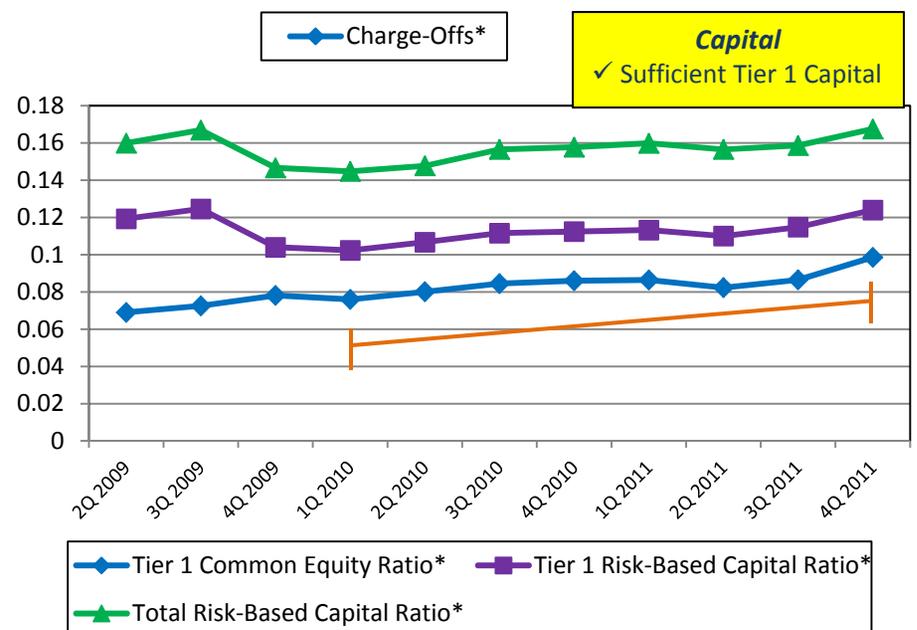
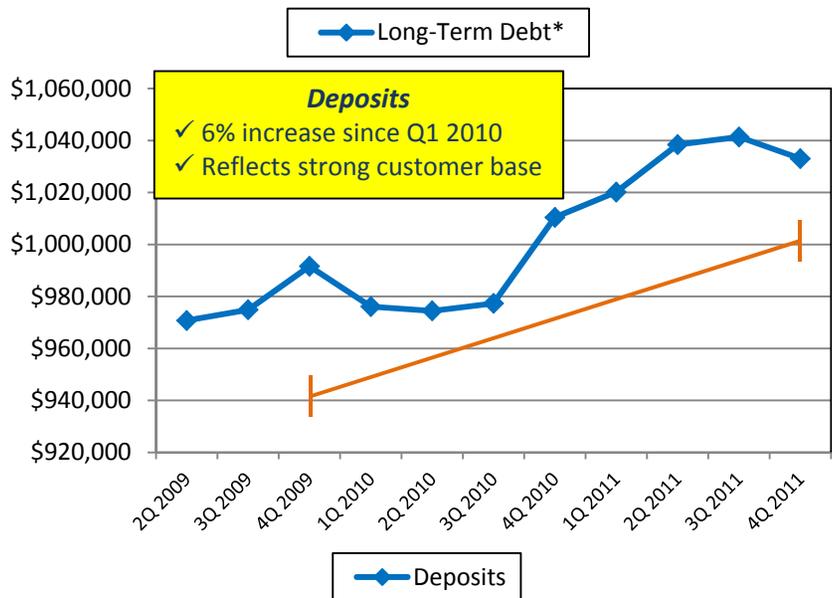
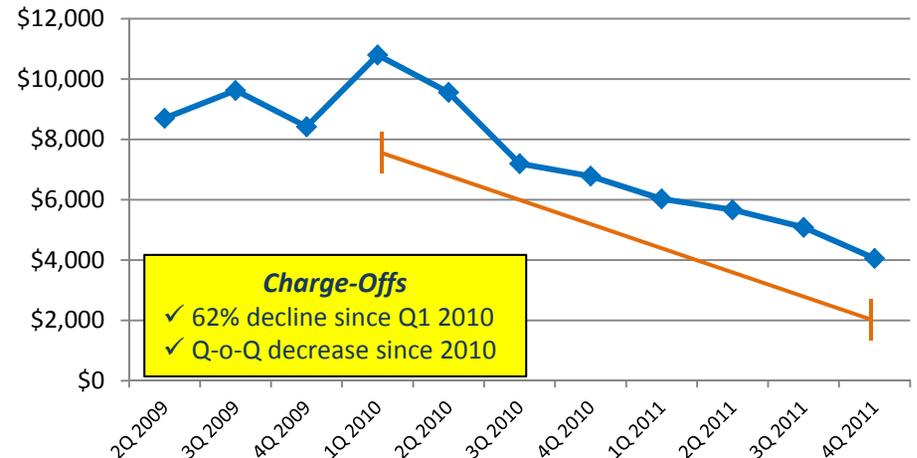
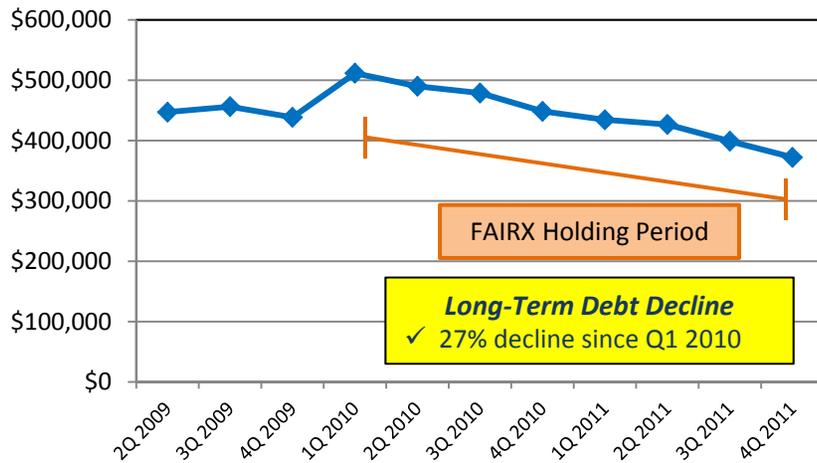
*“You’ve got to admit it’s getting better<sup>1</sup>...”*

## ***FDIC 3Q 2011 QUARTERLY BANKING PROFILE: INSURED INSTITUTION PERFORMANCE***

- ✓ Net income rose to \$35.3 billion as provision expenses fell further
- ✓ Loan-loss provisions declined for an eighth consecutive quarter
- ✓ Reported revenues include accounting gains at large banks
- ✓ Loan-losses posted fifth quarterly decline in a row
- ✓ Non-current loan levels fell for a sixth consecutive quarter
- ✓ Loan-loss reserves declined for sixth quarter in a row
- ✓ Internal capital growth improved
- ✓ Commercial lending activity rose
- ✓ Flow of large denomination deposits into large banks increased

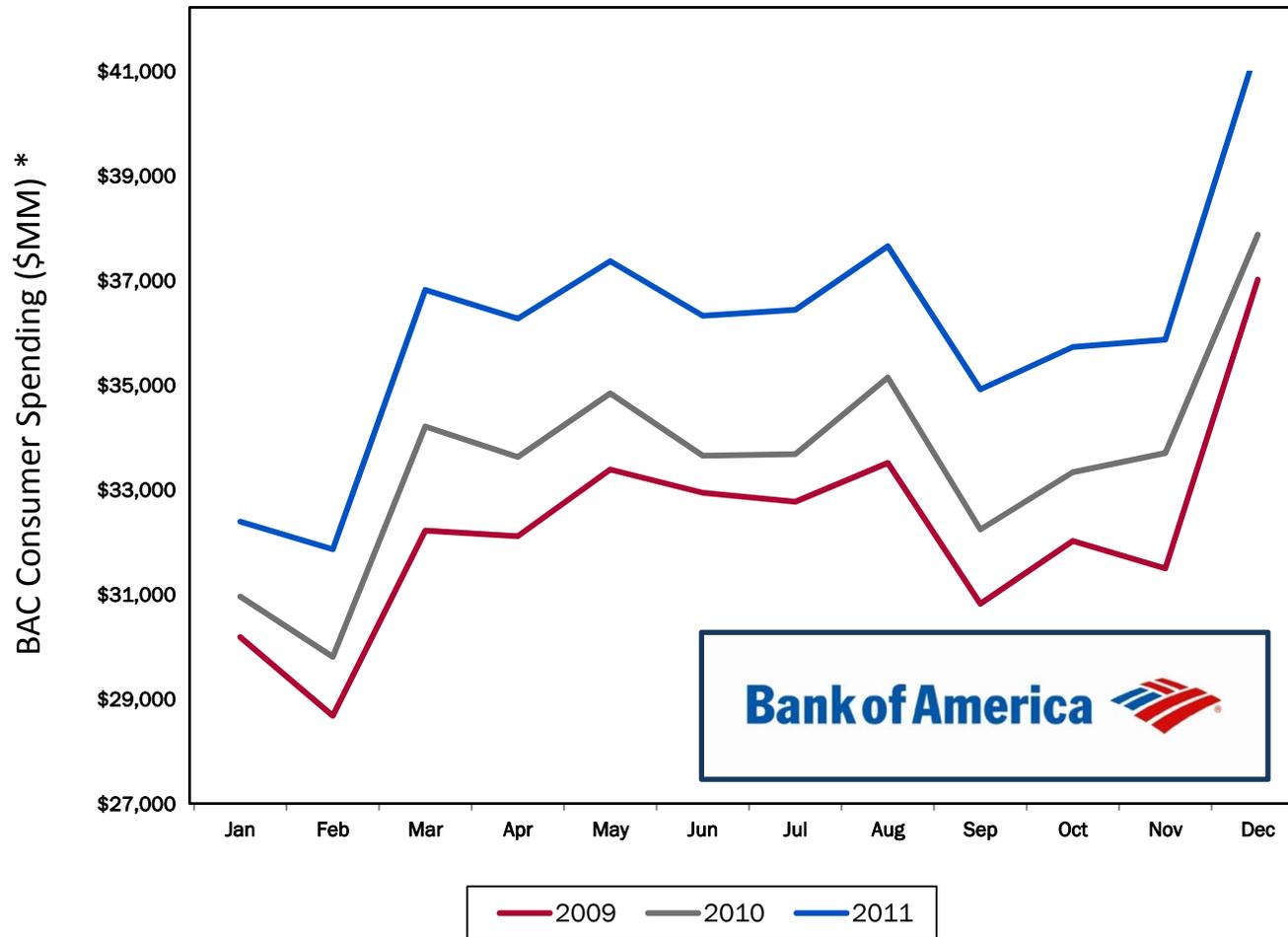
# BAC Fundamentals Are Improving

“...a little better all the time<sup>1</sup>.”



<sup>1</sup>: This is a direct quote from The Beatles 1967 Sgt. Peppers Lonely Hearts Club Band, and is not an implied guarantee.

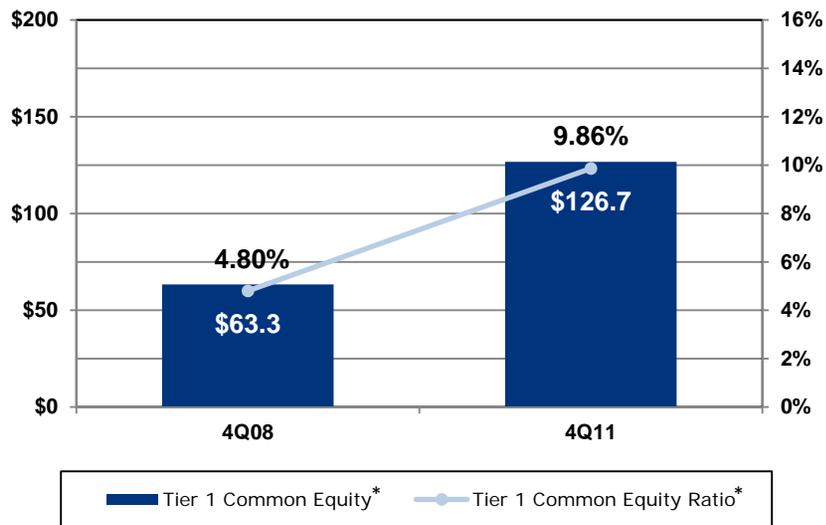
# BAC Consumer Spending Showing Signs of Improvement



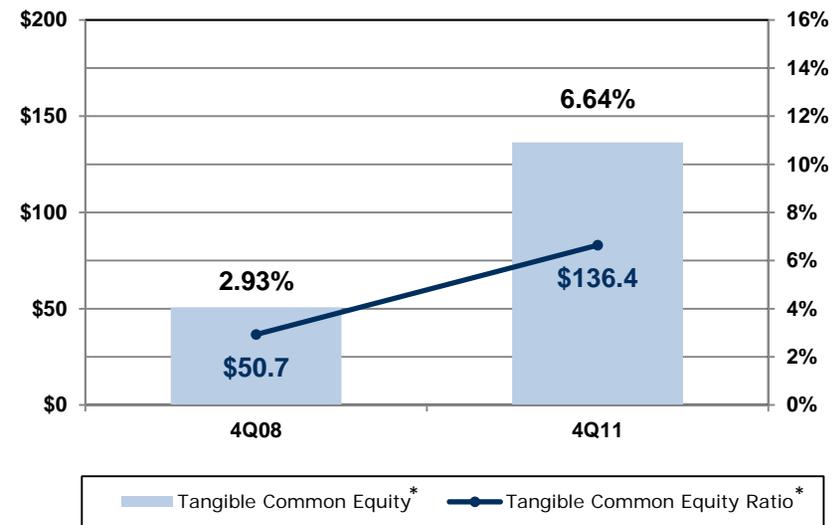
\* Source: Bank of America

# BAC is Prudently Accumulating Capital Well Above Regulatory Minimums

TIER 1 COMMON EQUITY (\$B)



TANGIBLE COMMON EQUITY<sup>1</sup> (\$B)



**“Our capital levels are among the highest they’ve ever been in this institution’s history.”**

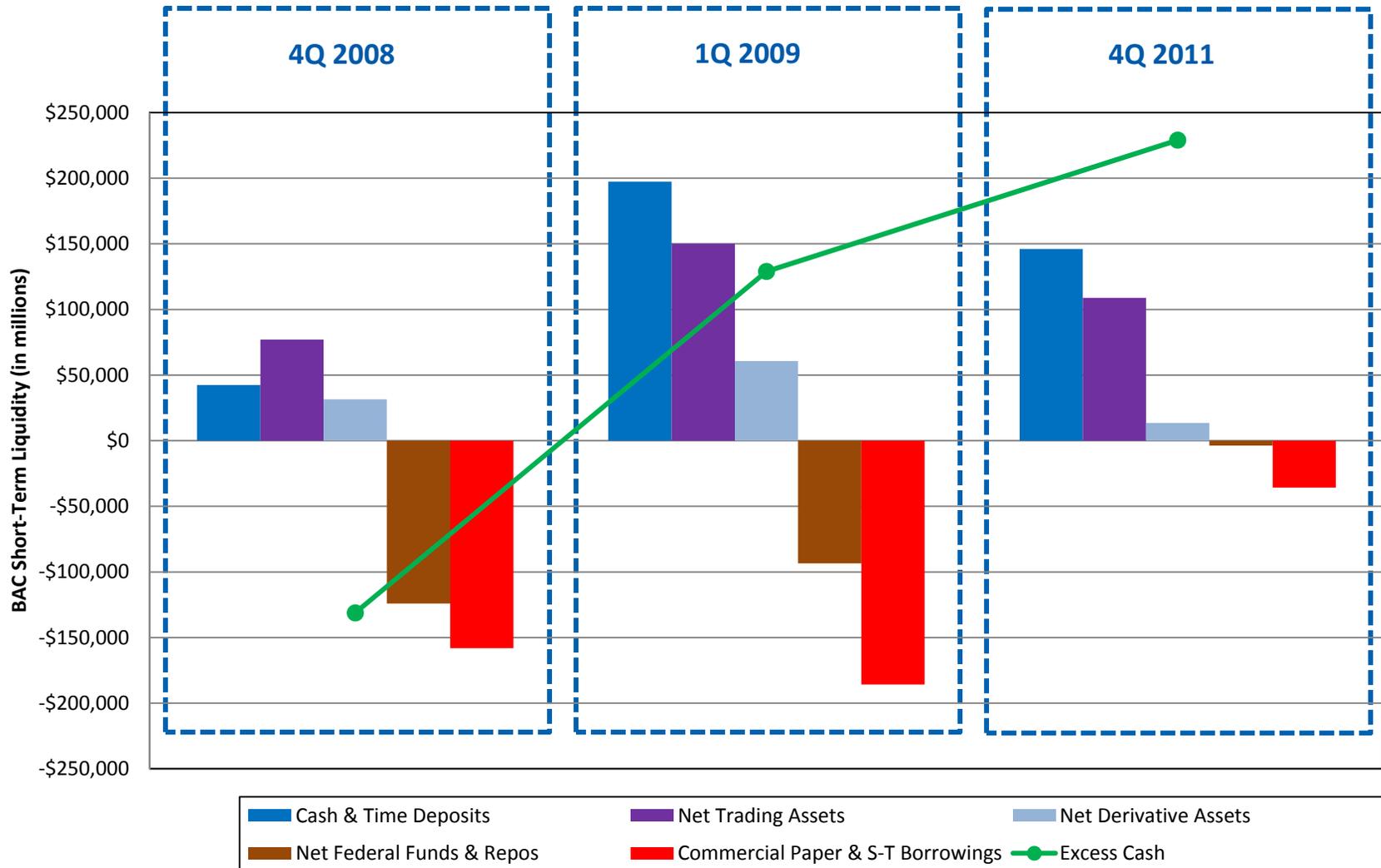
— Brian Moynihan, *President and Chief Executive Officer, BAC, August 10, 2011*

<sup>1</sup>: Represents a non-GAAP financial measure.

\* See last page for definitions of terms.

# “Count the Cash”

*BAC Short-Term Liquidity has dramatically improved since the financial crisis.*



# Trust But Verify

*Our Research has been Enhanced by Unprecedented Regulatory Disclosure*

These logos represent the government agencies examining BAC but in no way signify an endorsement of any kind.



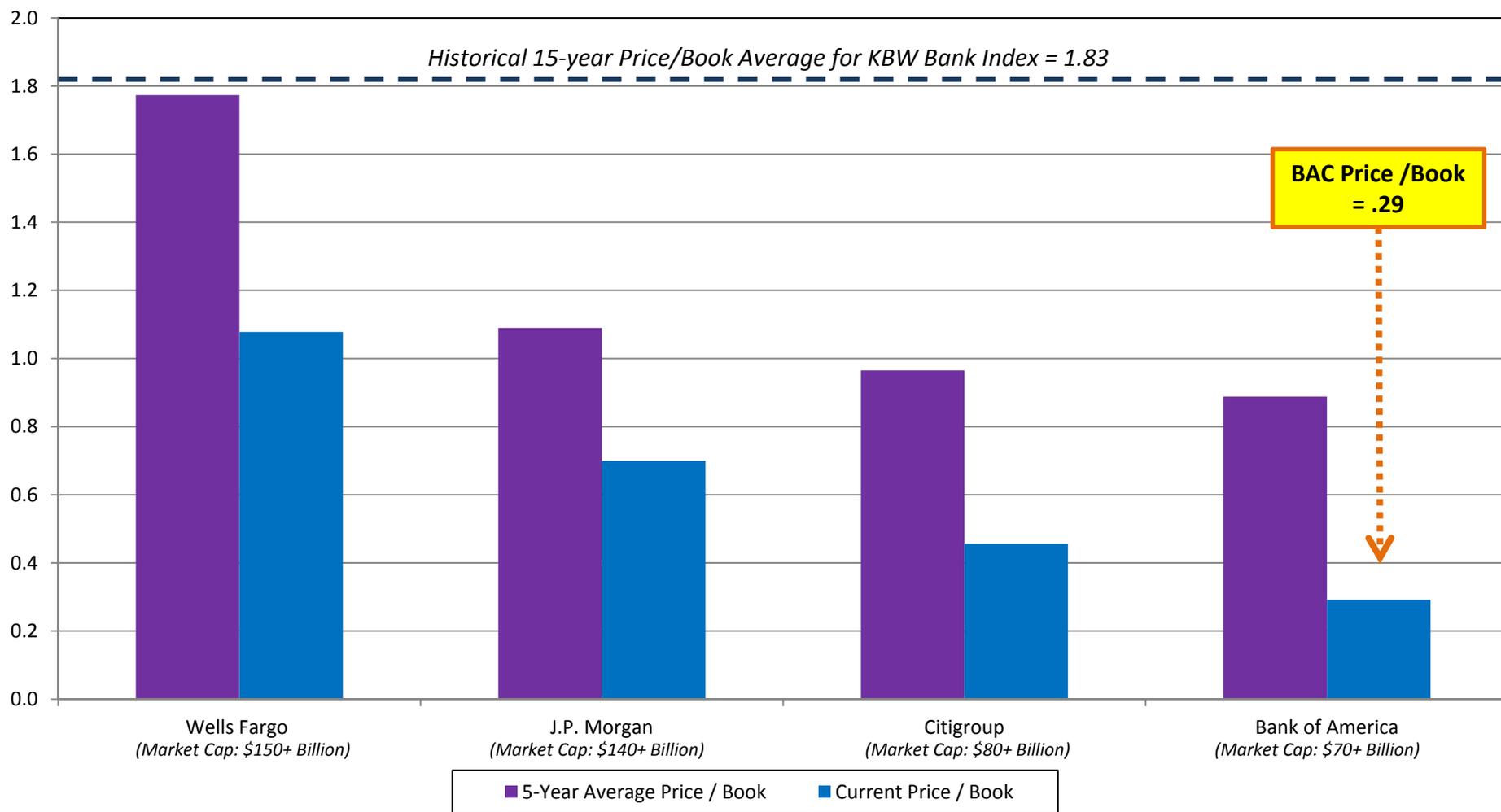
**FDIC**



“You also have to remember that in our industry we’re not alone, so we have regulators and others that look over our shoulders.”

– Brian Moynihan, *President and Chief Executive Officer, BAC*, August 10, 2011

# Compared to its Peers, BAC is Exceptionally Cheap

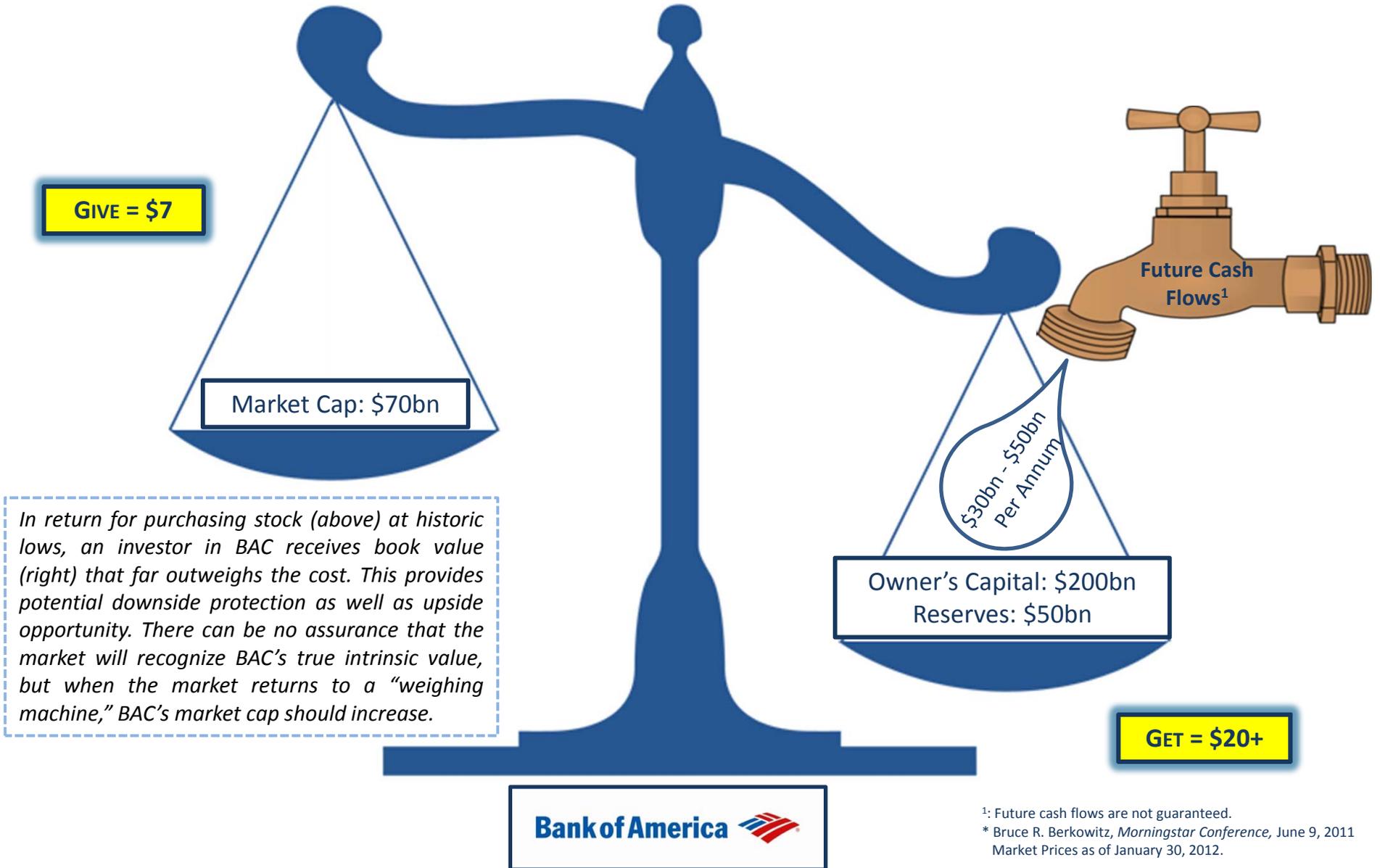


Price / Book: A ratio used to compare a stock's market value to its book value. It is calculated by dividing the current closing price of the stock by the latest quarter's book value per share.

Market Capitalizations as of January 30, 2012.

# \$7 Buys You \$20+...

“Investing is all about what you give versus what you get.” \*



In return for purchasing stock (above) at historic lows, an investor in BAC receives book value (right) that far outweighs the cost. This provides potential downside protection as well as upside opportunity. There can be no assurance that the market will recognize BAC's true intrinsic value, but when the market returns to a "weighing machine," BAC's market cap should increase.

<sup>1</sup>: Future cash flows are not guaranteed.  
\* Bruce R. Berkowitz, Morningstar Conference, June 9, 2011  
Market Prices as of January 30, 2012.

“Current headlines remain scary...[and] company stock prices at times become schizophrenic, but in the end, they consistently revert to reasonable assessments of value.”

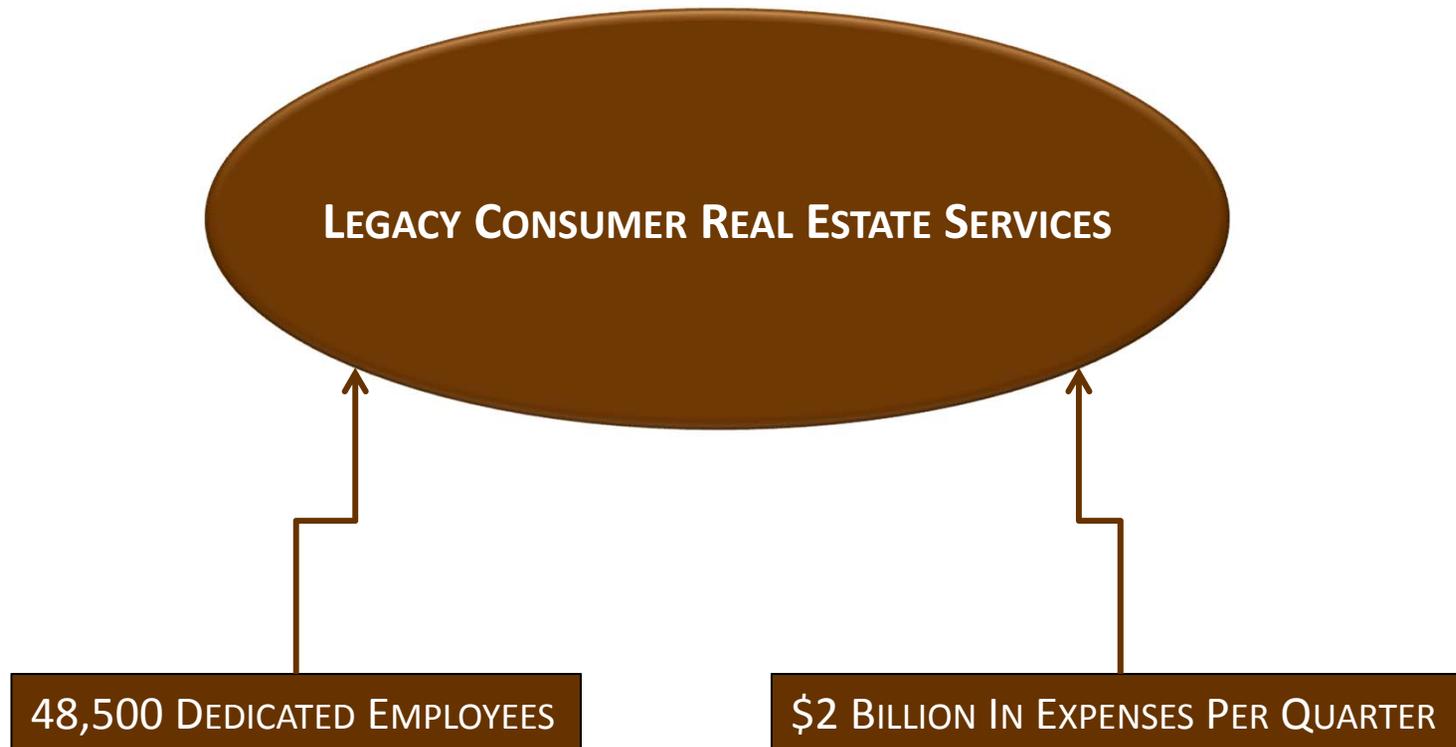
– Bruce R. Berkowitz, *Letter to Clients*, July 2008

September 12 – September 18, 2011 | [businessweek.com](http://businessweek.com)



# Moving Forward

*As part of its effort to generate long-term shareholder growth, BAC is continuing to aggressively address legacy Countrywide mortgage issues.*



# Mortgage Business Transformation

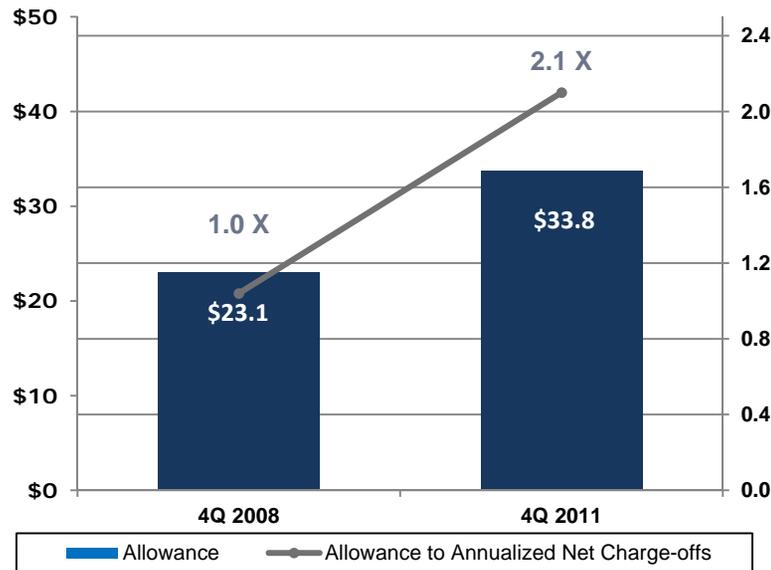
*BAC is fundamentally transforming its mortgage business to reduce risk, improve performance, and eliminate inefficiencies.*

FROM	TO
MORTGAGE MARKET SHARE DRIVEN	<ul style="list-style-type: none"> <li>✓ <i>INTEGRATED INTO CONSUMER FRANCHISE</i> <ul style="list-style-type: none"> <li>✓ 38K Home Loan referrals to Consumer Banking in 3Q11</li> <li>✓ 162K Consumer Banking referrals to Home Loans in 3Q11</li> </ul> </li> </ul>
MULTI-CHANNEL PRODUCTION	<ul style="list-style-type: none"> <li>✓ <i>DIRECT TO CONSUMER</i> <ul style="list-style-type: none"> <li>✓ Exited Wholesale and Correspondent channels</li> </ul> </li> </ul>
ADDING MORTGAGE SERVICING RIGHTS (MSRs)	<ul style="list-style-type: none"> <li>✓ <i>REDUCING MSRS</i> <ul style="list-style-type: none"> <li>✓ As of 3Q11, completed sale of servicing on 150K loans</li> <li>✓ Additional sales executed in 4Q11</li> <li>✓ Exit of Correspondent channel will result in adding less MSRs in the future</li> </ul> </li> </ul>
REGULAR AND DEFAULT SERVICING TOGETHER	<ul style="list-style-type: none"> <li>✓ <i>LEGACY ASSET SERVICING ESTABLISHED</i></li> </ul>
ANCILLARY BUSINESSES	<ul style="list-style-type: none"> <li>✓ <i>EXITING NON-CORE ACTIVITIES (E.G., BALBOA, REVERSE MORTGAGE, ETC.)</i></li> </ul>

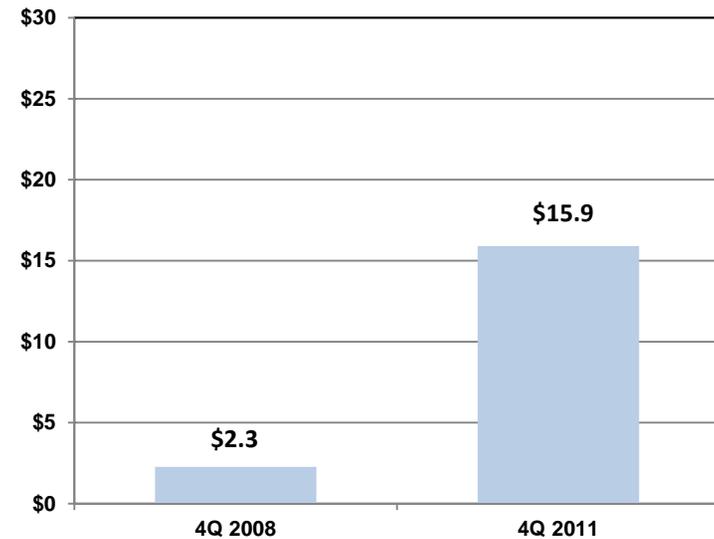
# Building a Strong Cushion

*BAC is conservatively managing its legacy mortgage exposures by increasing charge-off allowances as well as put back and liability reserves.*

**ALLOWANCE FOR LOANS AND LEASES (\$B)  
AND COVERAGE OF ANNUALIZED NET CHARGE-OFFS**



**REPRESENTATIONS AND WARRANTIES RESERVES (\$B) \***

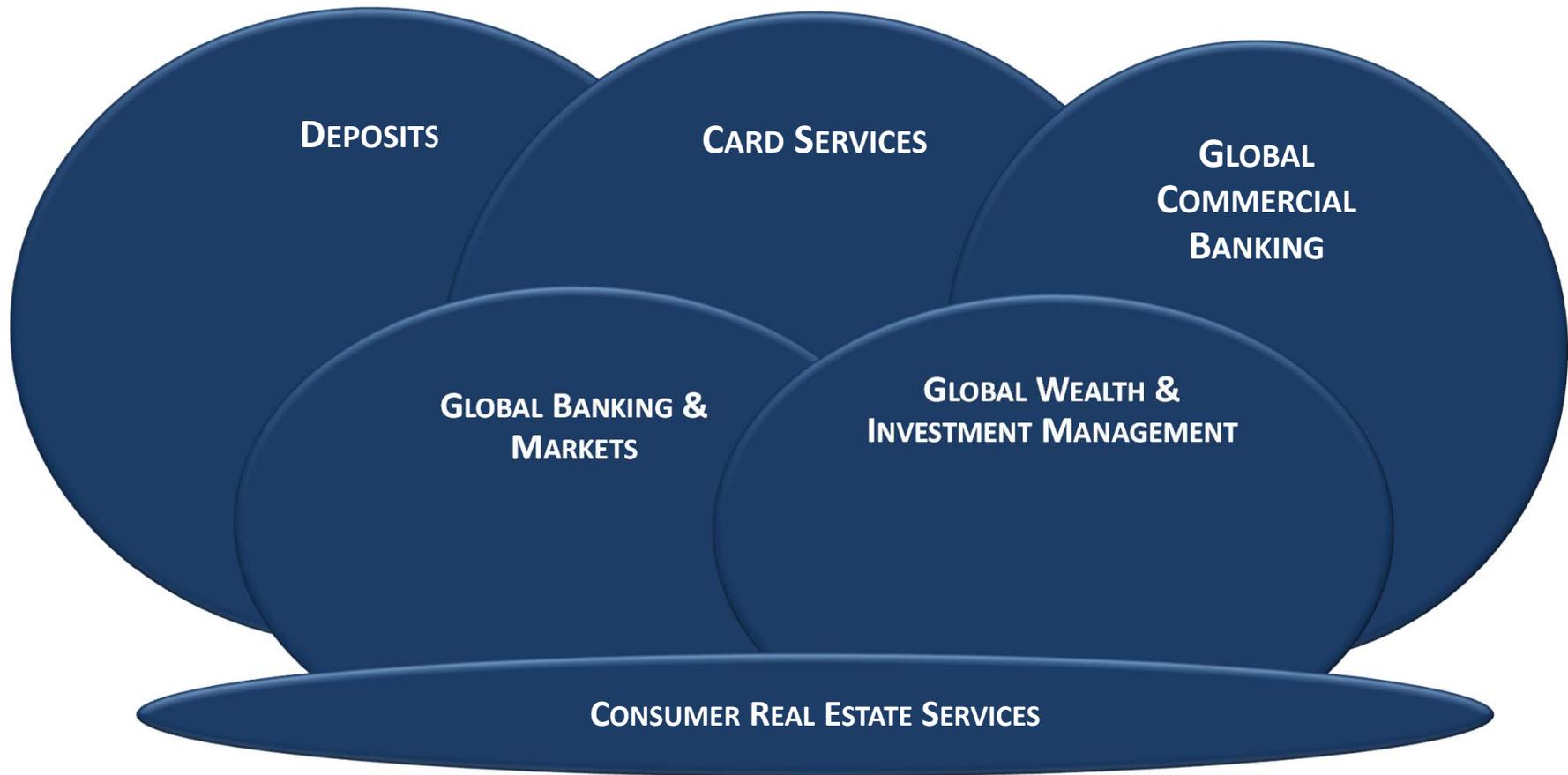


**These charts show that monies have been set aside on BAC's balance sheet to deal with a wide array of potential credit problems and litigation issues. They also show that the amount of these monies that have been set aside have increased substantially over the last three years.**

\* Representations and warranties reserves do not include litigation accruals established.

# Powerful Franchises

*With ongoing reductions in risk and expenses, “New BAC” should benefit from the strong performance of its profitable franchises.*



# In Sum...

*“...Its earnings power has been disguised by the intense provisioning for loan losses. But when the provisioning gets back to a normal level, you’ll start to see that incredible earnings power come down to the bottom line. And it’s as simple as that.”*

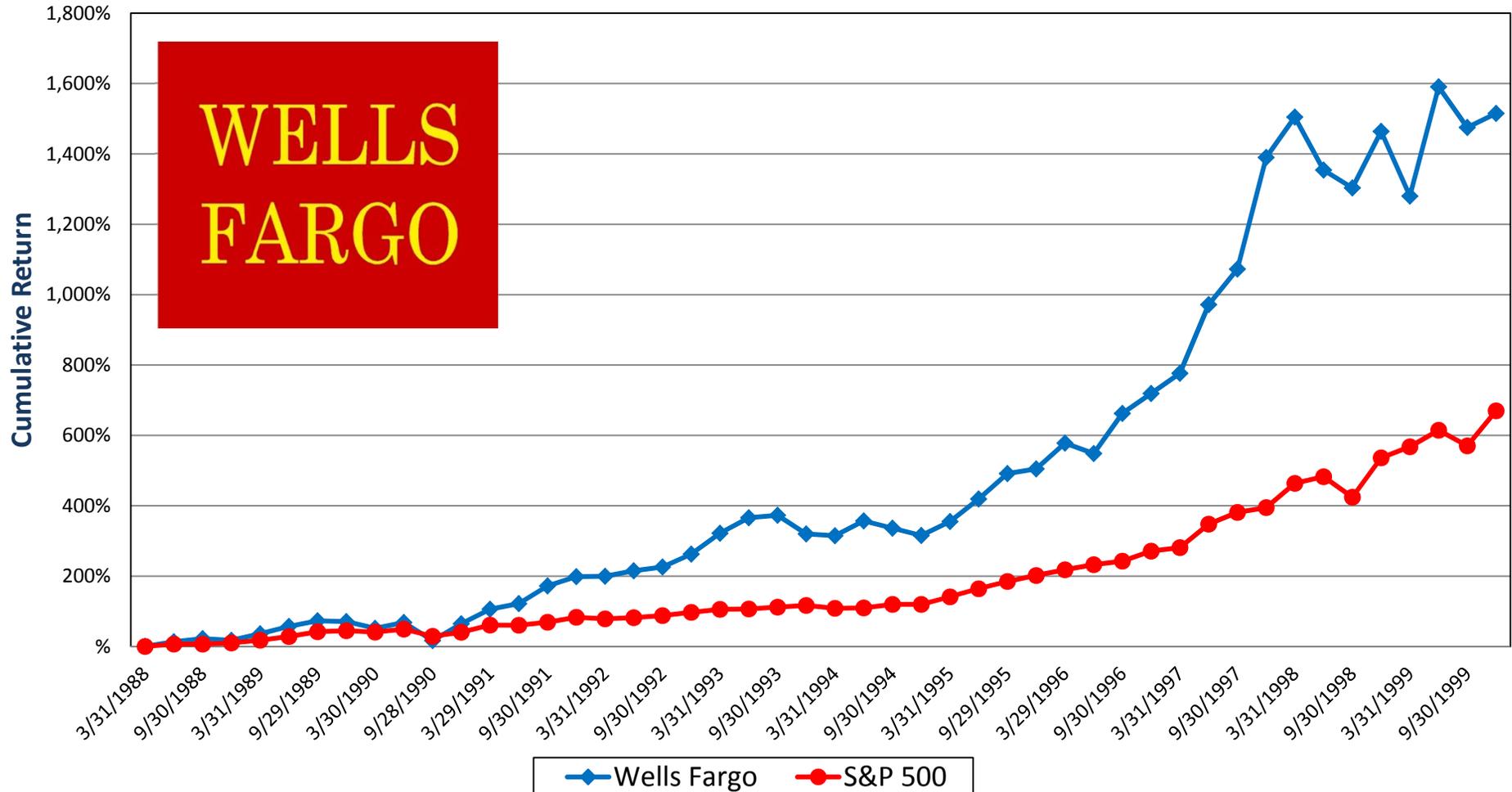
# Déjà vu?

*“...Its earnings power has been disguised by the intense provisioning for loan losses. But when the provisioning gets back to a normal level, you’ll start to see that incredible earnings power come down to the bottom line. And it’s as simple as that.”*

Bruce R. Berkowitz  
*Outstanding Investor Digest*  
November 25, 1992

# Banks Have Been Here Before...

*Wise investors do not permit "Mr. Market's" daily fluctuations to affect their understanding of fundamental value.*



Wells Fargo began to fix its problems in several fundamental way in the early 1990's. However, the stock market did not reflect these changes in revaluing the stock's price until years after the improvements began.

# Staying the Course

## *Courage of Conviction*

*“Our inclination remains to run from the popular and embrace the hated where prices tend to reflect such mistrust...we eventually get it right by seeing beyond temporary conditions and by avoiding diversification that leads to mediocrity.”*

Bruce R. Berkowitz  
*Semi-Annual Report*  
May 31, 2011

**Book Value:** The net asset value of a company, calculated by total assets minus and liabilities.

**Charge-off:** The declaration by a creditor (usually a credit card account) that an amount of debt is unlikely to be collected.

**Implied Annual Return on Investment:** Calculated by dividing a company's implied annual earnings by its total market capitalization at the time of investment.

**Long-term Debt:** Loans and financial obligations lasting over one year.

**Tier 1 Capital:** a regulatory measure of a bank's financial strength. It is composed of core capital, which is principally common stock and retained earnings.

**Tier 1 Common Equity Ratio:** the measurement of a bank's core equity capital compared with its total risk-weighted assets. This is the measure of a bank's financial strength. The Tier 1 common capital ratio excludes any preferred shares or non-controlling interests when determining the calculation.

**Tier 1 Risk-Based Capital Ratio:** the ratio of Tier 1 capital to its Risk-weighted assets. Risk-weighted asset is a bank's assets or off-balance sheet exposures, weighted according to risk.

**Return on Assets (ROA):** An indicator of how profitable a company is relative to its total assets. ROA gives an idea as to how efficient management is at using its assets to generate earnings. Calculated by dividing a company's annual earnings by its total assets, ROA is displayed as a percentage. Sometimes this is referred to as "return on investment".

**Return on Equity (ROE):** The amount of net income returned as a percentage of shareholders equity. Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

**Risk-based capital (RBC):** an amount of capital based on an assessment of risks that a company should hold to protect customers against adverse developments.

**Tangible Common Equity Ratio (TCE):** A ratio used to determine how much losses a bank can take before shareholder equity is wiped out. The Tangible Common Equity (TCE) ratio is calculated by taking the value of the company's total equity and subtracting intangible assets, goodwill and preferred stock equity and then dividing by the value of the company's tangible assets. Tangible assets is the company's total assets less goodwill and intangibles.

The historical return shown for Wells Fargo is based on Closing Price of its Common Stock. The chart refers to the purchase and sale of Wells Fargo stock by Fairholme Fund's portfolio manager while he was a portfolio manager for Shearson Lehman Brothers. Wells Fargo securities were not among the Fairholme Fund's top ten holdings as of February 29, 2012, and were not held by Fund as of its last shareholder report dated February 29, 2012.

Fairholme Distributors, LLC (06/12)