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ANNUAL REPORT

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THE FAIRHOLME FUND

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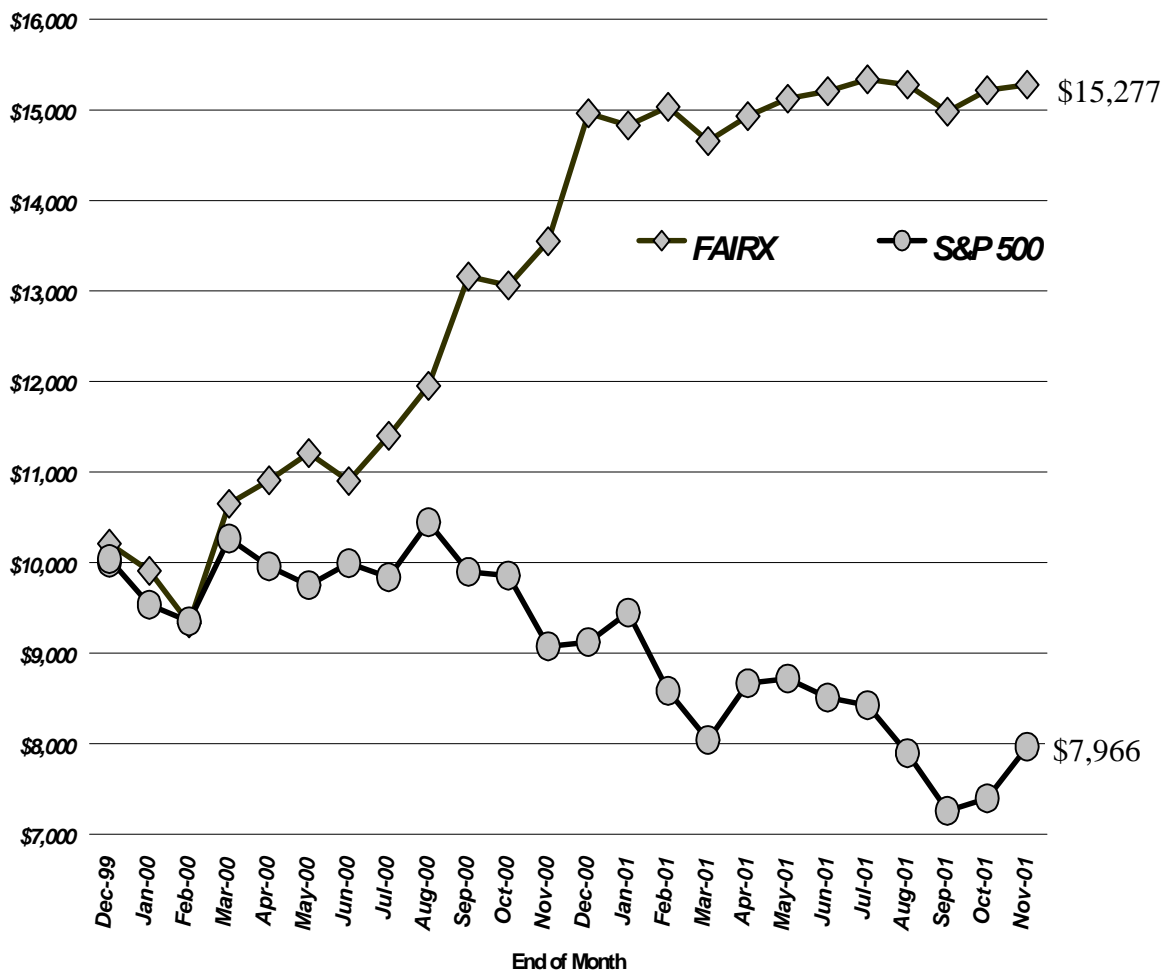
*A No-Load Capital Appreciation Fund*

*For the Fiscal Year Ended:*  
November 30, 2001

**[www.fairholmefunds.com](http://www.fairholmefunds.com)**

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## VALUE OF \$10,000 INVESTED AT INCEPTION THE FAIRHOLME FUND VS. THE S&P 500



This chart covers the period from December 29, 1999 (the date Fund shares were offered to the public) to November 30, 2001 (the end of the second fiscal year). Past performance is not a guarantee of future results and past performance should not be considered as representative of the capital gain or loss which may be realized from an investment made today in The Fund. Results do not reflect any taxes that a taxable shareholder might have incurred as a result of distributions by the Fund. Data for both the S&P 500 Index and The Fund are presented assuming that all dividends have been reinvested.

## THE FAIRHOLME FUND ANNUAL REPORT 2001

January 7, 2002

Dear Fellow Shareholder:

September 11<sup>th</sup> and subsequent events still permeate society. Our thoughts remain with the victims, their families, and the men and women serving to protect the world.

Below is a comparison of the Fund's performance and that of the Standard and Poor's 500 Index (with dividends reinvested) for the Fund's fiscal year ended November 30, 2001 and since inception:

	Fiscal Year	Since Inception
The Fairholme Fund	+12.7%	+52.8%
The S&P 500 Index	-12.2%	-20.3%

The Fund experienced good absolute performance, and very good relative performance as the bursting of the tech-stock bubble caused negative returns for the market averages. We are also pleased with our absolute and relative performance since inception.

Over the past two years, investing in selected property-casualty (P&C) insurance companies has contributed to recent returns and positions the Fund well for 2002. P&C policy prices and terms were improving before the events of 9/11, which caused the largest ever insured loss (estimated at between \$40 and \$70 billion). Many sectors of the insurance business are continuing to see attractive rate increases for policies that have tighter terms and conditions.

Three of our holdings, Berkshire Hathaway, White Mountains Insurance Group, and Markel Corporation, are well positioned to pay their 9/11 claims and to take advantage of the current environment. They have corporate cultures that prize underwriting profit and sensible investing. These characteristics and an industry tail wind make for attractive long-term returns.

Beyond insurance, formal indicators have confirmed what many have known for some time – the country is in a recession. While our non-insurance holdings are not immune from a weak economy, they generally have strong cash flows and sustainable competitive advantages. We expect them to emerge from this downturn well positioned for future growth and profitability.

Occasional periods of economic weakness bring opportunity. As we said last May, "While claiming no predictive ability to recognize or time the next recession, we are not afraid of periods of slow business and weak markets. Only in adverse environments do owner-oriented companies with proven records and strong balance sheets sell at bargain prices." The Fund enters the New Year with ample liquidity in the form of cash and short-term U.S. Treasuries. We are hunting for a few exceptional investments. At the right prices, we are ready to pounce.

Lastly, we say goodbye to Peter "Tony" Russ, who left us at year-end to form his own firm. We thank him for his contributions, wish him well on his new venture, and look forward to a continued friendship.

To learn more about The Fairholme Fund and its adviser, Fairholme Capital Management, L.L.C., please visit [www.fairholmefunds.com](http://www.fairholmefunds.com). Thank you for your support.

Sincerely,



Bruce R. Berkowitz



Lawrence S. Pitkowsky



Keith D. Trauner

# THE FAIRHOLME FUND

Schedule of Investments  
November 30, 2001

Shares/Principal Amt.—% of Assets	Market Value	Shares/Principal Amt.—% of Assets	Market Value
<b>COMMON STOCKS - 70.13%</b>			
<b>Financial Services - 3.43%</b>		<b>Security Brokers and Dealers - 2.46%</b>	
30,000 American Express Co.	\$ 987,300	20,000 Jefferies Group Inc.	\$ 707,000
<b>Gold Ores - 0.47%</b>		<b>Diversified Holding Company - 32.99%</b>	
9,000 Barrick Gold Corp.	136,170	3,130 Berkshire Hathaway Cl B*	7,302,290
<b>Home Furnishings - 2.31%</b>		52,500 Leucadia National	1,409,100
18,000 Ethan Allen Interiors, Inc.	663,840	2,500 Wesco Financial Corp.	775,000
<b>Hospital/Medical Services - 2.00%</b>		<b>TOTAL COMMON STOCKS</b>	
20,000 Oxford Health Plans	576,200	<u>20,164,916</u>	
<b>Newspapers: Publishing and Printing - 0.18%</b>		<b>CLOSED-END MUTUAL FUNDS - 1.40%</b>	
100 Washington Post Co. Cl. B	51,000	25,000 Boulder Total Return Fund	401,250
<b>Personal Credit Institutions - 4.24%</b>		<b>U.S. TREASURY OBLIGATIONS - 20.79%</b>	
16,500 Household International Inc.	973,335	2,000,000 3 Month T-Bill 0%, 1-17-2002	1,994,136
3,200 Student Loan Corp.	245,184	2,000,000 6 Month T-Bill 0%, 3-7-2002	1,982,264
	1,218,519	2,000,000 2 Year Treasury Note 3.125%, 11-30-2003	2,000,559
<b>Property and Casualty Insurance - 16.58%</b>		<b>TOTAL U.S. TREASURY OBLIGATIONS</b>	
7,021 Mirkel Corp.*	1,286,739	<u>5,976,959</u>	
17,000 Mercury General Corp.	743,750	<b>CASH EQUIVALENTS - 7.05%</b>	
8,100 White Mountains Insurance Group Ltd.	2,737,800	<b>Money Market Funds - 7.05%</b>	
	4,768,289	2,027,832 UMB Money Market (Current Yield 0.39%)	2,027,832
<b>Racing, Including Track Operations - 2.87%</b>		<b>TOTAL CASH EQUIVALENTS</b>	
20,784 Intl. Speedway Cl. A	825,333	<u>2,027,832</u>	
<b>Real Estate Operations - 1.67%</b>		<b>TOTAL INVESTMENTS - 99.37%</b>	
540,500 Homefed Corp.*	481,045	(Identified Cost \$24,414,076)	
<b>Retail Apparel - 0.92%</b>		<b>OTHER ASSETS LESS LIABILITIES - 0.63%</b>	
7,000 TJX Companies, Inc.	\$ 263,830	<u>181,824</u>	
		<b>NET ASSETS - 100.00%</b>	
		<u>\$ 28,752,781</u>	

\* Non-Income Producing Securities

The accompanying notes are an integral part of the financial statements.

## THE FAIRHOLME FUND

Statement of Assets and Liabilities  
November 30, 2001

### Assets:

Investment Securities at Market Value	\$ 28,570,957
(Identified Cost \$24,414,076)	
Cash	239,097
Dividends and Interest Receivable	<u>5,747</u>
Total Assets	<u>28,815,801</u>

### Liabilities:

Payable to Broker	26,728
Accrued Management Fees	23,420
Shareholder Redemptions	<u>12,872</u>
Total Liabilities	<u>63,020</u>

Net Assets \$ 28,752,781

### Net Assets Consist of:

Paid-In Capital	\$ 24,388,148
Accumulated Undistributed Net Investment Income	42,438
Accumulated Undistributed Realized Gain (Loss) on Investments - Net	165,314
Unrealized Appreciation/(Depreciation) in Value of Investments Based on Identified Cost - Net	<u>4,156,881</u>
Net Assets for 1,918,087 Shares Outstanding	<u><u>\$ 28,752,781</u></u>

Per Share Net Asset Value and Redemption Price \$ 14.99

(\$28,752,781 divided by 1,918,087 shares)

The accompanying notes are an integral part of the financial statements.

## THE FAIRHOLME FUND

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### Statement of Operations

	Dec. 1, 2000 to Nov. 30, 2001
Investment Income:	
Dividends	\$ 93,599
Interest	<u>194,644</u>
Total Investment Income	288,243
Expenses:	
Management Fees (Note 3)	<u>231,975</u>
Total Expenses	<u>231,975</u>
Net Investment Income	<u>56,268</u>
Realized and Unrealized Gain (Loss) on Investments:	
Realized Gain (Loss) on Investments	165,314
Unrealized Appreciation (Depreciation) on Investments	<u>1,861,815</u>
Net Realized and Unrealized Gain (Loss) on Investments	<u>2,027,129</u>
Net Increase (Decrease) in Net Assets from Operations	<u>\$ 2,083,397</u>

The accompanying notes are an integral part of the financial statements.

## THE FAIRHOLME FUND

### Statement of Changes in Net Assets

	Dec. 1, 2000 to Nov. 30, 2001	* Dec. 29, 1999 to Nov. 30, 2000
<b>CHANGE IN NET ASSETS:</b>		
From Operations:		
Net Investment Income	\$ 56,268	\$ 28,084
Net Realized Gain (Loss) on Investments	165,314	266,851
Net Unrealized Appreciation (Depreciation)	<u>1,861,815</u>	<u>2,295,066</u>
Increase (Decrease) in Net Assets from Operations	2,083,397	2,590,001
From Distributions to Shareholders:		
Net Investment Income	(41,914)	0
Net Realized Gain from Security Transactions	<u>(266,851)</u>	<u>0</u>
Net Decrease in Net Assets from Distributions	(308,765)	0
From Capital Share Transactions:		
Proceeds From Sale of Shares	14,301,172	11,565,624
Shares Issued on Reinvestment of Dividends	308,371	0
Cost of Shares Redeemed	<u>(1,541,315)</u>	<u>(245,704)</u>
Net Increase in Net Assets from Shareholder Activity	13,068,228	11,319,920
<b>NET ASSETS:</b>		
Net Increase in Net Assets	14,842,860	13,909,921
Net Assets at Beginning of Period	<u>13,909,921</u>	<u>0</u>
Net Assets at End of Period ( including accumulated undistributed net investment income of \$42,438 and \$28,084 respectively)	<u><u>\$ 28,752,781</u></u>	<u><u>\$ 13,909,921</u></u>
<b>SHARE TRANSACTIONS:</b>		
Issued	976,437	1,048,732
Reinvested	20,992	-
Redeemed	<u>(106,147)</u>	<u>(21,927)</u>
Net Increase (Decrease) in Shares	891,282	1,026,805
Shares Outstanding at Beginning of Period	<u>1,026,805</u>	<u>-</u>
Shares Outstanding at End of Period	<u><u>1,918,087</u></u>	<u><u>1,026,805</u></u>

\* Commencement of Operations

The accompanying notes are an integral part of the financial statements.

## THE FAIRHOLME FUND

### Financial Highlights

Selected data for a share outstanding throughout the period.

	Dec. 1, 2000 to Nov. 30, 2001	* Dec. 29, 1999 to Nov. 30, 2000
Net Asset Value at Beginning of Period	\$ 13.55	\$ 10.00
Net Investment Income	0.05	0.05
Net Gains or Losses on Securities (Realized and Unrealized)	1.67	3.50
Total from Investment Operations	1.72	3.55
Distributions from Net Investment Income	(0.04)	0.00
Distributions from Capital Gains	(0.24)	0.00
Total Distributions	(0.28)	0.00
Net Asset Value at End of Period	\$ 14.99	\$ 13.55
Total Return	12.75%	35.50 %
Ratios/Supplemental Data:		
Net Assets at End of Period	\$ 28,752,781	\$ 13,909,921
** Ratio of Expenses to Average Net Assets	1.00 %	1.00 %
** Ratio of Net Investment Income to Average Net Assets	0.24 %	0.46 %
** Portfolio Turnover Rate	29.40 %	45.88 %

\* Commencement of Operations

\*\* Annualized

The accompanying notes are an integral part of the financial statements.



# THE FAIRHOLME FUND

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NOTES TO FINANCIAL STATEMENTS  
November 30, 2001

## **Note 1. Organization**

Fairholme Funds, Inc. (the “Company”), a Maryland Corporation, is registered under the Investment Company Act of 1940, as amended, as a non-diversified, open-end management investment company. The Company’s Articles of Incorporation permit the Board to issue 100,000,000 shares of common stock at .0001 par value. The Board of Directors has the power to designate one or more separate and distinct series and / or classes of shares of common stock and to classify or reclassify any unissued shares with respect to such series. Shares of one series have been authorized, which shares constitute the interests in the The Fairholme Fund (the “Fund”).

The Fund’s investment objective is to provide long-term capital appreciation. The Fund seeks to achieve its objective by investing in common stocks without restrictions regarding market capitalization. The Fund will invest 75% of total net assets in U.S. common stocks and intends to hold a focused portfolio of no more than 25 stocks.

Fairholme Capital Management, L.L.C. (the “Adviser”), serves as investment adviser to the Fund. The Adviser is a Delaware limited liability company and is registered with the Securities and Exchange Commission as an investment adviser. The Adviser’s principal business and occupation is to provide financial management and advisory services to individuals, corporations, and other institutions throughout the world.

## **Note 2. Significant Accounting Policies**

The following is a summary of significant accounting policies followed by the Fund in the preparation of its financial statements.

*Security Valuation:* Securities, which are traded on any exchange or on the NASDAQ over-the-counter market, are valued at the last quoted sale price. Lacking a last sale price, a security is valued at its last bid price except when, in the Adviser’s opinion, the last bid price does not accurately reflect the current value of the security. All other securities for which over-the-counter market quotations are readily available are valued at their last bid price. When market quotations are not readily available, when the Adviser determines the last bid price does not accurately reflect the current value, or when restricted securities are being valued, such securities are valued as determined in good faith by the Adviser, in conformity with guidelines adopted by and subject to review of the Directors of the Company.

Fixed income securities generally are valued by using market quotations, but may be valued on the basis of prices furnished by a pricing service when the Adviser believes such prices accurately reflect the fair market value of such securities. A pricing service utilizes electronic data processing techniques based on yield spreads relating to securities with similar characteristics to determine prices for normal institutional-size trading units of debt securities without regard to sale or bid prices. When prices are not readily available from a pricing service, or when restricted or illiquid securities are being valued, securities are valued at fair value as determined in good faith by the Adviser, subject to review of the Directors of the Company. Short term investments in fixed income securities with maturities of less than 60 days when acquired, or which subsequently are within 60 days of maturity, are valued by using the amortized cost method of valuation, which the Adviser has determined will represent fair value.

*Federal Income Taxes:* The Fund intends to qualify each year as a “Regulated Investment Company” under the Internal Revenue Code of 1986, as amended. By so qualifying, the Fund will not be subject to federal income taxes to the extent that it distributes substantially all of its net investment income and any realized capital gains.

*Dividends and Distributions:* The Fund intends to distribute substantially all of its net investment income as dividends to its shareholders on an annual basis. The Fund intends to distribute its net long-term capital gains and its net short-term capital gains at least once a year.

*Estimates:* The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, to disclose contingent assets and liabilities at the date of the financial statements; and to record revenues and expenses for the accounting period being reported. Actual results could differ from those estimates.

*Other:* The Fund follows industry practice and records security transactions on the trade date. The specific identification method is used for determining gains or losses for financial statements and income tax purposes. Dividend income is recorded on the ex-dividend date and interest income is recorded on an accrued basis. Discounts

## THE FAIRHOLME FUND

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NOTES TO FINANCIAL STATEMENTS  
November 30, 2001

and premiums on securities purchased are amortized over the life of the respective securities.

### **Note 3. Related Party Transactions**

Certain directors and officers of the Company are also members and officers of the Adviser. For its advisory and administrative services, the Fund pays the Adviser an annualized management fee equal to 1.00% (0.50% of which are investment advisory fees and 0.50% for administrative and other services) of the average net assets of the Fund, such fees to be computed daily based upon the daily average net assets of the Fund. The Adviser received \$231,975 for its services during the year.

The beneficial ownership, either directly or indirectly, of more than 25% of the voting securities of a fund creates a presumption of control of the fund, under section 2 (a) (9) of the Investment Company Act of 1940. As of November 30, 2001, National Financial Services Corp. for the benefit of its customers owned over 66% of the Fund.

### **Note 4. Investments**

For the period ending November 30, 2001 purchases and sales of investment securities, other than short-term investments, aggregated \$13,434,077 and \$4,971,090, respectively. The gross unrealized appreciation for all securities totaled \$4,364,480 and the gross unrealized depreciation for all securities totaled (\$207,599), for a net unrealized appreciation of \$4,156,881. The aggregate cost of securities for federal income tax purposes at November 30, 2001 was \$24,414,076.

## INDEPENDENT AUDITOR'S REPORT

To The Shareholders and  
Board of Directors  
The Fairholme Fund:

We have audited the accompanying statement of assets and liabilities of The Fairholme Fund, including the schedule of portfolio investments, as of November 30, 2001, and the related statement of operations for the year then ended, the statements of changes in net assets and the financial highlights for the year then ended and for the period from December 29, 1999 (commencement of operations) to November 30, 2000 in the period then ended. These financial statements and financial highlights are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of November 30, 2001, by correspondence with the custodian and brokers. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of The Fairholme Fund as of November 30, 2001, the results of its operations for the year then ended, the changes in its net assets and the financial highlights for the year then ended and for the period from December 29, 1999 (commencement of operations) to November 30, 2000 in the period then ended, in conformity with accounting principles generally accepted in the United States of America.

McCurdy & Associates CPA's, Inc.  
Westlake, Ohio  
December 11, 2001

**Board of Directors**

Bruce R. Berkowitz  
Avivith Oppenheim, Esq.  
Keith D. Trauner  
Joel L. Uchenick  
Leigh Walters, Esq.

**Officers**

Bruce R. Berkowitz, President  
Keith D. Trauner, Secretary & Treasurer

**Investment Adviser**

Fairholme Capital Management, L.L.C.  
51 JFK Parkway  
Short Hills, NJ 07078  
Telephone: 973-379-6557

**Dividend Paying Agent,  
Shareholders' Servicing Agent,  
Transfer Agent**

Mutual Shareholder Services L.L.C.  
8869 Brecksville Rd., Suite C  
Brecksville, OH 44141  
Telephone: 800-417-5525

**Custodian**

UMB Bank N.A.  
1010 Grand Blvd.  
Kansas City, MO 64106

**Counsel**

David Jones, Esq.  
1288 Valley Forge Rd., Suite 87  
Valley Forge, PA 19482

**Independent Auditors**

McCurdy & Associates CPA's, Inc.  
27955 Clemens Rd.  
Westlake, OH 44145

This report is provided for the general information of the shareholders of The Fairholme Fund. This report is not intended for distribution to prospective investors in the funds, unless preceded or accompanied by an effective prospectus.