

BLOOMBERG TV “STREET SMART” INTERVIEW WITH BRUCE BERKOWITZ

**June 9, 2011
3:15 p.m. ET**

Bloomberg: Welcome back to "Street Smart." Leaders from across the investment industry are meeting today at the Morningstar Investment Conference in Chicago. "Inside Track's" Erik Schatzker is there, and with him now is the Founder and Chief Investment Officer of Fairholme Capital Management Bruce Berkowitz. Last year he was named domestic fund manager of the decade by Morningstar. He's also the chairman of the real estate operating company St. Joe. Great setup, great guest. Erik, all yours.

Carol, it's a brave Bruce Berkowitz who's sitting across from me this morning. Not because he's talking to me but because he has laryngitis and has stuck around to do the interview. Bruce, I'll ask you this question to start off with. The debate over financial regulation is raging again, thanks in large part to a showdown the other day between the Fed Chairman Ben Bernanke and Jamie Dimon, the CEO of JP Morgan Chase. Whose side are you on?

Bruce Berkowitz: Clearly it is time to move on. Everybody has to settle up their differences and for the sake of the country move on. You can't punish new people for past acts. You can't tighten too hard right now. It has to be phased in. So I think Jamie has points. I don't know if this point should be given to Bernanke or to others, but he has points. It's time for the sake of the country - to move forward.

Bloomberg: So maybe while he does have a point to make he should be making it less publicly, less aggressively, and encourage everybody else to do what you say is necessary, just move on?

Berkowitz: Everybody had a hand in this and everybody can help out and move us forward.

Bloomberg: You own a lot of financials. You have for a while. AIG, Bank of America, Morgan Stanley, Goldman Sachs, Citigroup, Regions, the list goes on. Are you still as certain as you were then when you bought those stocks that they will deliver the returns that you expect. Do you have the same level of conviction?

Berkowitz: More so. Because I've been able to see their earnings for the past few quarters. The trends are getting better. The balance sheets are building. Tangible book value is growing. The cash flow, the pretax, preprovision income is there to take care of the problem. The problems from 2007, 2008 still have a ways to burn through. I would say we're more than halfway through the problem. Now we just

have to get rid of the uncertainty in the environment, give people confidence to move forward.

Bloomberg: Many people would agree with you that there is no question uncertainty plays a role. But there is more than just uncertainty here. There's more than just temporary headline risk. Many people would point to some deep structural obstacles facing the financial industry in the form of regulation, in the form of limits on fees, for example. For credit cards, the Senate was unable to extend the deadline imposed on the credit card industry by the Federal Reserve. How long is it going to take for all of those things to go away for these stocks to turn around?

Berkowitz: I think Winston Churchill had it right when he said we go through every alternative, and finally on the last possible alternative we get it right. And sometimes we seem to do extremely well during times of crisis, extreme crisis. Like - I hope we can do it a little faster this time, but everybody knows what needs to be done.

Bloomberg: Can you put a timeframe on it? I know it's difficult.

Berkowitz: Before the next election.

Bloomberg: Before the next election. What happens if the economy turns south? We've all seen the very discouraging, and frankly disappointing signs from last week. The jobs numbers. Consumer confidence. The list goes on.

Berkowitz: I'm not good on the macroeconomics. What I do know is that our financial system, the banks that I own, the brokers that I own, the insurers I own, they are the financial system of the United States. I think the United States Treasury, the Federal Reserve -- they're not that big a place. Companies are the financial system of the United States and they will be fine, and they're stronger and better than they've been in a very long time.

Bloomberg: Bruce, if your thesis is sound, if financials are just beaten down and it won't be that long before they bounce back, why not own the best company in an out of favor industry? As the best run bank in America, why not own JP Morgan instead of Bank of America?

Berkowitz: The investment process is about comparing what you give versus what you get. So it's the intrinsic value of an organization versus the stock market price. I think Bank of America right now is the kicking boy for the whole real estate residential mess. I think Brian Moynihan's doing a good job. He'll continue to do a good job. I think they're ahead of the curve in reducing late fees. There's some very great properties, Merrill Lynch, MBNA. And they're getting killed for being patriotic, taking over Countrywide, which will one day again will be serving a good purpose, making loans.

They have the balance sheet. They're selling below tangible book value. You have 30,000 extra people working the residential mortgage issue to try and get it over with as quickly as possible. They're doing and making all the right moves. And the price of Bank of America reflects an extreme pessimism that JP Morgan's price doesn't have. So when you compare what you have to pay to what you get, I'm with Bank of America.

Bloomberg: That was a very articulate answer, and you – in some respect answered what my next question was going to be -- a degree of confidence that you have in Bank of America management. Why 18 months in to Brian Moynihan's 10 years as CEO, do you feel this confident about his ability to turn the bank around because I know that you've seen some encouraging signs but numbers still aren't that great. It had to backtrack on things like promising a dividend. Those are alarming signals to some investors and clearly they voted with their feet.

Berkowitz: You have to go back and really understand the nature of the residential home housing crisis. It started more than a decade ago with a great idea, everyone should own a home. But when it started with everyone should own a home, could they afford to own a home? Because without the ability to pay for that home, it becomes a ball and chain around your ankle and then you had Freddie and Fannie losing their standards, you had advocacy groups like Acorn demanding that the lenders lower their standards so that everyone could own a home. Of course with such demand, prices went up, interest rates were low, huge problem and sometimes the hangover can take longer than the party to go through. And so, Brian, he has inherited the Countrywide mess and they are aggressively working through it. If you do the numbers: 30,000 people, the number of loans that needs to be worked through, you're talking about 1 to 2 years, but you don't have to wait till the end. You can now work your way through it. I think in another six months it is going to be obvious to everyone what is going on and I think they are doing it in a very decent and respectful way.

Bloomberg: Six months isn't that far into the future. You're absolutely certain that he's the right guy for the job?

Berkowitz: I have talked with him. I like him. He understands the business. I think he understands the components. I agree with him and I don't see anyone better for the job.

Bloomberg: How about Goldman Sachs? Lots of questions swirling I think these days. Goldman seems to be dragged into the headlines day after day after day. Is in your opinion the Goldman Sachs franchise intact or at this price it doesn't even matter whether negative publicity drives away some customers or the prosecutors find something or someone to nail with a criminal charge?

Berkowitz: You're right about the price, that the price of financials are just so cheap. The price already builds in a bad result, so there is a huge margin of safety in my

opinion built in with the financials. Goldman's franchise in my opinion is they attract very bright, creative, honest people. They have been of tremendous help to us in the Far East, all our insurance positions. We like the people that have done a good deal for us and they're just in some areas, you know they are - as a firm they're best in class, There's always good people in every firm but we typically hold an entire firm. If we had to pick one firm to go to, it would be Goldman Sachs.

Bloomberg: Do you feel – do you believe, Goldman Sachs comes out of this period? I don't even know how to call it.

Berkowitz: Yes.

Bloomberg: But on the other end of this, it comes out a stronger firm?

Berkowitz: Yes.

Bloomberg: Or would it be a weaker firm than when it went in?

Berkowitz: It will be a stronger firm because...

Bloomberg: A profitable firm?

Berkowitz: Well the great point that you made before was, you don't have to think about that because the price reflects for the profits. For example Bank of America if they just make 1% return on assets and they have to have an immense amount of capital say 10% which is immense, and that would mean if you bought it at book value, you make a 10% pre-tax return. But, you're buying it at half the book value, that's 20%, so then – if the price is cheap enough then you don't have to worry too much about the returns.

Bloomberg: Why own companies that compete with each other? Bank of America, Citigroup, Morgan Stanley and Goldman Sachs? Many people would say, just pick the one horse you want to bet on, don't try to pick the win place and show.

Berkowitz: In the mutual fund world we have a certain amount of diversification among companies. There are certain rules. For example, if a company has a broker dealer, no more than 5% of the fund can be in that broker dealer. So, if we could pick one we'd rather have 10%. We would but we can't by the rules and of course there's a liquidity issue as your home gets bigger. We have to have enough liquidity to buy and sell based upon what our shareholders want.

Bloomberg: Are you selling anything right now, in order to do what you have been doing adding to existing acquisitions that you like and that you have ...

Berkowitz: No.

Bloomberg: So to the degree that you're doing that, you're funding it with out of the cash that you have or ...

Berkowitz: We were criticized for holding massive amounts of cash -- billions of billions - 20+ percent in cash. We always held that cash for rainy days, when we need to do something, if shareholders want their money and that was a lesson learned very early. You should always have cash. It's very valuable.

Bloomberg: And how much cash do you have now?

Berkowitz: Right now, the fund is about 5% cash, down from about 20%. We've had redemptions and we've made more investments.

Bloomberg: Do you still believe in the -- call it "in for a penny, in for a pound" approach which is to say that you need to dollar cost average down with those stocks that you hold that as they get cheaper you need to buy more?

Berkowitz: It's not a sufficient reason in and of itself. You have to be right. But if you're right and if you believe something is a good buy at X and you could buy it at half of X, well there can't be anything better in life. Except if you run out of money.

Bloomberg: [Chuckles] Is there any danger of that?

Berkowitz: No.

Bloomberg: AIG is one stock to which you have the penny, up until at least February according to Public Disposure.

Berkowitz: We did participate in the sale and the recent public offering also.

Bloomberg: Okay, so you continue to add and will continue to add opportunistically?

Berkowitz: We have certain limitations but we have. But we like AIG very much. The US Treasury's ownership of AIG has created an overhang, people want to stay away until the United States Treasury is out which has pushed the price down dramatically so, I could buy AIG with half of book value. Great international franchise with charters, great domestic companies on America, bits and pieces, mainland 2, mainland 3. One-third of AIA is cash. I think that's ridiculous -- thank you. That was good.

Bloomberg: There's a lot there.

Berkowitz: You know, in many ways it's all in the buying and if you could buy a great story name at half the value and a significant discount to tangible book value, well what do you need?

Bloomberg: So did you believe then that the catalyst for that stock is going to be the government “getting out”? By which I assume you mean getting to less than 50% of the share.

Berkowitz: It seems to be the number 1 worry. That’s the number 1 worry, I like that.

Bloomberg: How long do you think that will take? They’re at what? 76% now? How long to get to 50?

Berkowitz: If I had enough cash it wouldn’t take long at all. I think a bunch of people should really get together, really recognize the value of AIG and just take the United States Treasury out tomorrow.

Bloomberg: There was a conversation about another stock that you own not so long ago. Not unlike what you just said, CIT a company that may, according to Jeff Aronson from Centerbridge be a takeover target. He said 65 bucks a share; would you sell CIT at 65?

Berkowitz: It depends on what was going on when it was 65. If it were 65 tomorrow then it would be within my concept of fair value. John Thain’s just starting, he’s doing a great job. CIT was very lucky to get him, very unfortunate what happened at Merrill Lynch. I’m thinking he’s doing a great job, superb executive and he’s going to take CIT, he’s going to make it bigger and bigger and better I think. It’s very much like when Sandy Weill of American Express started with commercial credit. I think there’s some analogies there. John Thain’s a meticulous executive and I’m very comfortable owning a big position in CIT.

Bloomberg: You certainly wouldn’t want to happen to John Thain what ultimately happened to Citigroup that a company, many would say got too big for its own good.

Berkowitz: Well it’s too big and it’s interesting it’s an interesting story play on succession in the end -- who you picked and why you picked up. I think John’s too young for that issue right now.

Bloomberg: A couple of other questions here...

Berkowitz: Sure.

Bloomberg: ...Bruce. St. Joe was a very public battle. You won and now the chairman of the company, how much of your time is that job taking?

Berkowitz: We have a Principal Executive Officer in the company, so not much time at all. We’re still in the discovery phase. There is a tremendous amount of land at 900 square miles, a little smaller than the state of Rhode Island, huge coastlines, railroads, airport, deep water ports. We have quarter of a billion dollars in cash, we can lower the burden rate and try and get the place closed and break even. We

can afford to very meticulously look at all the assets, make sure what we understand. Because St. Joe has huge possibilities. We can just wait for the property market to turn and we sell off and make a very nice living, thank you. Specially with this new international airport or we could maybe think about creating the next step to St. Pete.

Bloomberg: Is there any point predicting when?

Berkowitz: No.

Bloomberg: The North Border Real estate market might recover?

Berkowitz: It's the history of real estate. It's just the nature of real estate; it's not worth a lot until you do something with it. When you do something with it, pop!

Bloomberg: They're selling timber rights which helps generate a profit there during the first quarter, signal anything about strategic direction they're going to take?

Berkowitz: If the signals were smart enough now to just sell the timber not the land, we get to keep the land. We have a lot more timber. We could do more, but we don't have to do more right now.

Bloomberg: And finally Sears. That has been a frustrating story for many people. What do you feel is the endgame at Sears? It's an unusual situation because it's like nothing the company has done has worked.

Berkowitz: If you put retailing spectacles on that's right, so far, but...

Bloomberg: So doesn't that – is that to say that it doesn't want to be a retailer? What does it want to be selling now?

Berkowitz: I think Eddie Lampert's doing a good job throwing a lot of spaghetti against the wall and seeing what's going to work. I do believe he has concern for the employees, Sears and K-Mart to try and do something, but then you know, Sears is real estate brands.

Bloomberg: I mean the real estate play has been talked about ever since he parted from the company. Given the state of the real estate market now.....

Berkowitz: If people are pessimistic about Sears and keep the price down, he'll keep buying stock back and eventually there will only be two shares, he'll have one, we'll have one, also have a chair.

Bloomberg: Okay that may be the case, but you would have both shares in a company whose sales are declining, whose profits are declining, that isn't investing in the business, that has been surrendering market share to rivals, all those things, doesn't matter whether you're a retailing expert or not. They're not good.

Berkowitz: You know, it's true trusting. During the merger this created over \$6 billion of free cash flow. The company's only valued at about 7¼ billion. So tremendous cash has been taken out of the operation which he has used to buy shares back. And that process will continue and on a per share basis the shares have not gone down.

Bloomberg: I see, so maybe we shouldn't be looking at it purely on the basis of Sears trying to compete with Retailer x, Retailer y, Retailer z?

Berkowitz: I have to think of Apple. Think of the time when Apple was almost down and out and Microsoft handed Apple a check. Now look at Apple today. Thinking of that, let's get a bit of an upturn in the economy and see what he can do.

Bloomberg: Alright Bruce, my pleasure speaking with you. Thank you very much.

Berkowitz: Thank you very much.