

BRUCE BERKOWITZ AAII PRESENTATION

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6:30 p.m. ET

Moderator: Tonight we're very fortunate to have a rather unusual gentleman. Very often, I tell you that somebody runs a fund that is done very well this year or two years ago.

But tonight's speaker has managed to outperform everybody in the domestic stock funds over the last 10 years. That's a trick. And it isn't a trick. It's a strategy and he's done it no matter how you look at it. In three-year averages, five-year averages, his averages, and 10-year averages. For that reason, he was selected by Morningstar as the Domestic Stock Manager of the Decade. He's going to talk tonight about beating the pack by breaking from it. That tells you- he's a contrarian.

To tell you more about Mr. Berkowitz- he's the founder, managing member, and chief investment manager for Fairholme Capital Management, and president and director of Fairholme Funds. Prior to founding Fairholme in 1997, he was a portfolio manager at Smith Barney and Lehman Holdings. He holds a BA in Economics from the University of Massachusetts, Amherst.

In 2010, as I said, Morningstar named him Domestic Stock Manager of the Decade. One thing I will tell you, which has a light aspect to it, is that Fortune Magazine called him "The Megamind of Miami." So, if we can have a welcome for Bruce Berkowitz, please.

Bruce Berkowitz: It's been a few years since I've talked with this great group. We had a good time, so hopefully we'll have a good time again. I'm just going to try to keep it simple. Let's go spend 10 minutes discussing what I do, how I do it. I'll give you an example, and then we'll go right to questions after I finish. And you could ask whatever you like. The tougher the better.

Most of what I learned in investing occurred before I went to college, probably, right around my second year in high school. Of the two things I learned, one was the accounting studying analysis of a business. I pretty much figured out that you count the money that goes in, and you count the money that goes out. What's left is your profit, and that's what you made. And that's all that really matters.

I remember being a newspaper boy. That's how it works. I remember working on the boardwalk; that's how it works. Grocery stores, that's how it works. I think that's how it works in most businesses. In fact, I'm

trying to think of an example where it doesn't work over the long term. The value of a stock is the amount of cash that the underlying company generates. Cash is important; because that's the only thing my family can spend.

The second thing that I learned was, when for some reason I decided to become a book-maker in my sophomore year in high school. I was under age; I was a minor. It was only for a couple of months and I learned a lot of perverse psychology. That is, what I have to say is simple, but for some reason it's extremely difficult and tough to do, even for me today. And we'll discuss that.

So, it's all about cash. It's all about counting cash. Very valuable, you run out of cash, you're dead, whether you're a business, an individual. Cash counts. So I count the cash. It's not just any kind of cash. It's the cash that an owner can keep after all the bills are paid and after the capital used to maintain the franchise of the business. A lot of companies cheapen off a lot of different ways. So you have to figure out what you can take out of the business after you've paid all of your partners the full amount, including Uncle Sam. And you've kept everything nice, new and shiny.

Once I have that cash count, I try and calculate it. When I have a range, I try and figure out how much on average a company can generate in cash. The bad years, the good years, what's normal? What should you expect over a cycle? And then, I try and kill it. What can stop the cash from coming in? Who can kill the company? How did almost all of our banks die almost a terrible death a couple of years back?

That's all I do. Then, I take that calculation, and I compare it to the price of the stock. Because after all, investing is nothing more than comparing what you give to what you're going to get in the future. A bird in the hands, worth two in the bush. What you pay today, the future cash flow you receive, what you give versus what you get. And try to figure if there is a margin of safety. Can I get hurt? Am I buying the stuff cheap enough, on bad luck or for miscalculations to some extent, then once I've done that, then compare that one investment, purchase price versus cash flows to all your other investments and rank order them. You see which is first, second, third, fourth. You buy more of your first or second or third if you can compare to buying your 50th best pick which I never really understood.

So, name of the game really is protecting against permanent loss by understanding the cash flows. Understanding that the volatility in the equity's price is not equal to the risk of the stock. Volatility is volatility. With volatility there is more opportunity, and then I would take the risk.

So I use the Webster's Dictionary definition of risk, the chance for permanent loss of capital. I try and understand how the company works with no leverage. I don't leverage up. I try and think about all the ways I could commit financial suicide and just try not to do them.

Once I do have this imbalance between the price and what I think a company is going to make, I ask myself "Why am I so lucky? Why am I the lucky one?" There are a lot of people much smarter than I am, so, "Why am I lucky?"

It gets at what I would call perception versus reality. I will give you an example. I am all in right now in the U.S. banking sector. I think, what a great time to be here. Because the most hated industry in the United States personally caused the crash in the housing market. We'll talk about that in a second. You will determine tonight whether I am insane or sane in how I view the banks. Then, we can have some fun.

We've gone through the process. The other thing that's required, I should say, is patience, because it's impossible to time it right. I know you're going to get some lessons on technical analysis. I've tried. It never worked for me. I've tried everything. Chicken bones, technical analysis. I just seem to always suffer from, what I could call premature accumulation.

I would buy and I would buy too soon. I would buy more, and more the way some people would buy their favorite product on sale at the department store. This requires fortitude, courage, confidence and conviction. And make sure you're not in denial about what you believe the cash flows of a company to be.

The example I'm going to use...by the way, that's my whole process. That's what we do. I will use an example now to go through it. An example is Bank of America which is a very large position of the fund, its a billion dollar plus position. We would own more if we could, but the rules for a mutual fund are you can't be have more than 5% of your fund because of the broker deal elements.

Bank of America, from my reading of the papers, single-handedly caused the housing crisis. That is the company they purchased, Countrywide Financial, and they're getting kicked around pretty hard right now.

We seemed to have forgotten how the housing crisis started. It started with little incremental moves by the government. It's a great idea to own a home. We eventually forgot the part about if you can afford to own a home. I started to think if I bought a home that way when I first got out of school, I would probably be driving a taxi cab in Boston. No one thought

about the flexibility you lose, how a home could be a ball and chain. The government pushed Freddie, Fannie, Acorn. We're not giving mortgages to lower-income families. They should have mortgages. And then the brokers, and the bankers, and the title insurance, and the builders and developers, then they securitize them and chop them, and made them incomprehensible; and then, sold them to someone thinking that the problem was no longer theirs.

But we have this great housing crisis which Bank of America is still in the middle of which also led to Dodd Frank which...I'm not exactly sure what Dodd Frank is. I mean, the changes, thousand of pages, and it hasn't been decided yet.

Then there's Basel III. I'm still not sure what Basel II was, and I think we're still under I. But the pendulum has swung from loose, optimistic, Greenspan. We know what we're doing to the other end where we don't know what we're doing. We need much more capital. We have to get rid of this risky stuff.

Then, there's this whole issue you may have read about called the reps and warranties. Give me all the negatives, by the way. Reps and warranties when the banks chopped up all this stuff and then sold it, never really told anyone that maybe it wasn't investment grade.

I'm getting a bit too much into it. But it's banking, it's a cyclical industry. Every 5 to 10 years, the banks blow up. There's tremendous uncertainty. People have lost decades of performance with the banks. Many investment advisers have lost their reputations because of getting into the financial services- companies and banks too early.

On the positive, Bank of America, so you know, is part of the financial system of the United States. The United States does not work without Bank of America. Now, I don't know if you've ever visited the United States Treasury or the Federal Reserve. They're not very big buildings. There aren't that many people in them. It's Bank of America, Citigroup, Goldman Sachs, Morgan Stanley, and a handful of others. They are our financial system. Nothing works without their financial system. We seemed to have forgotten that. Bank of America is global in scale, global in geography.

I like Brian Moynihan, the new CEO. He's ahead of the curve. He actually lowered late fees. Without being recognized, he's taking all the right steps for consumers. He's working out the mortgages. There's probably another two years to go. They own the dreaded Countrywide. They own the Old Nations Bank, MBNA credit cards. I think their first bank started in 1784. I don't know if you have read- how many touched

Bank of America in one way, shape or form. Did anyone bank with them? Does anyone use Merrill Lynch? Does anyone have an MBNA credit card? Has anyone ever dealt with Countrywide in terms of a mortgage?

Okay, it goes on. It is our financial system. So, it's an important company, but it's hated. I don't understand why it's so hated, because today the company is making money, about a dollar a share. It's selling for \$12.25. But they're still in the midst of problems. They have 30,000 extra people working on the mortgage issues, refinancing, re-mediating, foreclosure, trying to figure out an end to this problem. They're still digesting the issues of 2007, 2008. People have to understand that that's going to come to an end. People don't think it's going to come to an end.

For example, if you understand the nature of retail loans, consumer loans, floating rate, fixed, they have an average life. Let's say most loans are between five and seven years. For 2007, loans which were a very bad deal causing a lot of the problems, they only have 48% of those loans left. Think about a python eating a pig. It gets digested, slowly digested. Or think about it as vintages with wines, the way you look at years. In 2007, they only have 38% left. In 2008, around 48% left. As every month goes by, those problems are taken care of. And 2009, 2010, they put on tremendously great loans. So we have a business which is at an inflection point.

I'm going to stop with the qualitative stuff. I'm just going to give you the numbers now. Bank of America generates before reserving for bad loans and before taxes, \$45-50 billion a year. That's \$4.50 to \$5 a share for a company that's selling for \$11 and change, before provisioning for bad loans, and before taxes. That's \$3.50 to \$4 per share before taxes. It's going to be a long time before they pay taxes, given that they have to blow through \$80 billion roughly of past losses. Which means the next \$80 billion that they make, they don't pay any taxes on. So, that's \$3.50 to \$4. So what does that mean?

And then, when they blow through the \$80 billion, there'll be a little bit of growth, and they'll still be making that. But after tax, GAAP numbers would be about \$2.50 a share.

I'm sure people have talked to you about tangible book value. Tangible book value is the real assets of a company after you get rid of it. The goodwill, the fluff it used to be called, the extra that you pay for business. It's very unusual but the Bank of America's tangible book value is lower than liquidation value. It's \$13.21. Its book value is \$20-something.

If you look at the history of banking in a normalized period, it's not unusual to see a 1% to 2% return on assets. It's not unusual to see 10% to 15% return on equity. Any way you look at it, it's fascinating.

For me, the period that we're in right now is very reminiscent of the early 90s. I remember having a gigantic position in Wells Fargo. Everyone thought they were going to go bust, because they had all of these empty commercial buildings in California and all over the place. They didn't go bust. It was a rough time, and they made seven times money. I don't think its going to happen that way. But if people who are in the banks during this doom and gloom period made 5 to 10 times their money, history repeats itself.

Not exactly the same way but if you understand, critical to the functioning of this country, critical to job growth, critical to the safety and security of our nation, they have to succeed. Even if they succeed in a non-excessive way, with a very reasonable profit, one would do quite well based upon the price.

Very reminiscent of the start in the late '80s, and it went to the '90s, 1992, 1993, it went up, it came down. People didn't understand. They lost money again, and then boom! Because of this consolidation, there were fewer players; so tremendous uncertainty which should diminish over the next 12 months, big bias. This is how we do it. And usually it means buying something that's hated. And something where the newspaper everyday is going to tell you, "You're wrong." And your friends are going to tell you, "You're wrong." There's going to be something else that is hot and juicy, some new thing which you are going to want to get in on, and you usually feel pretty lousy about it. Because, when you're early, you look wrong. You make your most money when times are at their toughest. You just don't know it at the time.

It's not easy; it's a painful process. You climb this wall of worry eventually over a multi-year period. You get sharp drops like we had today in the market-place. You have to deal with this crazy accounting that companies have now.

The companies have to account for the possibility that they buy back their own debt. So, if a company gets better and is perceived to be of higher quality, then it would be more expensive for them to buy back their debt. They will have to take a loss in their earnings statement because of that. If a company gets crappy on the way to bankruptcy, it means their debt is going to got down in price. They'll be able to buy the debt back for less money. And they could take a profit on their income statement.

Next time you have somebody talk about GAAP accounting or whatever, why don't you ask them about that one? Try and figure out why that's a rule. Here's the last way to think about it. By the way, Bank of America, they supply a lot of what we're doing right now. I'm just going to give you one solid example. They're going to make in a more normal period which they're getting to, \$2+ per share. They will not need the capital in about 12 months' time. They are already stronger than I've even seen them. Balance sheet's great. The reserves are unbelievable. They'll probably need another 12 months to get to this over-capital position which everyone will be forced to, as the pendulum gets to the extreme before it starts to go the other way.

Then, they'll be able to take every penny of those earnings- that cash earnings- and give it to you in the form of a dividend or a share buyback. If it becomes a dividend which will slowly build...you're talking about \$2 a share dividend.

Think about it another way. If I use the money just to buy back stock, and the stock for some reason stays where it is for 10 billion shares, it would take them six years. In six years, they'll buy the entire company back that started in 1794 and had hundreds of billions of dollars of acquisitions that probably touches one out of every two people in the United States. Given the fact that they're not going to pay taxes, they'll probably buy back all the stock in five years.

I won't talk to you about how long it will take if it wasn't \$2 but \$3. Or there's a combination. They eventually pay you a 5% dividend, and it takes them 10 years to buy all the stock back. But of course, as they buy back, the earnings go up. The price goes up. It's a vicious cycle. So you end up with a company with good dividends, good capital gains, and very little downside. Those are the companies we're trying to look at for Fairholme and the Fairholme Funds. We're up to here with these companies right now.

We were in the healthcare companies when everyone told us we were crazy because of the new laws, the Obama Healthcare. Guess what? Nothing changed. Everyone thinks our financial system is going to dramatically change now. It's not going to.

So, a year from now, you will know whether I'm sane or insane. Five years from now, you'll know whether I'm lucky or good. We'll save when to sell for another day.

Count the cash. Try and kill it. Try and figure out when times are normal, the cash that you'd be able to put into your pocket after all the expenses are done. Think about all the different ways management can screw you

in terms of compensation and all the different tricks that they use when you read these reports. You compare the market price to all that, and then you decide whether you have a margin of safety. You compare it to everything else you're doing. You decide your top 10 or 20 things, and you go for it. You swing big in one or two of these investments in a lifetime to make a significant difference to your well being.

Now, we may be wrong. So, what we try and do is we typically try to use consultants to tell us not why we're right, but why we're wrong. And with the banks, we've been very lucky. I'm going to phrase this correctly, because it doesn't sound right. We had some great help which we didn't pay a penny for. These are the organizations which we use that have spent basically hundreds upon hundreds of millions of dollars researching the one point. Will these institutions make it? And what will they look like down the road?

The institutions that we used were the U.S. Senate, the Congressional Oversight Commission that the Senate started, the United States Treasury, the Federal Reserve, the GAO (Government Accounting Office), and the Financial Crisis Inquiry Commission. I mean, right now, no one knows this, but you can go to Stanford's website. There are a hundred interviews of every major executive in the financial services industry between 1 and 2½ hours long explaining what happened, where they are, what went wrong, why it's not going to happen again.

There are hundreds and thousands of pages of unbelievable consulting work. Right there, feel free to go on the web. You have to figure out where to go, where to dig. You have videos. You've got testimony. This is beyond SEC documents now and beyond annual reports, and beyond brokerage reports, and beyond presentation. This gives us various groups of people that had to try and kill these companies, because that was the mandate when they borrowed money from taxpayers. And the taxpayers are not GM, but when it comes to the banks and AIG, I'm going to get every penny back plus some. And if they did it right, taxpayers would make a really good profit. But that doesn't look to be the case right now.

This is where I started my career- in financial services. This is where I have to prove myself again. This is what I'm doing. This is what I'm involved in so, ask away.

These are the same theses by the way, for Citigroup, Bank of America, Goldman Sachs, and AIG. We have a huge position in AIG. What a horrible company. MBIA, the dreaded bond insurance that is supposed to go bust, that's been shorted by some famous people. We have the dreck of the dreck. We have the most hated companies in the United States which are going to make us a fortune.

Audience Member 1: I have a two-part question that's connected. I've given a lot of thought to what you said about that there's over a trillion dollars on fixed balance sheet. But I don't know what it means. I know that they can prep money. I know that's easy, but if it's only a balance sheet as opposed to the deficit. Is this something they really have to pay out?

Bruce Berkowitz: If they bought it when there was a credit crunch and no one could borrow money, not even General Electric and Goldman Sachs. Morgan Stanley was one day away from going broke with JP Morgan. It was during Bear Stearns and AIG. So they bought all these assets in order to put liquidity into the system. I'm not good at this. I'm just giving my best guess. So, now there was liquidity in the system. You have a whole bunch of people circling around thinking they're going to steal all those assets at a good price with the U.S. Government. So, they'll sell them that.

Audience Member 1: So, connecting it to the bank, then when they print money, you hear the Feds printing money. Is that the money on the balance sheet? I'm connecting it in a way that it seems to me...and I don't know that much, but that a lot of the advantage of the bank is that they can borrow money for nothing. I feel like I could be a great success in any business if I got a product for nothing.

Bruce Berkowitz: With five times starting a bat, nothing like borrowing money for zero. We have looked it. You can borrow, you're right. You can go to the Federal Reserve and borrow for very little money, and then do what you want with it, basically.

Audience Member 1: And is that the money on the balance sheet? Is that the money they're printing?

Bruce Berkowitz: On the balance sheet of the government?

Audience Member 1: Yeah, I mean, how does that all work, and if the banks couldn't borrow money this cheaply, would they still be so profitable?

Bruce Berkowitz: You also have to take into account who else is printing money around the world. I can only tell you one thing that I'm absolutely certain, it's great to own the printing presses.

So it's the trust and faith. Right now, we will still have the confidence and frankly, as far as I know, all the printing presses all around the world are just going at it; spitting out money all the time. I don't know how that's going to end. Maybe that's why we have a real estate company now, because you can't grow food on gold.

Audience Member 2: Please correct me if I'm wrong on this. But I'm under the impression that the Fairholme Fund has not made money this year. Would you comment on that?

Bruce Berkowitz: I can't correct you. You are right. We are down I think roughly 10%. Why is that? If you think that you could invest money in a fund and get above average performance, and do it in a nice way on a monthly basis, Bernie Madoff can help you out. Because it's pure fantasy, that's not reality.

We outperform because we take positions that are perceived to be fact. Which means they're probably going down in price and given that we don't have a crystal ball, we buy them and they go down. And we look like idiots for a little while. Maybe I'm going to look like an idiot for a long time.

Now, we were in the healthcare companies. We made good money. We should have stayed there. They kept going up. Now, the healthcare companies are the safe place to be.

When we bought them a couple of years ago, you had to be crazy to buy them because the new healthcare policy was going to destroy the model, which begs the question. How is the government going to change the healthcare system? They don't have anyone to change it. All they can do is write checks.

The people that they were yelling at are the same people they take advice from. At one end it's killing them. The other here is paying them, and it's a crazy system that we have. That's the same except you can use that with the banking analogy. You could study what happened with the healthcare, the healthcare insurance firm. And you could see that you have these banks. It's a similar process, a similar concept.

Audience Member 3: Easy question first. How much is under management at Fairholme?

Bruce Berkowitz: About \$18 billion, 20 billion.

Audience Member 3: Harder question. If the banks are making money because they're borrowing from the Fed at a few basis points and lending it to the treasury at a few percent, and then making money on that spread, what happens when the Fed stops lending them money at zero interest?

Bruce Berkowitz: I think as interest rates go up, they'll make more. It's hard to mark up something at 30 basis points that you're lending at four.

Audience Member 3: When the Fed stops lending because the banks don't think life support.

Bruce Berkowitz: They don't really need it. If you take a look at most of the banks that we're in, huge, lion's share amounts, 70%, 80%, and sometimes 100%. It's all deposits. It isn't the Fed. The Fed was in there during the crisis. We're not in the crisis mode. It would be nice if everyone got a bit more interest on their money and then we'd lend it a little higher rate. Banks made a lot of money, holding money for a couple of days over the weekend here and there. They make nothing. They used to make a lot of money doing that.

Audience Member 3: Your analysis of Bank of America is based on commonly known information, namely parts of their...

Bruce Berkowitz: Everything, right.

Audience Member 3: Commonly known information is often or almost all the time discounted...

Bruce Berkowitz: Excuse me, it's all public information.

Audience Member 3: Public, yes. Everyone knows the same things.

Bruce Berkowitz: But I don't know how many people knew about the toxic talk, you can go to the website and they have thousands of pages or reports hot off the printing press. How many people got the video of sworn testimony? How many people read the Dodd-Frank bill of 3,000 pages? Most people just pick up the newspaper. It's translated for you based upon the reporter's viewpoint, knowledge and so on.

Audience Member 3: All investment analysts can come up with the same public information and it would be priced at that amount but the price would've already been up.

Bruce Berkowitz: I guess, right.

Audience Member 3: There must be certain things that are holding it back possibly, certain loan portfolios which may go sour.

Bruce Berkowitz: No, I'm saying to you we had an informational edge. I believe we have an informational edge. That's what I'm saying. I don't believe that the market is efficient on this right now. It's as simple as that. But tell me if I'm wrong, anyone who goes to the GAO and reads their reports, it's like watching paint dry. You can't have a life to do this. Most analysts have to cover a whole bunch of companies.

Plus, I worked at Salomon's. I was a managing director of Salomon's. You're getting it now to the psychology of investing. You are assuming efficiencies which don't exist. In other words, your typical analyst rule number one is "Don't lose my job," which means rule number two is "I cannot do anything out of the box because if I'm wrong I will be fired."

We can keep going down that road and that's what I'm saying. When I was in the book-making business and I saw the perverse psychology of someone willing to gamble hundreds of dollars in pay and be upset about paying 5 cents for a cup of coffee or herd instincts or how people get anchored by certain concepts or how you're biased by the madness of an incident by that happened last week as opposed to last year and how you take shortcuts your risks...your driving is calculus. But we don't do calculus.

There are all sorts of ways you brain tricks you and you can be your own worst enemy. But if you think that the analytical world that publishes reports is efficient and unbiased, in my experience it's far from the truth. All those decisions made in a group setting which dummies it down to the lowest common denominator. I could be wrong about that but I've seen an awful lot of smart people get together and act like idiots.

Investing is a lone...one person has to be responsible for making the decision. The buck has to stop with one person. You can't have a group where something goes bad and everybody takes three steps back.

I'm just trying to explain to you why I don't think that is right. In fact, I don't think you could find three people that have done the research that Charlie and I have in the banking business in the United States. If you could find three people that swear on a stack of bibles that they went through the documents that I just mentioned to you, I would be very surprised.

With AIG, thousands and thousands of pages, it's impossible. We did a deal with GGP, the contract was 8,000 pages. It's a lot of work. It sounds easy. I'm trying to distill it down to what it is but it doesn't go beyond algebra. It's investigative reporting and it's a 24/7 job.

Audience Member 3: You had sufficient time to do the analysis, to do whatever you need to do. It sounds involved; you wouldn't want to be sidetracked.

Bruce Berkowitz: I go to sleep with headphones on. I'm listening to presentations during the wee early hours. Yes, once you do it for 20 or 30 years, you can't stop. It's an addiction and I don't have a hobby. It's not great for my family but they seem to be okay with it.

Audience Member 4: I'd like to ask you what do you think about the vote recently in Congress about the debt limit and what would really, truly happen to America if they didn't borrow anymore?

Bruce Berkowitz: It's insane. We've got to increase the debt limit and that's it. We're the reserve currency of the world. We're going to start paying our debts to the Chinese. We're going to default? It's insane. I don't even know how you can even begin to go there.

The elections are how far away? Eighteen months, something like that? Once this problem starts to get resolved faster now, every incumbent is going bye-bye. They're all going. It's about jobs. It's about growth. It's about moving forward. It's about everyday for three years now, about the same issues because that's entertainment in the newspaper. It's about moving forward. I'm going to move forward. Everybody has to come together, saddle up, move forward which is what we usually do. To makes things better, it takes the crisis.

Audience Member 5: What are your thoughts on Leucadia? I went to their annual meeting two weeks ago and they're very secretive guys. They seem to shed their skin every year. It'll be a hard company to analyze because they're a new company every year.

Bruce Berkowitz: It's a blind trust. You have to have faith in that guys know what they're doing. I've been an investor in Leucadia for probably 20 years. I've been the largest investor for a very long time. I don't even go to the meetings.

The annual report, I thought, this year was outstanding. They just lay it out. They're very conservative. It's hard to find negative surprises from them but they're both getting to an age where maybe they want to take it easy.

One is early 70's, the other late 60's. They're entitled after making people a fortune; they're entitled to a break.

Audience Member 6: I think you took over as chairman of St. Joe. Am I correct?

Bruce Berkowitz: Yes.

Audience Member 6: Is that an operating position? To some extent isn't it diverting you from running your funds?

Bruce Berkowitz: I grew up in a one-bedroom apartment and never had a backyard. So, I thought 600,000 acres would be a lot of fun.

We've been an investor in St. Joe for three years. If you live in Florida, St. Joe's is a storied company started by A.I. DuPont. In the 30's, I think Mr. DuPont married a cousin that was frowned upon. Eventually, there was a split. He moved to Florida with about 30-odd million dollars during the Great Depression; bought a million-and-a-half acres, used to own big chunks of Miami, railroads and papers. Now, the company is down to a little under 600,000 acres. We bought it at what we felt was a cheap price.

It's hard to discuss St. Joe. You have to go there. It has some of the prettiest beaches I've seen in the world, like the Hamptons. There's something about an east west beach with dunes, to see the sunrise. We have some great stuff.

There's no doubt about it, we'll do well. The only question is when because these are big, long projects. Everybody worried about inflation and maybe that will be good for St. Joe. Everybody's worried about food and growing, maybe that will be good for St. Joe. But you have to see some of the places, Rosemary Beach, seaside. It's great.

St. Joe; is a small position. It's a work in progress. There's nothing hidden there.

A brand new international airport opened up last May and that's what was missing; it took three cars, a train, a bus and a plane to get there. Now, there are 20 flights in and 20 going out and growing, and way ahead of schedule. The closest you can get now is Baltimore, right to Panama City International Airport. What we have to understand about that area is it's the closest area to the Panama Canal. There are two deep water ports. It's a long-term project but it's the airport. It's doing better than expected.

Audience Member 7: First of all, thank you for your presentation on Bank of America. I find it very informative. To somebody who, let's say, is interested in income, what is Bank of America paying now? They're paying a dividend of a couple of pennies?

Bruce Berkowitz: Zero.

Audience Member 7: Zero, okay. You talked about a year from now that people here will know if you're a genius or not. Is that about the timeframe in which both financially and politically it would be able to start paying a significant dividend?

Bruce Berkowitz: There's no secret here in the presentations of Bank of America. Brian Moynihan, the chairman and CEO, stated that they expect to payout all their money. Right now, he's thinking about maybe one-third

dividends two-thirds buybacks. It all depends on the price of the stock. You're a year away from something very interesting; but a year from now, if I'm right, everyone will know it.

Audience Member 7: Second question just prompted by your response to question about St. Joe's. Are you familiar with a timber REIT called Rayonier, which also has hundreds of thousands of acres in the Florida, Georgia area?

Bruce Berkowitz: No.

Audience Member 7: They've got a basic business producing fibers which is very profitable and successful. They're also the owners of hundreds of thousands of acres of timber land on that route 95 corridor in Florida. Georgia's very valuable and they pay nearly 5% dividends. I was wondering, given your interest in St. Joe's, if you were attuned to the Rayonier situation.

Bruce Berkowitz: We publicly stated that we just started the process. First, we're dramatically reducing cost, as we discussed at the annual meeting. It's so vast. We still have a hotel and three golf courses. We don't even know what's underneath the ground, 140 miles of coastline that touches the Gulf of Mexico, got an inland canal that's 20 miles long of which we own both sides. It could be worth zero; it could be worth a lot. I'm not promoting it. I'm just saying, "Yeah, that would be a real good idea one day." It could be a REIT. It could be a lot of things.

Got the BP oil spill. That's \$20 billion that BP is dying to give away. I don't think they've given four of it away. BP doesn't even know we exist.

We're probably the largest institution in Florida. That doesn't mean anything. But I'm saying we need some more time to understand what we have. All I know is if you take the value of the company divided by the acreage, that's going to give you a per acre price. Then, you've got to divvy it up to what you think. Eighty percent of our land is within 20 miles of the Gulf of Mexico.

I don't know whether we're just going to wait for a boom in real estate and sell it or whether we're going to create the next Tampa-St. Pete. I don't know but that's the history of real estate development. Until you do something, it's just talk.

Audience Member 8: What do you think of some of the smaller regional banks as opposed to the big ones? If you like any, can you recommend any?

Bruce Berkowitz: We're the largest owner of Regions Financial which is in the Southeast United States. Regions, we're okay there. From the last banking crisis, you just had to make it. That was the trick. You had to survive.

We're so focused on what we do. There's only so much we can do. For Regions, we'd rather deal with a bank we know and live near. Bank of America...I started my career at Merrill Lynch in London in 1982. I have a pretty good understanding of Merrill Lynch and what it can be, what it was, what happened, what went wrong, and again how they can be helpful. Bank of America is also a US trust. For me, personally, that's my circle of confidence. That's the industry in which I grew up and that's where I spent the last 30 years of my life.

Audience Member 9: Thanks for taking the time. Two questions if I may. Number one, how do you get your ideas? Number two, these financials that you look at have some very complicated balance sheets and it's very hard to assess what assets and values there are. Can you walk us through the process when you look at the balance sheets to see if they actually are the walking dead versus they have survived really due to, obviously, a lot of discounting and estimations. Can you just run us through that?

Bruce Berkowitz: Ideas by accident. I think the question, if I restate your question, how do you know what they own, what they owe? How do you really know? It's so complex with all those derivatives and all of that stuff.

It gets back to understanding burn rates and things that go bad in the bank, 90 days something happens, 180 days something happens. They've got to report if they renegotiate the loan. You have every regulation known to mankind over you. It's the burn rate. It's the pig in the python. That's true of insurance reserves. It's impossible to know every insurance policy. It's true of bank loans. But bank loans burn off. They have a half-life of about four years.

How many years have we been through? They've been under the microscope. The auditors are being sued. The U.S. Treasury staring at them. The supervisors are watching the U.S. Treasury. The senators are watching the supervisors, watching the U.S. Treasury, watching the auditors, watching the bank. Redundancy and time, it's been destroyed.

Let's not forget some of these companies that had reverse splits. For old shareholders, I don't see how they're getting passed. Also, you have to remember the investment process is comparing what you pay to what you get. If there's a big enough margin of safety, I don't have to be perfect. I have to be roughly right.

I wish I had a better answer but that's it. That's the big thing. Some people think that I'm insane. I actually stated personally two years ago, "You didn't know what they own, what they owe and who owns them." I think we're over that now.

Audience Member 9: You mentioned that Bank of America is also global. Could you speak a little bit more to that point?

Bruce Berkowitz: Merrill Lynch is a global franchise, investment banking and retail. Bank of America deals with most of the Fortune 500. They deal with most of the Fortune 1000. They have plenty of room to expand. They're not global like Citigroup is global... they don't have that global reach. Merrill Lynch is global; Bank of America, they're not 50/50. But they have good international presence and they're growing.

I think the bank isn't selling for much more than what Merrill Lynch used to sell for. You get everything else for free if you assume that price for Merrill Lynch is right. The MBNA credit cards, they sold us in the U.K. processors as European processors but they own a big chunk of Santander, which is a great bank. They just sold off. They have stuff they don't even know they have.

Everybody is so focused on the liabilities. Now is the time to change your focus and go to the left side of the balance sheet and try and appreciate the assets that these companies have. We spent four years understanding every weakness.

Derivatives aren't that complex. It's a derivative on an interest rate, it's on a currency. All new managements...what new management would want to go in there and not write-off the kitchen sink if they have chance to make a fortune. I don't understand why anyone would want to take on yesterday's problems. There's just no personal incentive for that.

If you're the new CEO, I think Brian is having a bite. But, basically, you want to get the stuff and rightly blame it on the previous guy and show how great you are.

Audience Member 10: In my opinion, I think that there's going to be a great bull market for maybe another 10 years because we're not going to default on the loan. The housing market is going to pay the ruins for 10 years easily or more. I don't know how Europe's going to fight for this but we...

Bruce Berkowitz: I'm sorry, I didn't understand you. You said there's going to be a bull market for 10 years.

Audience Member 10: A long time because our housing market's going to be down for 10 years or more.

Bruce Berkowitz: And that people have somewhere else to put their money?

Audience Member 10: In the stock market?

Bruce Berkowitz: Yes.

Audience Member 10: Yeah, there's no interest rate.

Bruce Berkowitz: Think about this, maybe life insurance is going to come back with minimum guarantees because everyone has spent all this time and energy. I based my self-worth on what a genius I am investing money. All of a sudden, pop, I've gotten nowhere. Maybe I'll go back to the old ways of putting it in a life insurance policy; you're guaranteed a minimum and go do something really productive. Save some people's lives or whatever.

A lot of people are just totally demoralized from the process that's taken place. I don't know whether or for how long there's going to be a bull market. But you may be wrong on real estate. It's going to take more time to burn through the inventory. For example, I was just told by one of the largest builders in Florida that there's going to be a shortage of rental properties because people don't want to buy. They're going to live somewhere. All of a sudden, there aren't enough rental properties. If there aren't enough rental properties then the price of those rental properties are going to go up. The stuff that you usually buy will become rental property. You know people trade a lot, you know, that's not unique, but it's the history of real estate.

Audience Member 11: I have a few parts, whatever you have time for. Last time, you said something to the effect of looking at what other people are buying; you can't really go by that because it doesn't work something to that effect. I just wondered if you could clarify that. Looking at great investors, what they're buying, you can't copy them, something to that effect.

Bruce Berkowitz: I think it helps to hear the negatives that other people have to say. I don't know if it helps to take parts of this. What's the point? If you're going to look at anybody else's work, you might as well read about or hear about all the ways that that person thinks you're an idiot. And then, hopefully without denial, try to figure out whether he or she is right or wrong.

Audience Member 11: You really don't look at what other people are buying?

Bruce Berkowitz: No, I don't look at what other people are buying.

Audience Member 11: We've had a lot of great managers and they came through the crisis with different results.

Bruce Berkowitz: They come and they go. I may be going to go now. Sucking this year.

Audience Member 11: I'm just wondering, some came through the crisis with different levels of success. You came through...

Bruce Berkowitz: We did okay.

Audience Member 11: I'm just wondering what can be judged by the way people came through the crisis. How do you determine...

Bruce Berkowitz: How should you determine?

Audience Member 11: Yeah, other people.

Bruce Berkowitz: I would say talk is cheap. Everybody can do great in a bull market. You study people and see how they survive during difficult times. That's one; that's how they get good records. Two, you've got to realize that people like myself, it's the last investment that can kill you because you start small, it gets bigger and bigger. Some very famous people went out on a very sour note. You have to look at the money weighing of returns. You've got to see where that person has his or her own money because, at some point if the person's very successful and they put all their money in what they're doing for all of their shareholders, the person's going to say, "You know, what's the point of trying to make more if I'm just going to lose what I already made?"

It gives you balance in your life. You have to try and understand the strategy of a person because, at the worst possible time, you will be shaken out. You will lose faith. You have to understand what the person's doing and have enough sense about it where you can hang tight during the inevitable difficult periods.

I'm having flashbacks right now of 1991 – 1992, that's not to say it's going to work out exactly the same, but all the same stuff.

Audience Member 11: Thank you very much for your presentation. I'd like to change gears a little bit. You strike me as a graduate of a college of hard knocks and your love of the business comes through. Anything you want to share with us? What motivated you to get into this business?

Bruce Berkowitz: What motivated me? Money. I didn't have any. I grew up in a lousy suburb of Boston. I wanted to have a better life than my parents, the great American dream. People do what they like so I started to like it. You can get good if you do something for 30 years, seven days a week for 24 hours a day.

Unlike other activities such as professional sports, this is an activity that as long as everything's good up top, you can do it for a long time, as long as you stay focused.

The question to ask yourself is why did some very smart people in this area get fooled by Bernie Madoff. I can understand the average person, but highly intelligent, professional people in the investing world got taken in. How did that happen? That's the question you have to answer and make sure you don't do that.

Audience Member 12: I have the last question. There are a number of close-end funds which focus on bank mergers. Do you see much of that occurring in regional banks and being absorbed by some of the big six?

Bruce Berkowitz: This is all going to cost consolidation. There's no doubt. I never understood how little community banks did really well, I mean, there is unbelievable profitability. I had all of my children open up accounts at the community bank I was very interested in. I noticed one of my sons was getting hit with hundreds of dollars of late fees. Because some of these little community banks, you don't even know it but you're signing a little overdraft facility. Every time you put your card in for \$5 or go to Starbucks, they're hitting you with a \$25 late fee.

That's what some of the arguments have been about lately and that's what the Bank of America has dramatically changed in terms of late fees. There were some egregious behaviors, none of the bigger banks. You have to ask yourself why do some of these small community banks do so well. Because they're either country clubs for the directors who want to get money or they're charging ridiculous fees.

My answer is I think the small guys die. The big guys eat the smaller guys. Fannie and Freddie are going to be dead. Banks are going to move to their more traditional role and they're going to do just fine. Hopefully, they will stay away at least until I make a lot of money.

Thank you everybody.