FAIRHOLME CAPITAL MANAGEMENT

Moderator: Bruce Berkowitz
February 11, 2009
3:00 p.m. CT

Operator: Good afternoon and welcome to the annual review of the Fairholme Fund. My name is (Ruth) and I will be facilitating the audio portion of today's interactive broadcast. All lines have been placed on mute to prevent any background noise. If you experience any issues during the call, please press star then zero on your touchtone phone. Each request will be answered as quickly as possible.

At this time I'd like to turn the call – the even over to Bruce Berkowitz, Chairman of the Fairholme Fund. Sir, you may begin your call.

Bruce Berkowitz: Thank you, (Ruth), and thanks, everyone, for calling in. By now I hope that all of our shareholders have received our annual report, which highlights the good, the bad and the ugly of 2008. We tried in the report to discuss all that we would want to know if our roles were reversed.

Just to highlight the report you know you last year we predicted rain and, boy, we got an awful lot of it. I'm sorry to say that we did not build a strong enough ark. The fund – the Fairholme Fund was down 30 percent versus the Dow being down 37 for the – excuse me – versus the S&P being down 37 percent. Well since inception of the fund about nine years ago, we're up about 150 percent versus the S&P being down 28 percent.

Well we're still above water. We're still ahead of the pack, but we've given an awful lot back and in dollar terms, we've given most of it back, if not all. We've had the worst 10 years – that is the S&P. S&P's been down now about 23 percent for a decade and with inflation it's down about 40 percent. But we're not going to fool ourselves because the relative performance doesn't matter as much. After all, you can't spend relative performance.

But I must admit, going forward, I am more optimistic than at any time. I can't tell you whether it's going to be 31 days or 31 months or longer before our portfolio companies begin to rise from the ashes, however I do believe that they will rise. In fact, it's very interesting in the – in the most recent issue I believe of Fortune Magazine there's an article titled Buffet Metric Says it's Time to Buy. When he compares the total market value of U.S. stock to the GNP of the country and in past, going back about 80 years, it was an awfully good time to buy equities when that figure was between 70 to 80 percent. That is the market – the value of all markets in the United States equaled about 70 to 80 percent of gross national product and we in fact are there now. The article – the (Charlie) in the article also shows that this ratio has gone lower. In fact it's gone under 50, so there may be more, but I do believe we're at a point where future performance at some time should quite – should become quite good.

Now regarding the portfolio, as of the last report we have over 50 percent of the portfolio in pharmaceuticals, HMOs, aerospace and defense. These are profitable, growing companies, generating lots and lots of cash in relationship to the prices we pay and in relationship to their present market caps. And Uncle Sam is by far their biggest customer, a customer that pays. And after all, really, what is more important than the health and safety of our families. These companies provide essential services to our families. The fund also remains with a reasonable cash position at 8 percent and it's amazing to me that many of our companies today appear to be worth more dead than alive when assessing their liquidating and run off value.

At this point, we've asked – we've asked for questions to be e-mailed to us and I've taken a handful of the questions that make sense. Well, they all make sense, but I've tried to get the questions which summarize all questions and I'd just like to go through them quickly and give you my response, my answers to them.

Question number one, I was wondering if you could talk briefly about the new members of the portfolio management team, Charles Fernandez, Paul Thompson. I read their short bios in the prospectus, but I'd like to hear a bit more about them as people and investors, what qualities they bring to Fairholme, do they plan on making any media appearances in the future as Keith Trauner and Larry Pitowsky did on a few occasions? Also have they invested any of their own money in the fund since becoming managers?

Well, yes we do have new members of the team, our analytical team and Charlie Fernandez is now the President of Fairholme Capital Management. Paul Thompson has taken on the mantle of Chief Financial Officer. Both bring a significant amount of operating experience, which in my opinion is invaluable to the firm, but has not yet shown up in the performance of the fund.

Charlie will eventually be making media appearances, but right now I'd like to hold him in the background, but of course during our Q and – when we open up the Q&A you're more than welcome to ask him any question that you would like. This may be a good time also just to talk a little bit about our portfolio management system.

As Managing Member of Fairholme, I'm the guy who makes the decisions. I'm the guy who pulls the trigger. I'm the guy who decides which positions go into the fund. Surrounded by me, I believe we have a group of talented analysts, both inside of the firm and outside of the firm. We do have a large – relatively large number of analysts behind the scenes and many of those analysts are independent consultants and are part of major law firms, consulting firms and other types of firms, people who have significant amounts of experience in the industries in which we're studying. So this is the system we've always used and as we focus on different industries in different sectors, different members of our analytical team will come to the forefront and that's pretty much our system. So you feel free to ask away if you want to talk with Charlie during the Q&A.

Another question, Bruce has become somewhat of a financial media darling in the last couple years and rightly so, considering excellent performance. I may disagree with that. Does this attention create any problems or advantages for the fund and does it distract Bruce from doing what he does best?

Well the answer to that is yes, it does create some distraction, but we've tried to save ourselves for difficult times. When we have good absolute and relative performance, we believe that that performance is enough. We don't need to do much more than that. But during these difficult times, it's really our job to keep shareholders tight and by using various media outlets I am able to tell you almost everything that I know in a public setting. So we're using our – we're using the media to try and communicate as best as we can with our shareholders. And while this has taken up a bit of time, I feel that it's extremely important as we – as we go through this most difficult environment.

Another question, are my day to day functions similar today as they were five years ago? Well the answer is yes and no. I do have somewhat of different focuses, given the larger size of the organization, but I am trying my best to build a firm that will last beyond me.

Another question, while you have a thoughtful, effective investment philosophy, I trust that you have a similar process on the issues of assets under management. Do you have a specific total assets under management feeling established that will allow Fairholme to comfortably build or eliminate positions without affecting execution or opportunity costs? There's plenty of empirical evidence that a key to our performance other than good picks is preventing our portfolio from becoming too unwieldy to manage. I note that you touched on it briefly in the last Fairholme report.

In this environment it is proven – cash is proven to be a valuable strategic asset and I believe it will continue to be so. The problem will become when we and our companies start to improve in value and they're no longer companies that we can buy at reasonable prices. I know it's hard to believe that such a time will exist again, but at that time we will then have to make the assessment as to when to close down the fund. But at this point, cash inflows have been quite valuable and we continue to ask ourselves the question about cash inflows on a monthly basis.

What are the – next question, what are the top successes of Eddie Lampert's track record as a capital allocator? (Our key) is rather wide. How do you get comfortable with his ability for much of what he does and his hedge fund is not public?

Well, we – Eddie Lampert's overall record is still quite deep and I don't know you know that paper trail is important, but what's most important to us is studying, see his balance sheet, its liquidation value. I have a whole bunch of more question on Sears that are coming a little – that – (of to an) answer and we go into a bit more detail. But we've always shares based upon its liquidation values and always thought that we were buying below liquidation values and we shall see. I still believe that Sears is quite reminiscent of Berkshire Hathaway's days with the – with Warren Buffet's days, I should say, with the Berkshire Textile Mills and that inflection point, that point when we decided it was time to move on and reallocate the cash to more productive uses. There's nothing I see at this point which tells me that will not happen at Sears.

Another question, please explain why Mr. Larry Pitowsky and Mr. Keith Trauner stepped – have stepped down from portfolio management. Well Larry and Keith's job at the fund for the next two years is on the generating of new, brilliant ideas. We get to a certain size, we have to divvy up responsibilities and I've charged and discussed with both Larry and Keith a process, a focus, a structure where they can quietly sit in a room and come up with ideas. And that's how they joined Fairholme and that's what they're going to be doing.

Has Mr. Berkowitz, Mr. Pitowsky and Mr. Trauner reduced their stake in the fund during 2007 through 2009 through selling? I don't know that anyone at Fairholme Capital Management or affiliated with Fairholme Capital Management has reduced the stake and I could tell you personally that every month I continue to add to my stake in the Fairholme Fund.

Another question, how likely do you think it is that the current recession will turn into a really long one, similar to the Japanese Decade? I don't know. It's possible, but stock markets or markets of stocks that companies, and I believe that the companies that we have focused on, have the earnings, the backlogs, the growth rates to do well, even in this environment.

Question, I hold you in highest regard of mutual fund managers. Your record is impeccable. You're a straight-shooter. My loyalty's with you. What are some of the metrics that you utilize when determining when the decline is going to end and turn for better? As they say, the market's already six months ahead, so if I do the math we have 14 months into the recession/depression, whatever you want to call it, and I add six more months to that, equaling 20. How much longer can this decline continue and what are some of the key metrics that you watch?

Well I discussed one metric, which is quite interesting, looking at the gross domestic product versus the market capitalization. On more of a micro-company level, we still believe that it's all about free cash flow. It's all about the amount of cash a company generates that can be passed to its owners in relationship to the price that you have to pay for a share of their company. And it's really what we – what we focused on and while those valuation levels can go lower, eventually the market will correctly value those cash flows. As Benjamin – as Benjamin Graham once said, in the short term the market's a voting machine, but in the long term the market is a weighing machine. Eventually the market will get it right and I think the longer it takes, the more we can potentially prosper.

Finally another question, when do you deploy the remaining cash to take advantage of rock bottom – these rock bottom prices? Or is it the possibility of incremental redemptions that inhibit you from doing so? I think that's a correct assumption. We will always have some cash. I'll never say always, but it's most likely that we will keep cash, just a case for redemption and also for the next idea or two. And if we use that cash, we'll figure out a way be – to build up more cash for then whatever may come.

Onto questions about Pfizer, was the Wyeth acquisition the type of investment you were hoping Pfizer would make with their cash on hand? Honestly, I did not know what type of acquisition Pfizer would make, if any. What we do understand is Pfizer's free cash flow, which we estimated at $2 and over and we did understand that Jeff Kindler would measure any acquisition in relation to – in relationship to the acquisition of his own repurchases – repurchasing his own shares back. We believe that the acquisition will be accretive to the company and they said a company's basics going to be accretive in second year, but we're not paying much attention to that. We continue to believe that the company has at least $2 per share of free cash flow and in many ways that the acquisition will make that goal more easily attainable and probably take the company to about two-and-a-half dollars plus of free cash flow in 2012.

What about Pfizer? Does Pfizer-Wyeth becoming such a big holding, has the Wyeth purchase changed this all? You know Pfizer – well we went to buy Pfizer, triple-A quality, triple-A balance sheet, huge free cash flow generator, about $17 billion a year, largest distribution system probably in the world and for me it was very reminiscent of Philip Morris, Exxon Mobile were always bumping around the bottom before you know most people figured it out. And at today's prices and today's free cash flows, we're talking about a company generating 14 to 17 percent free cash flow yields, depending upon your assessments of ongoing free cash flow between two and two-and-a-half dollars per share. To me, that justifies a large investment, especially when you take into account the sterling balance sheet.

How do you feel about Pfizer cutting the dividend? Does this lower yield mean you will lower the size of the holding? The answer is no. I mean I understand that the dividend had to be cut in order to pay for the acquisition. In fact this acquisition, the cash component and the debt component for the acquisition should be paid for in about 30 months and this is a statement from the company and statement pretty much backs up our estimate of you know conservative free cash flows in this most difficult environment.

Moving on to Sears, could you explain how you have tried to kill Sears and could not? For example, how long can Sears whether the poor economic conditions, which may persist for the next two, three more years? When for the next few years – how can they pay their annual interest payments of 300 million a year, plus meanwhile annual revenues of 50 billion in operating income off 0.5 billion? Well $50 billion, even of declining revenues, is quite a significant amount of revenues and so is an operating income of 1.5 billion with only 120 million shares. Also, when you take a look at the company's balance sheet, and we really have truly assessed Sears based upon its balance sheet, you'll see over $10 billion of inventories, payables, four-and-a-half billion – I mean just the inventories alone equal the price of the stock. If you want, cut it in half. We haven't even gotten to real estate, Kenmore, Craftsman, DieHard, Landon, the brands, cash on the balance sheet.

Has our evaluations of liquidation value declined in this environment? The answer is yes. Is it still dramatically above where Sears is trading today? The answer is yes.

Question, can Sears pay off their debt? Can they refinance at reasonable terms? I think – I think the answer to both questions is yes and if Eddie Lampert has any difficulties I think he should call Fairholme cause we would be willing to help him at the right price.

And let's see. If Sears retires a debt, but stops or curtails stock buybacks, what happens to the stock price when Sears can't fend off the short-sellers? Well, probably if the short-sellers are still there it goes down. And I think – I hope the stock does go down because it will be to our long-term benefit. I mean after all, when you take a look at the $500 million chunk of cash he's using to buy back stock, that half-a-billion dollars goes an awfully long way at $40 per share.

One other question, how will you know when Eddie Lampert reaches the point where you have to sell the underlying real estate at distressed prices in order to prop up the retail side of Sears? Wouldn't it be wise to meet with Lampert to get a sense of whether he actually has a turnaround or asset sale plan? I guess we'll know when he sells, but even when he starts to sell, we always say that they're going to have to be careful. I mean the real estate probably very much matches up with some type of – and in our opinion is correct – some type of 80/20 rule, where you have 20 percent of the real estate is very, very valuable, even today, and 80 percent may not be as valuable as some might think.

In terms of meeting Eddie Lampert, it's probably a good time, but it – just like Buffet though, I think if you – if you – if you read his letters, if you go through the queues and the news releases, I think he pretty much tells you the plan. And the plan does match up in my mind, again, with how Warren Buffet behaved with the Berkshire Textile Mills.

Few other questions, can you speak to your team's decision to sell your holdings in Berkshire Hathaway? In a recent shareholder letter, Mr. Buffet mentions that we continue to need elephants in order for us to use Berkshires glut of incoming cash. (Charlie) and I must therefore ignore the pursuit of mice and focus our acquisition efforts on much bigger game. We sold because Mr. Buffet stated that we should not hope or expect for Berkshire to do better than two percent above the S&P.

Another question, in the last 12 to 15 months, Mr. Buffet's companies made notable investments and regularly used Wrigley's, Marmon Holdings, G.E., Goldman Sachs, Constellation Energy, Harley-Davidson, to which we'd name a few. Isn't this a large number of elephants for Berkshire Hathaway in such a short amount of time that are not properly reflected in the intrinsic value of the company?

Well, it's a reasonably large amount, but really at the size of Berkshire it takes an awful lot of $5 billion gains to get the mood of you know to move – you need $5 billion gains basically to start to get their needle a push. So don't get me wrong. We sold Berkshire because we thought we could do better, not because we're smarter than Warren Buffet, because we're not. Because we're much smaller than Berkshire Hathaway and we have the chance to make some investment that maybe Mr. Buffet could not because of size constraints.

Question, it looks like you have faded investing in Leucadia Investments, AmeriCredit, Jefferies, others rather than Leucadia. Is there any reason for this? Yes, there is a reason. In order for Leucadia to keep and to not – in order for Leucadia not to taint their significant taxed net operating losses, significant assets on the balance sheet of the firm, they are limiting any one legal entity to five percent of the company and we can't go above that five percent limitation at this point.

Another question, can you discuss AmeriCredit's liquidity? Can you describe how you analyze and think about the AmeriCredit securitization deals in uncharted territory for consumer credit? Can AmeriCredit issue securitization deals at 18 percent and still create shareholder value? Could the Moody's and S&P ratings even remotely reflect the risk the securitization deal?

Well I am now on the board of AmeriCredit. I can't talk about AmeriCredit, but I can point you to AmeriCredit's tangible book value, which I believe estimates the liquidation value of the company on an undiscounted basis. That is if they were to close their doors and run off the portfolio. Sometimes it's just better to know what happens if you die and if that value is significantly higher than the price you pay then maybe, if that's your worst case that something even better happened.

Next question, debt securities, have you added to the fund's net holding since November 30? Well on that point I can't tell you. And will you remained focused on adding debt securities given the state of the markets? Will you be looking more towards debt securities of companies whose equity the fund already owns or to others not currently in the portfolio? Well, we are looking at debt security, focusing on the debt securities of portfolio companies up and down and if we are able to get excess equity type returns, being in the senior credit classes of the company, we're very interested.

Question on aerospace, to what extent do the delays of the 787, the potential funding shortfall for new aircraft deliveries concern you regarding the investments in Boeing and Spirit AeroSystems? Are you concerned about General Dynamics' exposure to the corporate jet market? Yes, we're concerned about all of that and we've taken that into our account – into our thinking and this continued environment will eventually diminish the quite significant backlogs of our aerospace and defense companies. On the other hand, you really have to focus on the military backlogs that these companies have as a buffer to that. But we remain confident that this economic environment shall pass. We just are not confident as to how long it's going to take.

OK, can you comment on Mueller Water? It's been a lousy performer. Do you see any merit in it at this level? Is there a chance for takeover? Yes, it's been a lousy performer. Do you see any merit in it at this level? Well it gets to be a bit more merit as the level goes down and I have no idea on a chance for takeover. And I was to going to keep my comments to that on Mueller for confidential reasons.

Please expound more on the issues you have with URI Management? Can these issues derail the company? Are you – are you convinced that the coming stimulus plan will have a positive effect on URI? Well I'll take this back with I'm not convinced that the stimulus plan will have a positive effect on URI. The issues that I'm concerned about can derail the company, but I am happy to report that the company appears to now be making moves in the right direction regarding capital allocation. This company generates a tremendous amount of cash and we just want to make sure that the cash isn't wasted. And I believe the new CEO and his operating team is heading in the correct direction and I think the board now fully understand the importance of putting that free cash and the – and the significantly higher amounts of cash to work, such as in maybe the repurchase of companies' debt at significant discounts.

Can you explain how you value Leucadia? Since it's dropped more than 60 percent would it be smart to accumulate it at these levels, presuming that they will take advantage of all the cheap assets around? Well you're going to have to you know see. Investors out there will have to make their own determination as to whether or not it's smart to buy Leucadia. All I can tell you about Leucadia is that it is now probably selling at tangible book value, even with all the declines in their equities and affiliated companies. I haven't seen that in quite a bit of time.

Usually if you see one roach in the cupboard there are many behind the wall. Why are you so sure that there are no more shoes to drop regarding WellCare, which could permanently – which would permanently impair the company? Well, at Fairholme we count cash, we try to kill it. A lot of people don't get – can't get information on WellCare for some reason, because they're late in filing their SEC document or any type of report, but they do file with the various insurance departments in which they do business and from those filings we are quite confident that WellCare will put their present legal matters to bed and will move on. The company's growing. They have significant amounts of cash. Their numbers are increasing. They're getting paid reasonable amounts to take care of those numbers. Their quality of care is good and by going to regulatory departments we have been able to dig out the details that we need, the facts to tell us that we're on the right track.

What do you see in the defense sector and why did you pick Boeing, Northrop, General Dynamics? Well we picked those companies because they basically are the defense sector and form an oligopoly or dualopoly. We picked them again because of the cash that they generate, the earnings that they're generating, the growth that they will have and the fact that they're absolutely vital to the national interests.

Question, any interest in the tech sector? No, not really, unless we find companies generating huge amounts of cash and we can figure out ways in which they'll keep generating that cash.

Do you see any value in the financial sector? Another manager I follow is making a big bet on them. Well, I've said in the past, it's very difficult to know what financial companies own and what they owe and not it's becoming more difficult for many companies knowing who owns them. But that being said, there are some great opportunities now in the financial sector and we're going to save that discussion for another time.

Hertz has a very high level of debt. What makes this company unkillable? Well, going through Hertz' books you'll see that they have about three-quarters-of-a-billion of unrestricted cash, a big bulk of their debt is not due until 2014. We calculate they have a reasonable free cash flow of over a dollar, that if you take into account taxes and what they call defleeting, you'll see that they generate much cash that what we call free cash flow and that cash can and should be used to pay down debt and to pay down that large level of debt. And plus, in terms of their fleet debt, recently Avis did a securitization of their fleet and we don't see any issues with Hertz, when they need to securitize debt for their fleet. Also, it doesn't hurt – it doesn't hurt

Hertz – doesn't hurt our portfolio to read a couple of days ago that Hertz increased their prices up $5 per car per day, not so easy to do that in this environment. And Hertz has done it and I think it's because they have a fear that they are getting towards right-sizing the fleet and they also realize that there are significantly – there are significant cost cuts – cost savings to be had at Hertz, they're – if they – if they can figure out how to more efficiently use their fleets.

OK, we've already talked about Berkshire Hathaway, our decision – the decision to sell and all of that and we're done. At this point I've gone through all of the questions – most of the questions that we received and I would ask (Ruth) to open up the call for any questions.

Operator: At this time if you would like to ask a question, press star then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key. We'll pause for just one moment please.

Your first question comes from the line of John Smith. Your line is open.

John Smith: Hi, Bruce. If your – you were just running yours and the team's money, didn't have to report daily prices and had – have that money locked up, how would the portfolio be different in terms of concentration and the mix between various asset classes?

Bruce Berkowitz: If we – in some way we are running it exactly the same because of the amount of our own personal money that's in the fund. But if we did not have the constraints of the 1940 Investment Company Act, we would most like – we would be – we would be more concentrated.

John Smith: Got it, got it. And then my last question is regarding you know with most of your companies, you can look at free cash flow yields. You can look at discounts to intrinsic value and other metrics to evaluate the relative merits of one name versus another. When you're looking at names like Lampert and – I'm sorry, with Sears and Leucadia you know the bet is more predicated on the jockey, I would – I would say. And if you're looking at them as capital allocators and measuring that ability, what do you look at between say

Lampert versus you know Steinberg and Cumming and then what – how are you evaluating them as capital allocators?

Bruce Berkowitz: Well you're right. In the case of a Sears, Leucadia (and to) Berkshire Hathaway, there is an element of a – of a blind trust and we tend to focus more on a liquidation value and then try and get the – a bit – try and capture the premium on a – on a liquidation value. That clearly is the case with Sears and then in the case of Leucadia it's even more so. I mean we like the guys. We've studied them for about 20 years. They have a better record than Berkshire Hathaway, but they've taken it on the chin lately, so we are happy to be their silent partners, especially at these prices.

In other – in other areas, where you know they're – the free cash flow is hard to see would be a company like Saint Joe, where we have – I think we just recently filed to get on Saint Joe and probably their largest owner. And there's a company that isn't generating free cash, but it basically has 600,000 acres of land in Florida, selling basically for swampland prices. But we have, I think in all three, we do also have some insights or some type of informational arbitrage or view that the public doesn't have. I mean overall, Mr. Market doesn't have and it's only going to – time will tell whether or not we have the correct insights.

John Smith: Thank you.

Bruce Berkowitz: Thank you, John. Next question.

Operator: Your next question comes from the line of (Marion Secrapone). Your line is open.

(Marion Secrapone): Thanks for taking my question, Bruce. With the new Obama administration making plans of moving out of Iraq in the next couple of years and the news to (lessen the market) placing too much emphasis on Homeland Security (a lot), can you give a rationally for such a heavy (dirt) in the aerospace and defense sector?

Bruce Berkowitz: I must admit, reviewing the – reviewing the Obama plan in the press, if I knew he was going to do what he was going to do we would have had a party for him before he was elected. I think that you know the defense budget was already set, dramatic increases and it – there's nothing in his plan that I see or the plan that's going to lower that. I mean there's going to be no sitting president or official in my mind that's going to want to see any type of attack on the United States and we will spend what needs to be done and I think the budgets that been passed show that.

Same as the case with healthcare. I mean in the current proposals there is a huge increase on per person spending on Medicare. And in many ways it makes sense to me. These are programs that government can get a you know a shorter term result by passing the money directly. So given you – desire for universal healthcare, improved healthcare, given the fact that the baby boomers are entering Medicare at record rates, given the war on terror and given the numbers that are coming out of Congress and given the selections that the Obama administration – given the people that they're picking for key slots from National Security Advisor to the various healthcare administrators, I think it so far has backed up – has backed up our thoughts in the matter, but that being said, we never counted on a stimulus package helping us. We assume that it's not going to help us and we're reasonably happy with what the company's already happy for any type of stimulus package.

(Marion Secrapone): OK. And as far – is it possible for you to give me a percentage or a range – in the form of a range of insider ownership?

Bruce Berkowitz: Insider ownership of?

(Marion Secrapone): Of the shares, Fairholme Fund shares. The total insider ownership as a percentage.

Bruce Berkowitz: Well I think the – I think our latest documents show over three million shares. I don't know what the total number is, but it's over three million shares and growing on a monthly basis.

(Marion Secrapone): OK, the last (contents) call is was 320 million, so I would say around one percent?

Bruce Berkowitz: If that's what it comes out to, three million, 20, but yes that makes sense. But it's – I don't know the importance of that measure. All I can tell you is I'm trying as hard as I can to put every extra penny I have into the Fairholme Fund. But that's a function of who else joins me and number of new shareholders, so – and appreciation of the fund.

(Marion Secrapone): OK, thank you very much.

Bruce Berkowitz: All right. Thanks for listening and calling and asking the question. Next question.

Operator: Your next question comes from the line of (Raj Birdavidean). Your line is open.

(Raj Birdavidean): Hi, Bruce. Thanks for hosting the call. I just had two quick questions. First, I understand that the companies that you're buying continue to generate strong earnings even in the current environment, but what do you think about – or do you think that there's a possibility that the multiples that the market will pay for these earnings can remain compressed for a prolonged amount of time over five years? And my second question, what do you think about just the general economic outlook, given that the U.S. economy got into this mess because of leverage and we're using leverage to get ourselves out of it as well?

Bruce Berkowitz: Well it's possible that the earnings – that the valuation on earnings stay compressed for quite a long time. I have no way of predicting that.

(Raj Birdavidean): Yes.

Bruce Berkowitz: At some point it will change. When, I don't know. I just know to some extent it's like pulling back on a rubber band and the longer it takes, our companies will continue to grow in intrinsic value. So the gap between what a company is really worth and what it's trading for, that gap will widen and widen so that whenever – so when we get to that point where the markets become a bit more rational and the fear factors [will] go down.

In terms of how we're getting out of this mess, I – on a macro level, I don't know if you call it leverage. I guess it is, but it just seems to me like we got off – the U.S. has the printing presses going 24/7 and they're going to keep going until we get out of this and then we'll have to address the ramifications of having those printing presses on 24/7.

(Raj Birdavidean): Thank you.

Bruce Berkowitz: Welcome.

Operator: Your next question comes from the line of (Richard Testano). Your line is open.

(Richard Testano): Hi, Bruce, and thanks for the segue. I was going to ask what you think are the potential outcomes of the – of the printing presses running so much, what your views are on inflation or dollar devaluation and how you factor that in in trying to kill companies?

Bruce Berkowitz: Well, inflation, degradation of the dollar. It seems to me in terms of degradation of the dollar, we're not the only country that's going to go through this. So, on a relative basis it's hard to know. Inflation, well the – in times of cheap money, assets and companies making lots of money tend to do much better than the holding of cash. So I think that – it's my belief that we're now heading in the right direction and (have) some strong desire to hold gold. I think you'll eventually see real assets going up in value and real companies making lots of real money should also go up in value, off put, counterbalanced by a higher discount rate. So it's not going to be good, but we'll – but we'll cross that headwind when it develops.

(Richard Testano): Thanks.

Operator: Your next question comes from the line of (Thomas Viatorres). Your line is open.

(Thomas Viatorres): Bruce, thank you for taking my question. I want you to know that I talked to our common friend, (Johnny Rome), and we are both happy to be with Fairholme. I would like to ask you an economy question. Before this downturn got serious, you had demand projections for the various companies that you were evaluating. And obviously as things were collapsing these went down.

In different sectors, was there a big difference between the kinds of downward change you experienced, the first question? And what do you expect from the stabilization measures as far as how demands will go up in the certain sectors?

Bruce Berkowitz I don't know if I can answer the question. I do know that the economy and thinking about the demand for the products that our companies make went down more than I thought.

In some cases, gone up in the case of healthcare. In other cases such as in defense and aerospace, I believe that the companies have such large backlog you know we're going to another you know year to really, to assess the situation given the demand of that exists today, even with the cancellation orders.

And then of course, you have to take into account companies like Boeing that takes the hardest and how many of years the backlogs go out and how they ship orders in the backlog and so on and so forth.

I think the answer is we didn't – even though we expected a bad environment, we did not expect it to be this bad. It has affected demand to some extent more so than some companies more so than others but we try and buy with companies, and parts of companies, with a significant margin of safety in order to take into account you know bad luck, a stronger estimate than occur.

So I'm comfortable where we are today with our companies and I'm confident they're quite cheap in relationship to this current stressed environment and this environment continuing for quite a bit of time.

And in regards to the stimulus package, I think the more money we throw at it probably the more it's going to help companies. And as I said, our defenses companies have just records of – you know there is just the record spending on expense funds, record spending on the healthcare front.

Both sectors are just huge parts of a potential budget and not necessary expenditures. In terms of our supply companies, I think its going to help in terms of bonus depreciation. It should help them so these packages are designed to help the economy and should help the economy. And they should help our company.

Male: Thank you, Bruce. I want to say and what's happening confirms my feeling that the logic to which you are using to make the decisions have been underlined a concerned by the bad times. Congratulations.

Bruce Berkowitz Well, Thank you. I don't know if I feel congratulations are in order but we're doing our best to get through this period and get everybody to the other side. I just can't tell you when.

Next question, please.

Operator: Your next question comes from the line of (Mike Newton). Your line is open.

(Mike Newton): Hey, Bruce. Bruce thanks for the call. I just had a question for (FordesQ). I know that’s a new addition and didn’t really – you know I understand (Loacadia) has a huge position and the terms that they had but you know one of the things that concern me is them issuing stock to pay shipping contractors.

And then also I have a follow-up to that on what you think – you know if they think that they have an opportunity to buy any of the assets from (Rio Tinto)?

Bruce Berkowitz One it also concerns me, even though it was relatively small amount. Two, I have no idea about (Rio Tinto) but – and three, I'm happy to see where the price of iron ore is and even with a significant reduction in the price iron ore, given the production increases, (inaudible) I'm very happy with the price we paid and for the asset, for the company after it had dramatic decline.

I think we'll do reasonably well but its subject in the short-term to the vagaries of the commodity market. And we shall see but it makes sense for a company like (FordesQ) to be able to capture so much of the business and the production that comes from South America and other higher cost operators.

(Mike Newton): Good enough. Thanks, Bruce.

Bruce Berkowitz Thanks for the question, (Mike).

(Mike Newton): You bet.

Operator: Your next question comes from the line of (Carter Shirperkic). Your line is open.

(Carter Shirperkic): Hi, Bruce. I just want to say thank you very much for the transparency in the fund. You know all the shareholders appreciate the call. I just have one question.

At the distressed pricing of some companies of the auto industry, in particular auto suppliers, why haven't we taken advantage of this pessimism in the market?

Bruce Berkowitz Probably because I'm not smart enough in that area. I mean what's interesting about a bear market that we're in, a difficult market, whatever you want to call it. The reason why prices get so cheap is because there are more good ideas than money.

And that's what we're going through with securitization markets frozen and with the degradation and individual balance sheets and with those trying to delever, they're just as – cash is not there. And for those that have cash, they have gotten to a point where they feel they can't participate.

So there are many good ideas and as I said before, there are many ways to get to Heaven but I wish I knew about the [auto] industry and so on. But I don't so we're going to stick to our circle of confidence and try and do in the areas where we feel we have an edge.

Thanks for the question. Another question, please (Ruth).

Operator: Your next question comes from the line of (Rick Bulk). Your line is open.

(Rick Bulk): Good afternoon, (Ruth). I was curious about an article that you had in an interview in Kiplinger Magazine. You – two areas of just clarification one regarding Pfizer and I'm wondering if regarding Pfizer and their drive to be number one provider of established brand products, if you're talking about Pfizer being number one in the generic versions of their own drugs like Lipitor or if you think they're competing head to head their brand name versus the generic because people would prefer brand.

And then the second question deals with the whole HMO side. I certainly understand the increasing demand in healthcare but I'm wondering are you looking at these healthcare providers HMO making money simply on the claims processing side? Or actually on the insurance side where I actually don't see them making money right now.

Bruce Berkowitz Well let me try and do this backwards.

(Rick Bulk): Yes. Sure.

Bruce Berkowitz And you tell me what I've missed. I mean we can see, our HMOs have different levels of business and claims processing and just the management of not for profit. And being the actual insurer.

And being the actual insurer to me is very analogous with the auto insurance companies where you have relatively short (inaudible) and you're going to make your money on the one hand by having an underwriting carpet or having what I guess in health insurance is a reasonable medical loss ratio and have a reasonably tight administrative expense for a huge scale.

And on the other side, you're going to make yourself a few pennies on the holding of investment premiums and earning a few dollars in interest rate. I'm very interested in the HMOs because I think no one else can do it.

I don't believe there is an alternative to them. I don't believe they're charging a lot. I believe they are capable of making a profit on the insurance side. And they're going to be a vital part of the healthcare solution.

Then when you take into account how their stock market prices have just fell off a cliff in relationship to the free cash flow that they generate, then they became an appealing investment. And they are actually companies that don't require a lot of investment intensity and there are whole bunch of other reasons which I'd like to keep under my hat but…

(Rick Bulk): Sure, sure.

Bruce Berkowitz I think it's possible that they can make a reasonable living in the insurance sector in the same way that a Progressive or a Geico or others can make a reasonable living in underwriting auto insurance policies.

It's quite statistical. Yes, you can make mistakes. The mistakes shouldn't last in terms of pricing for more than you know six to eight months and they have a right to make a reasonable profit.

It's just that reasonable profit in relationship to the prices at which they're trading at now make them compelling investments.

In terms of Pfizer and branded products, I believe this – the new CEO of Pfizer understands the mistakes the past CEOs of Pfizer made and I think he's being quite diplomatic and you're never going to hear about it but you know Pfizer and all the other large biopharmaceuticals gave the generic business away.

And from their companies in India and Israel developed multi – and other places developed multi, multi billion dollar businesses. And I'm also fascinated by the fact that people you know – citizens in the United States look at generics, they spend less time thinking about the generic pill they're taking than they think about the piece of chocolate they're putting in their mouth.

I can see a Lipitor competing against the generic version at the correct price point. And I can see Pfizer also becoming the number one generic company in the world. Why not? They have the distribution system. They have the know how. They have the cash.
They have the ability and it's not such a bad business.

And to just give it away makes no sense to me and I think if you look close you'll see that Pfizer is already coming in the ranks and together with (inaudible) it doesn't seem to me to be that big stretch for them to be a dominant in the branded products.

And I very much, I mentioned an analogy and Pfizer is analogous to Phillip Morris, Exxon Mobile in terms of you know thinking about a merchant banking aspect, thinking about just – you know dominant distribution channels and especially when you can mix in the generic products.

So and there are whole lot of other elements too that we like about Pfizer. It's not just about the generics and the distribution system. So I hope that helps answer the question. But I'm going hold score of accounts, we like Pfizer and I know the companies hate it right now and I know the CEO is just like – I think he's doing good job and it takes a bit of time to turn around such a large company. And he's doing it.

And there is an awful lot of activity that's going on beneath the surface that's very difficult to see. But from our investigative work, we see it and we're excited about what they're going to do. We'll see.

Over a decade ago, investors could not get enough Pfizer at 40, 50 times their earnings and today it's the most dreaded stock at seven, eight times the earning. So our attack line is that we ignore the crowd. We're ignoring the crowd on this one because we see the cash and time will tell if we're right.

(Rick Bulk): OK. One thing I'll just mention about Lipitor just some information for you. In Minnesota, the largest healthcare company has just taken that off their list of their formulary list to take generics or competitor of Lipitor. So just to be aware of that.

Thanks though.

Bruce Berkowitz Yes. I thank you for that. We see it. We see it in other places. We know that there is lots and lots of pushes in this area. But thankfully in the U.S. healthcare system we try not to practice various forms of triage in other areas.

So Pfizer is heading in the right direction and people are just still crazy about Lipitor going off patent in two to three years time. And we think that Ken Lair has evaluation it properly and time will tell.

(Rick Bulk): Great. Thank you.

Bruce Berkowitz OK, thanks a lot. Take care. OK, I think we're past the hour. I don't want to bore everyone to death. Why don't we just take a couple more questions and call it a day.

Operator: Your next question comes from the line of (Marcus Mau). Your line is open.

(Marcus Mau): Hi, Bruce. This is (Marcus) I got a question for you about hedge funds. What do you think about using the techniques that the hedge funds have to increase return on performance by short-selling their margins and using margins? Can you comment on that, please?

Bruce Berkowitz There's nothing wrong with it especially if you get it right. But you know short selling in margin can be two forms of Russian roulette, which I don't wish to play. I mean if you're long and you're wrong, it goes to zero.

If you're long and you're short insanity can lapse for a time and you can run out of cash. Margins leverage just speeds up the game. It just decreases return but it’s a two way store.

Bottom line is both I think of forms of Russian roulette and even though if the gun may have a 1,000 chambers and one bullet, I don't wish to play the game.

(Marcus Mau): Thank you very much.

Bruce Berkowitz You're welcome. Last question, please (Ruth).

Operator: OK. Your last question comes from the line of (Larry Birkett). Your line is open.

(Larry Birkett): Thank you. Hi, Bruce. I had a question about Mueller Water Products. Obviously that's hasn't been doing too well lately. What's your current opinion of it?

Bruce Berkowitz That it hasn't been doing too well lately. You know they've had some good branded products and they been resting on their laurels and it's been tough on the whole water infrastructure business. They're feeling the pain and there's not much they can do about it right now except to get much more aggressive on the selling and marketing side.

Because there still is business out there. But they're facing a huge headwind and I believe the stock price more than reflects that.

(Larry Birkett): Do you think there is potential takeout on it?

Bruce Berkowitz I have no idea about that. My guess on that plus $2 may get you a cup of coffee at Dunkin Donuts.

(Larry Birkett): OK. Well, thank you.

Bruce Berkowitz Take care. Well now that was our last question, please if any questions haven't been answered on this call, feel free to e-mail (Joe Mareo) at joe@fairhome.net and we will endeavor to answer them.

I can't thank you enough for supporting the fund and sticking with us during this difficult time and we will try and do everything we possibly can to get through this difficult period and get to a happier place.

Thank you very much. Good night.

Operator: This concludes today's conference call. You may now disconnect.

END