



**FAIRHOLME**

*Ignore the crowd.*

*“(E)ven the intelligent investor is likely to need considerable willpower to keep from following the crowd.”*

*- Benjamin Graham*



**FAIRHOLME**  
*Ignore the crowd.*

**PORTFOLIO MANAGER'S REPORT**  
July 2012

*“Traditionally the investor has been the man with patience and the courage of his convictions who would buy when the harried or disheartened speculator was selling.”*

*- Benjamin Graham & David Dodd*

# FAIRHOLME CAPITAL MANAGEMENT, LLC

PORTFOLIO MANAGER'S REPORT  
For the Six Months Ended June 30, 2012

*Mutual fund investing involves risks including loss of principal. Performance information quoted herein represents past performance and is not a guarantee of future results. The investment returns and principal values of investments in the Funds will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance information quoted within. The Fairholme Fund and The Allocation Fund impose a 2.00% redemption fee on shares held less than 60 days. Performance data does not reflect the redemption fee, which if imposed, would reduce returns. Any questions you have regarding the latest month-end performance can be obtained by calling shareholder services at 1-866-202-2263.*

## At June 30, 2012

To The Shareholders and Directors of Fairholme Funds:

Financial disasters start with great investment ideas taken to illogical extremes. For example, what has been more beneficial to family wealth than home ownership? Yet, we recently witnessed a near collapse caused by residential real estate.

Great investment ideas start with disasters. Liquidity disappears. Assets are marked to mayhem. Intangibles are written off. Companies with fixable problems become unusually cheap and again profitable. Yet, they remain hated for past sins and sell for less than assets minus liabilities, reported as book value. They have little, if any, investment risk.

This is when we focus on buying. This is also when we look dead wrong and have periods of underperformance. This is also how The Fairholme Fund has outperformed the S&P 500 Index in ten of the past twelve years.

In 1988, Warren Buffett wrote "...our marketable equities tell us by their operating results – not by their daily, or even yearly, price quotations – whether our investments are successful. The market may ignore business success for a while, but eventually will confirm it." Twenty years later, the 2008 collapse of financial markets was caused by companies ill-prepared for a national decline in home prices, the freezing of credit, and knock-on effects. Today, they stand at polar opposites.

## The Fairholme Fund (FAIRX)

The Fund gained 24.7% versus 9.5% for the S&P 500 Index in the first six months of this year. A \$10 investment in the Fund at its inception has grown to \$37.33 (assuming reinvestment of distributions) compared to \$11.74 for the S&P 500 Index. Cash and equivalents stand at \$1.25 billion (17% of the Fund). The following chart compares The Fairholme Fund's unaudited performance (after expenses) with that of the S&P 500 with dividends and distributions reinvested, for the period ending June 30, 2012.

<u>The Fairholme Fund Performance to 06/30/2012</u>	<u>Six Months</u>	<u>One Year</u>	<u>Five Years</u>	<u>Ten Years</u>	<u>Since Inception 12/29/1999</u>
<b>Cumulative:</b>					
The Fairholme Fund	24.71%	(6.96)%	6.02%	136.95%	273.26%
S&P 500 Index	9.49%	5.45%	1.09%	68.13%	17.40%
<b>Annualized:</b>					
The Fairholme Fund		(6.96)%	1.18%	9.01%	11.11%
S&P 500 Index		5.45%	0.22%	5.33%	1.29%

*This page is not part of the Fairholme Funds, Inc. 2012 Semi-Annual Report.*

# FAIRHOLME CAPITAL MANAGEMENT, LLC

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PORTFOLIO MANAGER'S REPORT (continued)  
For the Six Months Ended June 30, 2012

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Our best idea remains AIG common (35% of the Fund) with a reported book value of \$57 per share. There are few occasions when systemically important franchises sell for half of book value and are profitable. This is one of those times. AIG warrants held by the Fund (another 3% of the Fund) provide the right to 21+ million shares at \$45, or maybe more shares at lower strike prices for the next 34 quarters if dividends above \$0.675 per trailing 12-month period are paid.

Bank of America is the Fund's next largest financial holding (9% of the Fund) affected by the great housing price collapse. The company's reported book value is over \$20 per share. We believe that America's bank is returning to its retail roots (think of Wells Fargo) with a \$1 trillion deposit franchise and that bank profits will skyrocket as legacy real estate loans burn-off.

Sears Holdings (11% of the Fund) is one of the largest corporate real estate organizations in the world, with a portfolio of retail locations that is second to none. Generally Accepted Accounting Principles ("GAAP") mandate valuing their real estate at the lower of cost or market. GAAP would force the Dutch settlers to value Manhattan today at the 1626 purchase price of \$23.70. The company's reported book value of \$43 understates real values.

Warrants received by the Fund from General Growth Properties (7% of the Fund) during its reorganization provide the Fund the right to "cash-in" the difference between GGP's market price and the current strike price of \$9.52 on now 45 million shares. For the next 22 quarters, distributions by GGP will further reduce this strike price and increase the number of shares.

## **The Fairholme Focused Income Fund (FOCIX)**

The Fund seeks, among other things, current income. The Fund gained 6.5% versus a gain of 2.4% for the Barclays Capital U.S. Aggregate Bond Index ("Barclays Bond Index") in this latest six month period. In its first 30 months, the Fund gained 17.5% versus 17.6% for the Barclays Bond Index.

MBIA senior, unsecured bonds maturing between 2022 and 2028 represent the Fund's largest holding (29% of the Fund). These bonds have an average current yield of 10.1% and yield to maturity of 11.4% per annum. MBIA surplus notes of 2033 (another 12% of the Fund) are the most junior of MBIA bonds held by the Fund and have a current yield of 25.9% and yield to maturity of 22.4%.

Sears Holdings' 6.625% of 2018 and Emigrant Savings Bank's 6.25% of 2014 (each 21% of the Fund) have respective yields to maturity of 8.9% and 10.6%. They compare quite favorably to equivalent U.S. Treasuries. Cash and equivalents are at \$30 million (12% of the Fund).

## **The Fairholme Allocation Fund (FAAFX)**

The Fund seeks long-term total return. We have typically sought investments for the Fund that are too small to make a big impact on a larger fund. The Fund gained 11.3% while the Barclays Bond Index and S&P 500 earned 2.4% and 9.5%, respectively, in the past six months. In its first 18 months, the Fund is down 4.3% versus a gain of almost 10.4% for the Barclays Bond Index and 11.8% for the S&P 500. Cash and equivalents are at \$11 million (4% of the Fund).

MBIA common (32% of the Fund compared to 3% of FAIRX) has a reported book value of \$10 per share. GAAP mandates no value attributed to unearned premiums and mark-to-market reversals estimated to be worth \$20 per share. Since 2008, the company has paid \$35 per share on faulty real estate-backed bonds. Management expects to

*This page is not part of the Fairholme Funds, Inc. 2012 Semi-Annual Report.*

# FAIRHOLME CAPITAL MANAGEMENT, LLC

PORTFOLIO MANAGER'S REPORT (continued)  
For the Six Months Ended June 30, 2012

receive at least half back of the \$35 from the issuers of the bonds and to restart the municipal bond insurance business with the cash proceeds.

AIG common (18% of the Fund) is our second largest idea for the Fund given valuations and liquidity.

Long-dated warrants on AIG, Bank of America, Wells Fargo, J.P. Morgan, and Hartford Financial held by the Fund (in total 16% of the Fund) are unique in that strike prices decline and conversion share amounts increase with dividends paid above threshold levels. The following table summarizes each warrant's current strike price and conversion ratio, expiration date, and quarterly dividend threshold. Estimated returns are attractive, if as assumed below, underlying common share prices meet book values growing at 10% per annum and exercised shares can be sold at such prices.

Warrant Summary	Strike	Shares/ Warrant	Expiration	Dividend Threshold	Theoretical Return**
American International Group	\$45.00	1.000	1/19/2021	\$0.17*	752%
Bank of America Class A	\$13.30	1.000	1/16/2019	\$0.01	592%
Hartford Financial Services Group	\$ 9.65	1.015	6/26/2019	\$0.05	750%
JP Morgan	\$42.42	1.000	10/28/2018	\$0.38	368%
Wells Fargo	\$34.01	1.000	10/28/2018	\$0.34	48%

\* Assumes trailing 4-quarter cumulative dividends of 67.5 cents.

\*\* There can be no guarantee that these assumptions will occur.

## Liquidity and Concentration of the Funds

Fund share redemptions have forced the Funds to raise liquidity. Rather than selling across the board, we have learned not to sell our best ideas. Again, Mr. Buffett: "The strategy we've adopted precludes our following standard diversification dogma. Many pundits would therefore say the strategy must be riskier than that employed by more conventional investors. We disagree. We believe that a policy of portfolio concentration may well decrease risk if it raises, as it should, both the intensity with which an investor thinks about a business and the comfort-level he must feel..."

Respectfully submitted,



Bruce R. Berkowitz

Managing Member

Fairholme Capital Management

*As reflected in its current prospectus dated March 29, 2012, The Fairholme Fund's Expense Ratio is 1.02%, which includes acquired fund fees of 0.02%. Acquired fund fees and expenses are those expenses incurred indirectly by the Fund as a result of investments in shares of one or more investment companies, including, but not limited to, money market funds.*

*This page is not part of the Fairholme Funds, Inc. 2012 Semi-Annual Report.*

# FAIRHOLME CAPITAL MANAGEMENT, LLC

## PORTFOLIO MANAGER'S REPORT (continued) For the Six Months Ended June 30, 2012

The following chart compares The Income Fund's unaudited performance (after expenses) with that of the Barclays Bond Index with dividends and distributions reinvested, for the period ending June 30, 2012.

<u>The Income Fund Performance to 06/30/2012</u>	<u>Six Months</u>	<u>One Year</u>	<u>Since Inception 12/31/2009</u>
<i>Cumulative:</i>			
The Income Fund	6.48%	2.15%	17.51%
Barclays Bond Index	2.37%	7.47%	17.62%
<i>Annualized:</i>			
The Income Fund		2.15%	6.67%
Barclays Bond Index		7.47%	6.71%

As reflected in its current Prospectus dated March 29, 2012, The Income Fund's Expense Ratio is 1.01%. The Manager contractually agreed to waive a portion of its management fees and/or pay The Income Fund's expenses (excluding taxes, interest, brokerage commissions, acquired fund fees and expenses, expenses incurred in connection with any merger or reorganization and extraordinary expenses such as litigation) in order to limit the expenses of The Income Fund to 0.75% of The Income daily average net assets for the period of March 30, 2011 through March 29, 2012.

The following chart compares The Allocation Fund's unaudited performance (after expenses) with that of the S&P 500 and the Barclays Bond Index, both with dividends and distributions reinvested, for the period ending June 30, 2012.

<u>The Allocation Fund Performance to 06/30/2012</u>	<u>Six Months</u>	<u>One Year</u>	<u>Since Inception 12/31/2010</u>
<i>Cumulative:</i>			
The Allocation Fund	11.28%	5.51%	(4.30)%
Barclays Bond Index	2.37%	7.47%	10.40%
S&P 500 Index	9.49%	5.45%	11.80%
<i>Annualized:</i>			
The Allocation Fund		5.51%	(2.89)%
Barclays Bond Index		7.47%	6.82%
S&P 500 Index		5.45%	7.73%

As reflected in its current Prospectus dated March 29, 2012, The Allocation Fund's Expense Ratio is 1.01%. The Manager contractually agreed to waive a portion of its management fees and/or pay The Allocation Fund's expenses (excluding taxes, interest, brokerage commissions, acquired fund fees and expenses, expenses incurred in connection with any merger or reorganization and extraordinary expenses such as litigation) in order to limit the expenses of The Allocation Fund to 0.75% of The Allocation Fund's daily average net assets for the period of December 29, 2010 through March 29, 2012.

This page is not part of the Fairholme Funds, Inc. 2012 Semi-Annual Report.



# FAIRHOLME CAPITAL MANAGEMENT, LLC

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PORTFOLIO MANAGER'S REPORT (continued)  
For the Six Months Ended June 30, 2012

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*This Portfolio Manager's Report is not part of the Fairholme Funds Semi-Annual Report. The Semi-Annual Report contains a Management Discussion and Analysis section covering the period ended May 31, 2012. Opinions of the Portfolio Manager are intended as such. Unless otherwise specified, any references in this Portfolio Manager's Report to a portfolio holding of a Fund is at the latest public filing of Fairholme Funds, Inc. with respect to such holdings at the time of publication. Portfolio holdings are subject to change at any time and are subject to risk. There can be no guarantee that undervalued securities will appreciate as anticipated.*

*Expense ratios for the Funds stated in the current Prospectus dated March 29, 2012 may differ from the actual expenses incurred by the Funds for the period covered by the Fairholme Funds Semi-Annual Report.*

*The S&P 500 Index is a widely recognized, unmanaged index of 500 of the largest companies in the United States as measured by market capitalization. The Barclays Capital U.S. Aggregate Bond Index is an unmanaged market-weighted index comprised of investment grade corporate bonds (rated BBB or better), mortgages, and U.S. Treasury and government agency issues with at least one year to maturity. Investors cannot invest directly in an index.*

*Investors should consider the investment objectives, risks, and charges and expenses of a Fund carefully before investing. The Fund's prospectus contains this and other information about the Fund. To obtain a copy of the Fund's prospectus, please visit [www.fairholmefunds.com](http://www.fairholmefunds.com) or call 1-866-202-2263. Please read the prospectus carefully before investing.*

*“The stock market is a voting machine rather than a weighing machine. It responds to factual data not directly, but only as they affect the decisions of buyers and sellers.”*

*- Benjamin Graham & David Dodd*



**FAIRHOLME**

*Ignore the crowd.*

**FAIRHOLME FUNDS**

No-load, non-diversified funds

**SEMI-ANNUAL REPORT**

For the Six Months Ended May 31, 2012

**THE FAIRHOLME FUND (FAIRX)**

Seeking long-term growth of capital

**THE FAIRHOLME FOCUSED INCOME FUND (FOCIX)**

Seeking current income and capital preservation

**THE FAIRHOLME ALLOCATION FUND (FAAFX)**

Seeking long-term total return

MANAGED BY FAIRHOLME CAPITAL MANAGEMENT

# FAIRHOLME FUNDS, INC.

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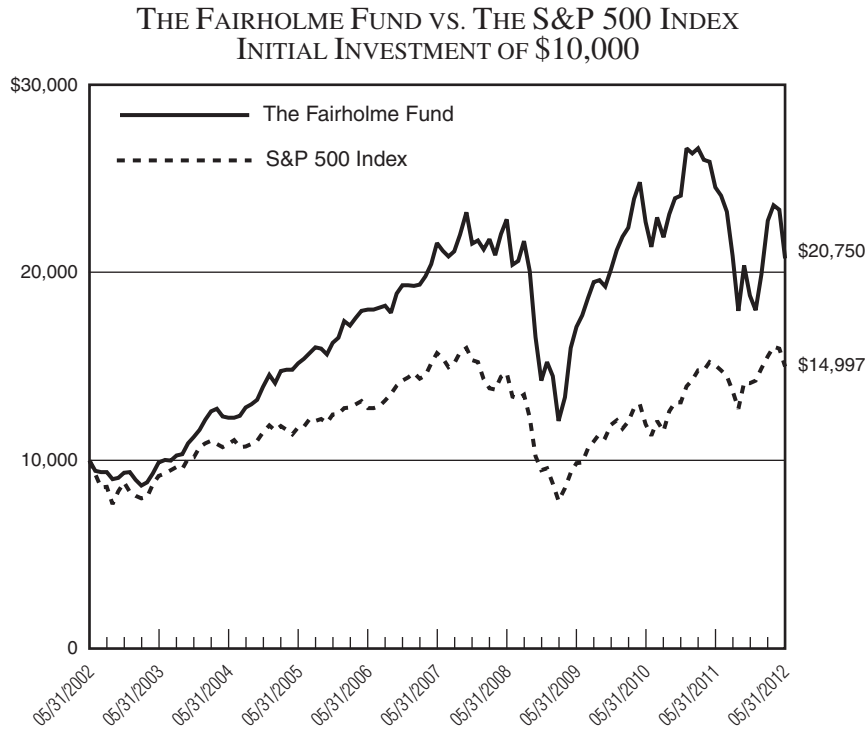
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May 31, 2012

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# FAIRHOLME FUNDS, INC.

CUMULATIVE PERFORMANCE (Unaudited)  
May 31, 2002 — May 31, 2012



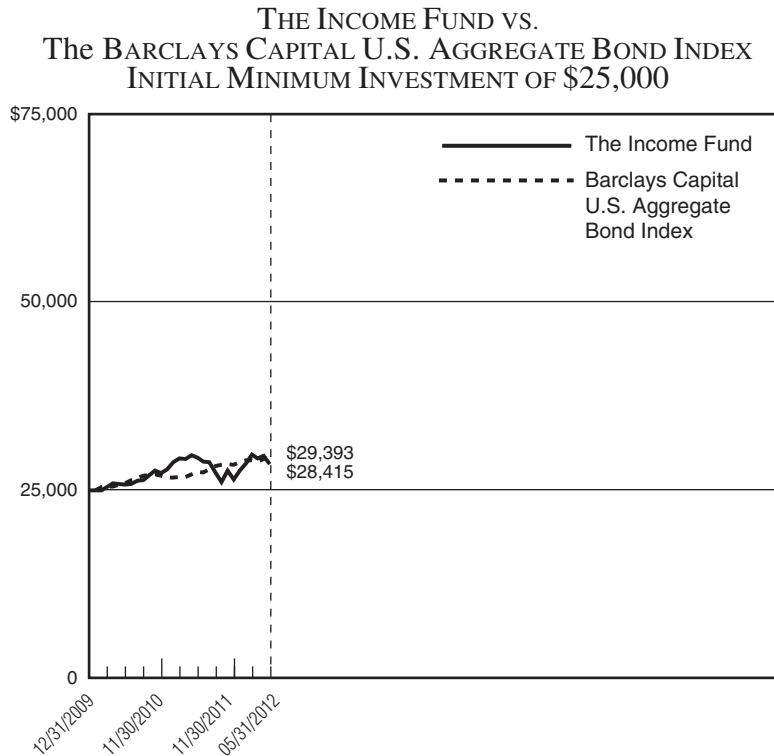
The Fairholme Fund commenced operations on December 29, 1999. The chart above presents the performance of a \$10,000 investment for up to ten years to the latest semi-annual period ended May 31, 2012.

The following notes pertain to the chart above as well as to the performance table included in the Management Discussion & Analysis Report. **Performance information in this report represents past performance and is not a guarantee of future results. The investment return and principal value of an investment in The Fairholme Fund will fluctuate, so that an investor's shares when redeemed may be worth more or less than their original cost. Current performance may be higher or lower than the performance quoted within. The performance information does not reflect the taxes an investor would pay on The Fairholme Fund distributions or upon redemption of The Fairholme Fund shares. Any questions you have regarding the latest month-end performance can be obtained by calling Shareholder Services at 1-866-202-2263.**

Data for both the S&P 500 Index and The Fairholme Fund are presented assuming all dividends and distributions have been reinvested and do not reflect any taxes that might have been incurred by a shareholder as a result of The Fairholme Fund distributions. The S&P 500 Index is a widely recognized, unmanaged index of 500 of the largest companies in the United States as measured by market capitalization and does not reflect any investment management fees or transaction expenses, nor the effects of taxes, fees or other charges.

# FAIRHOLME FUNDS, INC.

CUMULATIVE PERFORMANCE (Unaudited)  
Inception through May 31, 2012



The Fairholme Focused Income Fund (“The Income Fund”) commenced operations on December 31, 2009. The chart above presents the performance of a \$25,000 investment from inception to the latest semi-annual period ended May 31, 2012.

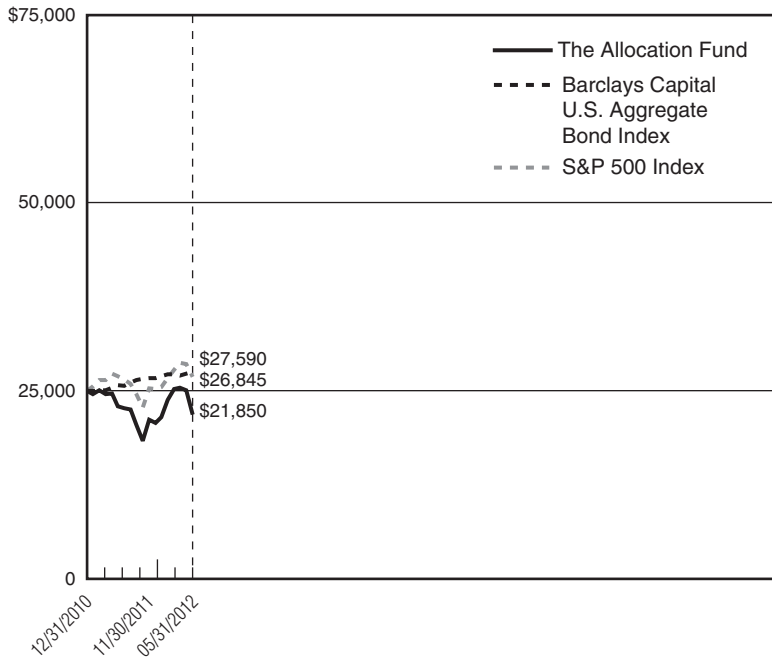
The following notes pertain to the chart above as well as to the performance table included in the Management Discussion & Analysis Report. **Performance information in this report represents past performance and is not a guarantee of future results. The investment return and principal value of an investment in The Income Fund will fluctuate, so that an investor’s shares when redeemed may be worth more or less than their original cost. Current performance may be higher or lower than the performance quoted within. The performance information does not reflect the taxes an investor would pay on The Income Fund distributions or upon redemption of The Income Fund shares. Any questions you have regarding the latest month-end performance can be obtained by calling Shareholder Services at 1-866-202-2263.**

Data for both the Barclays Capital U.S. Aggregate Bond Index and The Income Fund are presented assuming all dividends and distributions have been reinvested and do not reflect any taxes that might have been incurred by a shareholder as a result of The Income Fund distributions. The Barclay’s Capital U.S. Aggregate Bond Index is an unmanaged market weighted index comprised of investment grade corporate bonds (rated BBB or better), mortgages, and U.S. Treasury and government agency issues with at least one year to maturity and does not reflect any investment management fees or transaction expenses, nor the effects of taxes, fees or other charges.

# FAIRHOLME FUNDS, INC.

CUMULATIVE PERFORMANCE (Unaudited)  
Inception through May 31, 2012

## THE ALLOCATION FUND VS. THE BARCLAYS CAPITAL U.S. AGGREGATE BOND INDEX AND THE S&P 500 INDEX INITIAL MINIMUM INVESTMENT OF \$25,000



The Fairholme Allocation Fund ("The Allocation Fund") commenced operations on December 31, 2010. The chart above presents the performance of a \$25,000 investment from inception to the latest semi-annual period ended May 31, 2012.

The following notes pertain to the chart above as well as to the performance table included in the Management Discussion & Analysis Report. **Performance information in this report represents past performance and is not a guarantee of future results. The investment return and principal value of an investment in The Allocation Fund will fluctuate, so that an investor's shares when redeemed may be worth more or less than their original cost. Current performance may be higher or lower than the performance quoted within. The performance information does not reflect the taxes an investor would pay on The Allocation Fund distributions or upon redemption of The Allocation Fund shares. Any questions you have regarding the latest month-end performance can be obtained by calling Shareholder Services at 1-866-202-2263.**

Data for the Barclays Capital U.S. Aggregate Bond Index, the S&P 500 Index and The Allocation Fund are presented assuming all dividends and distributions have been reinvested and do not reflect any taxes that might have been incurred by a shareholder as a result of The Allocation Fund distributions. The Barclays Capital U.S. Aggregate Bond Index is an unmanaged market-weighted index comprised of investment grade corporate bonds (rated BBB or better), mortgages, and U.S. Treasury and government agency issues with at least one year to maturity. The S&P 500 Index is a widely recognized, unmanaged index of 500 of the largest companies in the United States as measured by market capitalization and does not reflect any investment management fees or transaction expenses, nor the effects of taxes, fees or other charges.

# FAIRHOLME FUNDS, INC.

## MANAGEMENT DISCUSSION & ANALYSIS For the Six Months Ended May 31, 2012

The Fairholme Fund, The Income Fund, and The Allocation Fund (each a “Fund” and collectively, the “Funds”) shares outstanding and unaudited net asset value per share (“NAV”) at May 31, 2012, the end of the Funds’ second fiscal quarter of 2012, and NAVs at other pertinent dates, were as follows:

	<u>05/31/2012</u> <u>Shares</u> <u>Outstanding</u>	<u>05/31/2012</u> <u>NAV</u> <u>(unaudited)</u>	<u>11/30/2011</u> <u>NAV</u> <u>(audited)</u>	<u>05/31/2011</u> <u>NAV</u> <u>(unaudited)</u>
The Fairholme Fund	263,788,120	\$26.70	\$25.10	\$32.82
The Income Fund	28,033,491	\$ 9.98	\$ 9.71	\$11.18
The Allocation Fund	27,969,187	\$ 8.74	\$ 8.29	\$ 9.17

At June 30, 2012, the unaudited NAVs of the The Fairholme Fund, The Income Fund, and The Allocation Fund were \$28.87, \$10.07, and \$9.57 per share, respectively.

Performance figures below are shown for the Funds as of the Funds’ semi-annual period ended May 31, 2012 and do not match calendar year figures for the period ended June 30, 2012 cited in the Portfolio Manager’s report.

<u>The Fairholme Fund</u> <u>Performance</u> <u>to 05/31/2012</u>	<u>Six</u> <u>Months</u>	<u>One</u> <u>Year</u>	<u>Five</u> <u>Years</u>	<u>Ten</u> <u>Years</u>	<u>Since</u> <u>Inception</u> <u>12/29/1999</u>
<b>Cumulative:</b>					
The Fairholme Fund	10.49%	-15.50%	-3.91%	107.50%	245.21%
S&P 500	6.23%	-0.41%	-4.52%	49.97%	12.76%
<b>Annualized:</b>					
The Fairholme Fund		-15.50%	-0.80%	7.57%	10.49%
S&P 500		-0.41%	-0.92%	4.14%	0.97%

For the six months ended May 31, 2012, The Fairholme Fund outperformed the S&P 500 Index (“S&P 500”) by 4.26 percentage points while over the last year the S&P 500 outperformed The Fairholme Fund by 15.09 percentage points. From inception, The Fairholme Fund outperformed the S&P 500 by 9.52 percentage points per annum or on a cumulative basis 232.45 percentage points over twelve years and five months.

<u>The Income Fund</u> <u>Performance</u> <u>to 05/31/2012</u>	<u>Six</u> <u>Months</u>	<u>One</u> <u>Year</u>	<u>Since</u> <u>Inception</u> <u>12/31/2009</u>
<b>Cumulative:</b>			
The Income Fund	7.71%	-3.08%	13.66%
Barclays Bond Index	3.46%	7.12%	17.57%
<b>Annualized:</b>			
The Income Fund		-3.08%	5.44%
Barclays Bond Index		7.12%	6.93%

For the six months ended May 31, 2012, The Income Fund outperformed the Barclays Capital U.S. Aggregate Bond Index (“Barclays Bond Index”) by 4.25 percentage points while over the last year the Barclays Bond Index outperformed The Income Fund by 10.20 percentage points. From inception, the Barclays Bond Index outperformed The Income Fund by 1.49 percentage points per annum or on a cumulative basis 3.91 percentage points over two years and five months.



## FAIRHOLME FUNDS, INC.

### MANAGEMENT DISCUSSION & ANALYSIS (continued) For the Six Months Ended May 31, 2012

<b>The Allocation Fund Performance to 05/31/2012</b>	<b>Six Months</b>	<b>One Year</b>	<b>Since Inception 12/31/2010</b>
<b>Cumulative:</b>			
The Allocation Fund	5.43%	-4.69%	-12.60%
S&P 500	6.23%	-0.41%	7.38%
Barclays Bond Index	3.46%	7.12%	10.36%
<b>Annualized:</b>			
The Allocation Fund		-4.69%	-9.07%
S&P 500		-0.41%	5.15%
Barclays Bond Index		7.12%	7.21%

For the six months ended May 31, 2012, The Allocation Fund outperformed the Barclays Bond Index by 1.97 percentage points and was outperformed by the S&P 500 by 0.80 percentage points while over the last year the Barclays Bond Index and S&P 500 outperformed The Allocation Fund by 11.81 and 4.28 percentage points, respectively. From inception, the Barclays Bond Index and S&P 500 outperformed The Allocation Fund by 16.28 and 14.22 percentage points per annum, respectively, or on a cumulative basis 22.96 and 19.98 percentage points over one year and five months.

In the opinion of Fairholme Capital Management, L.L.C. (the “Manager”), performance over short intervals is likely to be less meaningful than performance over longer periods. Further, shareholders should note that the S&P 500 and the Barclays Bond Index are unmanaged indices incurring no fees, expenses, or tax effects and are shown solely to compare the Funds’ performance to that of unmanaged and diversified indices.

Continuing economic recovery in financial services and insurance-related sectors contributed to each Fund’s overall performance. The fact that securities decline in value does not always indicate that the Manager believes these securities to be less attractive — in fact, the Manager believes that some price declines present buying opportunities. However, shareholders are cautioned that it is possible that some securities mentioned in this discussion may no longer be held by the Funds subsequent to the end of the fiscal period and that the Funds may have made significant new purchases that are not yet required to be disclosed. It is the Funds’ general policy not to disclose portfolio holdings other than when required by relevant law or regulation.

The Funds have different objectives, capitalizations, and considerations that may or may not lead to differing compositions of issuers, securities within an issuer, and cash levels within each Fund. The Manager invests the Funds’ assets in securities to the extent it finds reasonable investment opportunities in accordance with its Prospectus, and may invest a significant portion of the Funds’ assets in liquid, low-risk securities or cash. The Manager views such liquidity as a strategic asset and may invest a significant portion of cash and liquid assets in other more risky securities at any time, particularly in situations where markets are weak or a particular security declines sharply. At May 31, 2012, the Funds’ liquidity (consisting of cash, commercial paper, deposit accounts, U.S. Treasury Bills and money-market funds) represented 7.2%, 11.0%, and 6.4% of The Fairholme Fund, The Income Fund, and The Allocation Fund total net assets, respectively. Since inception, the Funds have held liquid, low-risk securities or cash for periods without negatively influencing performance, although there is no guarantee that future performance will not be negatively affected by the Funds’ liquidity.

# FAIRHOLME FUNDS, INC.

## MANAGEMENT DISCUSSION & ANALYSIS (continued) For the Six Months Ended May 31, 2012

The following charts show the top ten holdings by issuer and top ten holdings categories of the Funds at May 31, 2012, listed by their percentage of the Funds' net assets. Portfolio holdings are subject to change without notice.

<b>The Fairholme Fund Top Ten Holdings by Issuer* (% of Net Assets)</b>		<b>The Fairholme Fund Top Ten Categories (% of Net Assets)</b>	
American International Group, Inc.	36.8%	Multi-Line Insurance	36.8%
Sears Holdings Corp.	10.0%	Retail Department Stores	10.0%
AIA Group Ltd.	8.8%	Life Insurance	8.8%
Bank of America Corp.	8.5%	Diversified Banks	8.5%
CIT Group Inc.	6.6%	Cash and Cash Equivalents**	7.2%
General Growth Properties, Inc.	6.3%	Commercial Finance	6.6%
The St. Joe Co.	5.1%	Real Estate Investment Trust	6.3%
Leucadia National Corp.	3.5%	Real Estate Management & Development	5.8%
MBIA, Inc.	3.0%	Diversified Holding Companies	3.5%
Howard Hughes Corp.	0.7%	Surety Insurance	3.0%
	<u>89.3%</u>		<u>96.5%</u>

<b>The Income Fund Top Holdings by Issuer* (% of Net Assets)</b>		<b>The Income Fund Top Categories (% of Net Assets)</b>	
MBIA, Inc.	37.4%	Surety Insurance	37.4%
Emigrant Bancorp, Inc.	19.3%	Regional Banks	21.4%
Sears Holdings Corp.	18.6%	Retail Department Stores	18.6%
International Lease Finance Corp.	2.9%	Cash and Cash Equivalents**	11.0%
Regions Financial Corp.	2.1%	Commercial Services & Supplies	2.9%
General Growth Properties, Inc.	1.7%	Real Estate Investment Trust	1.7%
Wells Fargo & Co.	0.6%	Diversified Banks	0.6%
American International Group, Inc.	0.5%	Multi-Line Insurance	0.5%
Howard Hughes Corp.	0.2%	Real Estate Management & Development	0.2%
	<u>83.3%</u>		<u>94.3%</u>

<b>The Allocation Fund Top Ten Holdings by Issuer* (% of Net Assets)</b>		<b>The Allocation Fund Top Categories (% of Net Assets)</b>	
MBIA, Inc.	29.3%	Surety Insurance	29.3%
American International Group, Inc.	20.4%	Multi-Line Insurance	20.9%
Sears Holdings Corp.	9.5%	Diversified Banks	14.3%
Bank of America Corp.	7.6%	Retail Department Stores	9.5%
Jefferies Group, Inc.	5.3%	Cash and Cash Equivalents**	6.4%
Leucadia National Corp.	5.1%	Capital Markets	5.3%
Wells Fargo & Co.	4.8%	Diversified Holding Companies	5.1%
Emigrant Bancorp, Inc.	4.3%	Regional Banks	4.3%
JPMorgan Chase & Co.	1.9%	Specialty Retail – Home Improvement	0.1%
The Hartford Financial Services Group, Inc.	0.5%		
	<u>88.7%</u>		<u>95.2%</u>

\* Excludes cash, commercial paper, U.S. Treasury Bills (where applicable), and money market funds.

\*\* Includes cash, commercial paper, U.S. Treasury Bills (where applicable), and money market funds.

## FAIRHOLME FUNDS, INC.

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### MANAGEMENT DISCUSSION & ANALYSIS (continued) For the Six Months Ended May 31, 2012

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The Funds' Officers, the Board of Directors (the "Board" or the "Directors") and the Manager are aware that large cash inflows or outflows may adversely affect the Funds' performance. Such flows are monitored and appropriate actions are contemplated for when such flows could negatively impact performance.

The Funds may invest in non-U.S. securities and securities of corporations domiciled outside of the United States. Holding such securities may expose a Fund to adverse changes resulting from foreign currency fluctuations or other potential risks as described in the Funds' Statement of Additional Information.

Not all dispositions or additions to the portfolios are material, and, while the Funds and the Manager have long-term objectives, it is possible that a security sold or purchased in one period will be purchased or sold in a subsequent period. Generally, the Manager determines to buy and sell based on its estimates of the absolute and relative intrinsic values and fundamental dynamics of a particular corporation and its industry. However, certain strategies of the Manager in carrying out the Funds' policies may result in shorter holding periods. Investors are further cautioned not to rely on short-term results.

The Funds are considered to be "non-diversified" under the Investment Company Act of 1940, as amended (the "1940 Act"), which means that the Funds can invest a greater percentage of their assets in fewer securities than a diversified fund. The Funds may also have a greater percentage of their assets invested in particular industries than a diversified fund, exposing the Funds to the risk of unanticipated industry conditions as well as risks specific to a single company or security.

The Independent Directors continue to believe that it is in the best interests of the Funds' shareholders to have Mr. Berkowitz serve as Chairman of the Board given: his long-term relative performance; his experience, commitment, and significant personal investment in the Funds; the present constitution of the Directors and policies; and current rules and regulations. At May 31, 2012, a majority of the Directors are independent of the Manager, no stock option or restricted stock plans exist, Officers receive no direct compensation from the Funds, and Directors affiliated with the Manager receive no compensation for being Directors.

The Officers and the Directors of The Fairholme Fund, The Income Fund, and The Allocation Fund, hold an aggregate 10,938,971, 3,007,401, and 8,412,137 shares, respectively, at May 31, 2012. While there is no requirement that Officers and Directors own shares of the Funds, such holdings are believed to help align shareholder interests. Since inception, the Funds have been advised by the Manager. Certain Directors and Officers of the Funds are also Members and Officers of the Manager. For more complete information about the Funds, or to obtain a current Prospectus, please visit [www.fairholmefunds.com](http://www.fairholmefunds.com) or call Shareholder Services at 1-866-202-2263.

## FAIRHOLME FUNDS, INC.

### EXPENSE EXAMPLE

For the Six Month Period from December 1, 2011  
through May 31, 2012 (unaudited)

As a Fund shareholder, you incur direct and indirect costs. Direct costs include, but are not limited to, transaction fees at some broker-dealers, custodial fees for retirement accounts, redemption fees (on The Fairholme Fund and The Allocation Fund shares redeemed within 60 days of purchase), and wire transfer fees. You also incur indirect costs that include, but are not limited to, management fees paid to the Manager.

The following example is intended to help you understand your indirect costs (also referred to as “ongoing costs” and measured in dollars) when investing in the Funds and to compare these costs with the ongoing costs of investing in other mutual funds. This example is based on an investment of \$1,000 invested in The Fairholme Fund, The Income Fund, and The Allocation Fund at December 1, 2011 and held for the entire six month period ending May 31, 2012.

#### Actual Expenses

The first line of the tables below provides information about actual account values and actual expenses. You may use the information in this line, together with the amount you had invested at the beginning of the period, to estimate the expenses that you paid over the period. Simply divide your account value by \$1,000 (for example, an \$8,600 account value divided by \$1,000 = 8.6), then multiply the result by the number in the first line under the heading “Expenses Paid During the Period” to estimate the expenses you paid on your Fund holdings during this period.

#### Hypothetical Example for Comparison Purposes

The second line of the tables provides information about hypothetical account values and hypothetical expenses based on each Fund’s actual expense ratio and an assumed rate of return of 5% per year before expenses, which is not the Fund’s actual returns for the period presented. The hypothetical account values and expenses may not be used to estimate the actual ending account balance or expenses that you paid for the period presented. However, you may use this information to compare ongoing costs of investing in the Funds with the ongoing costs of investing in other funds. To do so, compare this 5% hypothetical example with the 5% examples that appear in the shareholder reports of other funds.

Please note that the column titled “Expenses Paid During the Period” in the tables below is meant to highlight your ongoing costs only and do not reflect any transactional costs, such as redemption fees (if any), or other direct costs. Therefore, the second line of the tables is useful in comparing ongoing costs only, and will not help you determine the relative total costs of owning different funds. In addition, if these direct costs were included, your total costs would be higher.

	<u>Beginning Account Value December 1, 2011</u>	<u>Ending Account Value May 31, 2012</u>	<u>Annualized Expense Ratio*</u>	<u>Expenses Paid During the Period December 1, 2011 Through May 31, 2012**</u>
<b>The Fairholme Fund</b>				
Actual	\$1,000.00	\$1,104.90	1.01%	\$5.31
Hypothetical (5% return before expenses)	\$1,000.00	\$1,019.95	1.01%	\$5.10
<b>The Income Fund</b>				
Actual	\$1,000.00	\$1,077.10	0.83%	\$4.31
Hypothetical (5% return before expenses)	\$1,000.00	\$1,020.85	0.83%	\$4.19
<b>The Allocation Fund</b>				
Actual	\$1,000.00	\$1,054.30	0.84%	\$4.31
Hypothetical (5% return before expenses)	\$1,000.00	\$1,020.80	0.84%	\$4.24

\* In the case of The Income Fund and The Allocation Fund, the annualized expense ratio is calculated taking into account the management fee waiver. In both cases, the management fee waiver expired on March 29, 2012.

\*\*Expenses are equal to each Fund’s annualized expense ratio, multiplied by the average account value over the period, multiplied by 183 days/366 days (to reflect the one-half year period).

# THE FAIRHOLME FUND

SCHEDULE OF INVESTMENTS  
May 31, 2012 (unaudited)

Shares	Value	Shares	Value
<b>DOMESTIC EQUITY SECURITIES — 70.1%</b>		<b>DOMESTIC PREFERRED EQUITY SECURITIES — 0.0%</b>	
<b>COMMERCIAL FINANCE — 6.6%</b>		<b>SPECIALTY RETAIL-HOME IMPROVEMENT — 0.0%</b>	
13,597,029	CIT Group Inc. <sup>(a)(b)</sup> \$ 464,882,422	601,693	Orchard Supply Hardware Stores Corp., Preferred, Zero Coupon, Series A <sup>(a)(b)</sup> \$ 932,625
<b>DIVERSIFIED BANKS — 8.5%</b>		<b>TOTAL DOMESTIC PREFERRED EQUITY SECURITIES (COST \$1,146,825)</b>	
81,607,015	Bank of America Corp. 599,811,560		932,625
<b>DIVERSIFIED HOLDING COMPANIES — 3.5%</b>		<b>WARRANTS — 10.1%</b>	
12,186,350	Leucadia National Corp. 247,626,632	<b>MULTI-LINE INSURANCE — 3.1%</b>	
<b>MULTI-LINE INSURANCE — 33.7%</b>		21,588,480	American International Group, Inc., Vested, Strike Price \$45.00, Expire 01/19/2021 <sup>(a)(f)</sup> 220,202,496
81,327,425	American International Group, Inc. <sup>(a)</sup> 2,373,134,261	<b>REAL ESTATE INVESTMENT TRUSTS — 6.3%</b>	
<b>REAL ESTATE MANAGEMENT &amp; DEVELOPMENT — 5.1%</b>		40,634,357	General Growth Properties, Inc., Vested, Strike Price \$9.519, Expire 11/09/2017 <sup>(a)(c)(d)(e)(f)</sup> 440,025,388
23,136,502	The St. Joe Co. <sup>(a)(b)(c)(d)(e)</sup> 358,405,239	<b>REAL ESTATE MANAGEMENT &amp; DEVELOPMENT — 0.7%</b>	
<b>RETAIL DEPARTMENT STORES — 10.0%</b>		1,896,270	Howard Hughes Corp., Vested, Strike Price \$50.00, Expire 11/09/2017 <sup>(a)(c)(d)(e)(f)</sup> 47,663,315
14,212,673	Sears Holdings Corp. <sup>(a)(b)</sup> 702,106,046	<b>TOTAL WARRANTS (COST \$351,676,339)</b>	
<b>SPECIALTY RETAIL-HOME IMPROVEMENT — 0.1%</b>			707,891,199
605,293	Orchard Supply Hardware Stores Corp., Class A <sup>(a)(b)</sup> 10,199,192	<b>Principal</b>	
<b>SURETY INSURANCE — 2.6%</b>		<b>DOMESTIC CORPORATE BONDS — 0.6%</b>	
20,501,100	MBIA, Inc. <sup>(a)(b)</sup> 183,894,867	<b>REGIONAL BANKS — 0.2%</b>	
<b>TOTAL DOMESTIC EQUITY SECURITIES (COST \$6,102,291,790)</b>		12,308,000	Emigrant Bancorp, Inc. 6.250%, 06/15/2014 <sup>(c)</sup> 11,351,668
<b>FOREIGN EQUITY SECURITIES — 8.8%</b>			
<b>CHINA — 8.8%</b>			
<b>LIFE INSURANCE — 8.8%</b>			
190,751,000	AIA Group Ltd. 621,783,059		
<b>TOTAL FOREIGN EQUITY SECURITIES (COST \$488,411,178)</b>			
	621,783,059		

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

# THE FAIRHOLME FUND

## SCHEDULE OF INVESTMENTS (continued) May 31, 2012 (unaudited)

<u>Principal</u>	<u>Value</u>	<u>Principal</u>	<u>Value</u>
<b>SURETY INSURANCE — 0.4%</b>		\$25,000,000	U.S. Treasury Bills 0.081%, 08/23/2012 <sup>(g)</sup>
			\$ 24,996,250
\$17,932,000	MBIA, Inc. 7.000%, 12/15/2025 <sup>(b)</sup>	\$ 12,014,440	
13,859,000	7.150%, 07/15/2027 <sup>(b)</sup>	9,216,235	
11,580,000	5.700%, 12/01/2034 <sup>(b)(c)</sup>	6,716,400	
		27,947,075	
<b>TOTAL DOMESTIC CORPORATE BONDS</b> <b>(COST \$44,770,478)</b>	39,298,743	<b>TOTAL U.S. GOVERNMENT</b> <b>OBLIGATIONS</b> <b>(COST \$124,980,395)</b>	124,985,683
<b>COMMERCIAL PAPER — 0.7%</b>		<b>MONEY MARKET</b>	
<b>AUTO</b>		<b>FUNDS — 4.7%</b>	
<b>MANUFACTURERS — 0.7%</b>		332,264,012	Fidelity Institutional Money Market Funds - Money Market Portfolio, 0.240% <sup>(h)</sup>
50,000,000	Ford Motor Co. 0.550%, 06/01/2012 <sup>(g)</sup>	332,264,012	
<b>TOTAL COMMERCIAL PAPER</b> <b>(COST \$50,000,000)</b>	50,000,000	<b>TOTAL MONEY MARKET FUNDS</b> <b>(COST \$332,264,012)</b>	332,264,012
<b>U.S. GOVERNMENT</b>		<b>TOTAL INVESTMENTS — 96.8%</b> <b>(COST \$7,495,541,017)</b>	
<b>OBLIGATIONS — 1.8%</b>		<b>OTHER ASSETS IN</b>	
25,000,000	U.S. Treasury Bills 0.075%, 06/21/2012 <sup>(g)</sup>	<b>EXCESS OF</b>	
25,000,000	U.S. Treasury Bills 0.088%, 08/09/2012 <sup>(g)</sup>	<b>LIABILITIES — 3.2%</b>	
25,000,000	U.S. Treasury Bills 0.095%, 08/16/2012 <sup>(g)</sup>	<b>NET ASSETS — 100.0%</b>	225,852,325
			\$7,043,067,865

<sup>(a)</sup> Non-income producing security.

<sup>(b)</sup> Affiliated Company. See Note 7.

<sup>(c)</sup> Security fair valued under procedures approved by the Directors. The procedures may include: a) utilizing the average bid of independent broker/dealer quotes, b) utilizing the average bid of independent broker/dealer quotes and observable market prices on the day of valuation, c) using simulation models, and d) the Manager's estimates of the discount necessary to reflect the current and existing restrictions on the Manager transacting in the securities. The value of these securities totals \$864,162,010, which represents 12.27% of The Fairholme Fund's net assets. Such securities may be classified as Level 2 measurements if the determination of fair value is based primarily on the use of significant observable inputs and Level 3 measurements if the determination of fair value is based primarily on the use of significant unobservable inputs.

<sup>(d)</sup> Security is deemed an illiquid security under procedures approved by the Directors.

<sup>(e)</sup> Restricted or controlled security under procedures approved by the Directors. The value of these securities totals \$846,093,942, which represents 12.01% of The Fairholme Fund's net assets. Information related to these securities is as follows:

<u>Acquisition</u> <u>Shares</u>	<u>Issuer</u>	<u>Acquisition</u> <u>Date(s)</u>	<u>Acquisition</u> <u>Cost</u>	<u>05/31/2012</u> <u>Carrying Value</u> <u>Per Unit</u>
23,136,502	The St. Joe Co.	12/12/2007-10/13/2010	\$607,609,975	\$15.4909
40,634,357	General Growth Properties, Inc., Warrants, Vested, Strike Price \$9.519, Expire 11/09/2017	05/10/2010	—	10.8289
1,896,270	Howard Hughes Corp., Warrants, Vested, Strike Price \$50.00, Expire 11/09/2017	11/05/2010	—	25.1353

<sup>(f)</sup> Warrants have terms and conditions based on dividends paid and other events that may lower the strike price and raise the shares per warrant conversion ratio. Reported strike prices and conversion ratios are as of the date of this report. All share-to-warrant conversion ratios are currently 1:1, excluding the General Growth Properties, Inc. warrants, which on May 31, 2012 had a conversion ratio of 1:1.1031.

<sup>(g)</sup> Rates shown are the effective yields based on the purchase price. The calculation assumes the security is held to maturity.

<sup>(h)</sup> Annualized based on the 1-day yield as of May 31, 2012.

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

# THE FAIRHOLME FUND

## STATEMENT OF ASSETS & LIABILITIES May 31, 2012 (unaudited)

### Assets

Investments, at Fair Value:	
Unaffiliated Issuers (Cost — \$5,132,945,968)	\$5,068,848,074
Affiliated Issuers (Cost — \$2,362,595,049)	<u>1,748,367,466</u>
Total Investments, at Fair Value	
(Cost — \$7,495,541,017)	6,817,215,540
Cash	3,155,510
Receivable for Investments Sold	234,984,359
Receivable for Capital Shares Sold	4,017,851
Dividends and Interest Receivable	<u>2,504,087</u>
Total Assets	<u>7,061,877,347</u>

### Liabilities

Payable for Capital Shares Redeemed	12,448,080
Accrued Management Fees	<u>6,361,402</u>
Total Liabilities	<u>18,809,482</u>

### NET ASSETS

\$7,043,067,865

### Net Assets Consist of:

Paid-In-Capital	\$8,088,415,819
Distributions in Excess of Net Investment Income	(40,292,139)
Net Accumulated Realized Loss on Investments and Foreign Currency Related Transactions	(326,730,338)
Net Unrealized Depreciation on Investments and Foreign Currency Related Translations	<u>(678,325,477)</u>

### NET ASSETS

\$7,043,067,865

Shares of Common Stock Outstanding* (\$0.0001 par value)	<u>263,788,120</u>
Net Asset Value, Offering and Redemption Price Per Share (\$7,043,067,865 / 263,788,120 shares)	<u>\$ 26.70</u>

\* 700,000,000 shares authorized in total.

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

# THE FAIRHOLME FUND

## STATEMENT OF OPERATIONS (unaudited)

	<b>For the Six Months Ended May 31, 2012</b>
<b>Investment Income</b>	
Interest — Unaffiliated Issuers	\$ 1,042,877
Interest — Affiliated Issuers	1,582,580
Dividends — Unaffiliated Issuers	<u>13,243,057</u>
Total Investment Income	<u>15,868,514</u>
<b>Expenses</b>	
Management Fees	38,858,723
Other Expenses	<u>292,458</u>
Total Expenses	<u>39,151,181</u>
Net Investment Loss	<u>(23,282,667)</u>
<b>Realized and Unrealized Gain (Loss) on Investments and Foreign Currency Related Transactions</b>	
Net Realized Gain (Loss) on Investments	
Unaffiliated Issuers	54,229,160
Affiliated Issuers	(17,075,601)
Net Realized Loss on Foreign Currency Related Transactions	(662)
Net Change in Unrealized Appreciation on Investments and Foreign Currency Related Transactions	<u>755,722,665</u>
Net Realized and Unrealized Gain on Investments and Foreign Currency Related Transactions	<u>792,875,562</u>
<b>NET INCREASE IN NET ASSETS FROM OPERATIONS</b>	<u><u>\$769,592,895</u></u>

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



# THE FAIRHOLME FUND

## STATEMENTS OF CHANGES IN NET ASSETS

	For the Six Months Ended May 31, 2012 (unaudited)	For the Fiscal Year Ended November 30, 2011
<b>CHANGE IN NET ASSETS</b>		
<b>From Operations</b>		
Net Investment Loss	\$ (23,282,667)	\$ (33,469,437)
Net Realized Gain (Loss) on Investments and Foreign Currency Related Transactions	37,152,897	(366,929,655)
Net Change in Unrealized Appreciation (Depreciation) on Investments and Foreign Currency Related Translations	755,722,665	(2,604,264,053)
Net Increase (Decrease) in Net Assets from Operations	769,592,895	(3,004,663,145)
<b>From Dividends and Distributions to Shareholders</b>		
Net Investment Income	—	(195,136,284)
Net Realized Capital Gains from Investment Transactions Return of Capital	(276,800,371)	(838,210,865)
Net Decrease in Net Assets from Dividends and Distributions	(276,800,371)	(1,033,347,149)
<b>From Capital Share Transactions</b>		
Proceeds from Sale of Shares	447,467,827	4,326,090,664
Shares Issued in Reinvestment of Dividends and Distributions	250,020,401	939,524,411
Redemption Fees	364,520	2,714,993
Cost of Shares Redeemed	(2,162,871,773)	(10,062,106,880)
Net Decrease in Net Assets from Shareholder Activity	(1,465,019,025)	(4,793,776,812)
<b>NET ASSETS</b>		
Net Decrease in Net Assets	(972,226,501)	(8,831,787,106)
Net Assets at Beginning of Period	8,015,294,366	16,847,081,472
Net Assets at End of Period	\$ 7,043,067,865	\$ 8,015,294,366
Distributions in Excess of Net Investment Income at End of Period	\$ (40,292,139)	\$ (17,009,472)
<b>SHARES TRANSACTIONS</b>		
Issued	16,312,335	127,523,200
Reinvested	10,652,155	27,554,666
Redeemed	(82,474,610)	(328,478,267)
Net Decrease in Shares	(55,510,120)	(173,400,401)
Shares Outstanding at Beginning of Period	319,298,240	492,698,641
Shares Outstanding at End of Period	263,788,120	319,298,240

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

# THE FAIRHOLME FUND

## FINANCIAL HIGHLIGHTS

	For the Six Months Ended May 31, 2012	For the Fiscal Year Ended November 30,				
	(unaudited)	2011	2010	2009	2008	2007
<b>NET ASSET VALUE, BEGINNING OF PERIOD</b>	\$25.10	\$34.19	\$28.90	\$20.95	\$32.30	\$29.40
<b>Investment Operations</b>						
Net Investment Income (Loss) <sup>(1)</sup>	(0.08)	(0.07)	0.33	0.28	0.13	0.26
Net Realized and Unrealized Gain (Loss) on Investments	2.59	(6.95)	5.22	8.20	(10.79) <sup>(2)</sup>	3.05 <sup>(2)</sup>
Total from Investment Operations	2.51	(7.02)	5.55	8.48	(10.66)	3.31
<b>Dividends and Distributions</b>						
From Net Investment Income	—	(0.39)	(0.27)	(0.11)	(0.22)	(0.24)
From Realized Capital Gains	—	(1.69)	—	(0.43)	(0.48)	(0.17)
From Return of Capital	(0.91)	—	—	—	—	—
Total Dividends and Distributions	(0.91)	(2.08)	(0.27)	(0.54)	(0.70)	(0.41)
<b>Redemption Fees<sup>(1)</sup></b>	0.00 <sup>(3)</sup>	0.01	0.01	0.01	0.01 <sup>(2)</sup>	0.00 <sup>(2)(3)</sup>
<b>NET ASSET VALUE, END OF PERIOD</b>	\$26.70	\$25.10	\$34.19	\$28.90	\$20.95	\$32.30
<b>TOTAL RETURN</b>	10.49% <sup>(4)</sup>	(22.10)%	19.37%	41.48%	(33.69)%	11.42%
<b>Ratio/Supplemental Data</b>						
Net Assets, End of Period (in 000's)	\$7,043,068	\$8,015,294	\$16,847,081	\$10,558,010	\$6,696,139	\$6,463,009
Ratio of Expenses to Average Net Assets	1.01% <sup>(5)(6)</sup>	1.01% <sup>(7)</sup>	1.00%	1.00%	1.01% <sup>(8)</sup>	1.00%
Ratio of Net Investment Income (Loss) to Average Net Assets	(0.60)% <sup>(6)</sup>	(0.22)%	1.02%	1.14%	0.44%	0.85%
Portfolio Turnover Rate	0.00% <sup>(4)</sup>	43.95%	88.74%	71.09%	81.35%	14.10%

(1) Based on average shares outstanding.

(2) Redemption fees per share, which were initially reported as a component of net realized and unrealized gain (loss) on investments per share, were reclassified to conform to the current presentation and are separately reported.

(3) Redemption fees represent less than \$0.01.

(4) Not Annualized.

(5) 0.01% is attributable to registration fees for securities borne by The Fairholme Fund outside of the 1.00% management fee.

(6) Annualized.

(7) 0.01% is attributable to legal expenses borne by The Fairholme Fund outside of the 1.00% management fee.

(8) 0.01% is attributable to shareholder meeting expenses borne by The Fairholme Fund outside of the 1.00% management fee.

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





# THE FAIRHOLME FOCUSED INCOME FUND

STATEMENT OF ASSETS & LIABILITIES  
May 31, 2012 (unaudited)

## Assets

Investments, at Fair Value (Cost — \$290,190,830)	\$272,499,068
Cash	560,315
Dividends and Interest Receivable	7,650,357
Receivable for Capital Shares Sold	31,677
Total Assets	<u>280,741,417</u>

## Liabilities

Payable for Capital Shares Redeemed	627,083
Accrued Management Fees	241,150
Total Liabilities	<u>868,233</u>

## NET ASSETS

\$279,873,184

### Net Assets Consist of:

Paid-In-Capital	\$302,642,300
Accumulated Undistributed Net Investment Income	4,346,536
Net Accumulated Realized Loss on Investments and Foreign Currency Related Transactions	(9,423,890)
Net Unrealized Depreciation on Investments and Foreign Currency Related Translations	<u>(17,691,762)</u>

## NET ASSETS

\$279,873,184

Shares of Common Stock Outstanding* (\$0.0001 par value)	<u>28,033,491</u>
Net Asset Value, Offering and Redemption Price Per Share (\$279,873,184 / 28,033,491 shares)	<u>\$ 9.98</u>

\* 200,000,000 shares authorized in total.

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

# THE FAIRHOLME FOCUSED INCOME FUND

STATEMENT OF OPERATIONS (unaudited)

	<b>For the Six Months Ended May 31, 2012</b>
<b>Investment Income</b>	
Interest	\$15,123,297
Dividends	<u>97,129</u>
Total Investment Income	<u>15,220,426</u>
<b>Expenses</b>	
Management Fees	<u>1,501,572</u>
Less: Management Fee Waiver	<u>(249,582)</u>
Net Expenses	<u>1,251,990</u>
Net Investment Income	<u>13,968,436</u>
<b>Realized and Unrealized Gain (Loss) on Investments and Foreign Currency Related Transactions</b>	
Net Realized Loss on Investments	(9,141,615)
Net Change in Unrealized Appreciation on Investments and Foreign Currency Related Transactions	<u>18,632,736</u>
Net Realized and Unrealized Gain on Investments and Foreign Currency Related Transactions	<u>9,491,121</u>
<b>NET INCREASE IN NET ASSETS FROM OPERATIONS</b>	<u><u>\$23,459,557</u></u>

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

# THE FAIRHOLME FOCUSED INCOME FUND

## STATEMENTS OF CHANGES IN NET ASSETS

	For the Six Months Ended May 31, 2012 (unaudited)	For the Fiscal Year Ended November 30, 2011
<b>CHANGE IN NET ASSETS</b>		
<b>From Operations</b>		
Net Investment Income	\$ 13,968,436	\$ 25,394,044
Net Realized Loss on Investments and Foreign Currency Related Transactions	(9,141,615)	(202,229)
Net Change in Unrealized Appreciation (Depreciation) on Investments and Foreign Currency Related Translations	<u>18,632,736</u>	<u>(44,625,687)</u>
Net Increase (Decrease) in Net Assets from Operations	<u>23,459,557</u>	<u>(19,433,872)</u>
<b>From Dividends and Distributions to Shareholders</b>		
Net Investment Income	(14,119,037)	(24,764,705)
Net Realized Capital Gains from Investment Transactions	<u>—</u>	<u>(1,303,780)</u>
Net Decrease in Net Assets from Dividends and Distributions	<u>(14,119,037)</u>	<u>(26,068,485)</u>
<b>From Capital Share Transactions</b>		
Proceeds from Sale of Shares	39,515,790	314,120,403
Shares Issued in Reinvestment of Dividends and Distributions	12,399,726	23,479,746
Cost of Shares Redeemed	<u>(80,606,916)</u>	<u>(357,108,236)</u>
Net Decrease in Net Assets from Shareholder Activity	<u>(28,691,400)</u>	<u>(19,508,087)</u>
<b>NET ASSETS</b>		
Net Decrease in Net Assets	(19,350,880)	(65,010,444)
Net Assets at Beginning of Period	<u>299,224,064</u>	<u>364,234,508</u>
Net Assets at End of Period	<u>\$279,873,184</u>	<u>\$ 299,224,064</u>
Accumulated Undistributed Net Investment Income at End of Period	<u>\$ 4,346,536</u>	<u>\$ 4,497,137</u>
<b>SHARES TRANSACTIONS</b>		
Issued	3,886,860	28,561,964
Reinvested	1,230,480	2,237,086
Redeemed	<u>(7,887,511)</u>	<u>(34,047,999)</u>
Net Decrease in Shares	(2,770,171)	(3,248,949)
Shares Outstanding at Beginning of Period	<u>30,803,662</u>	<u>34,052,611</u>
Shares Outstanding at End of Period	<u>28,033,491</u>	<u>30,803,662</u>

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

# THE FAIRHOLME FOCUSED INCOME FUND

## FINANCIAL HIGHLIGHTS

	For the Six Months Ended May 31, 2012 (unaudited)	For the Fiscal Year Ended November 30, 2011	For the Period Ended November 30, 2010 <sup>(1)</sup>
<b>NET ASSET VALUE, BEGINNING OF PERIOD</b>	\$9.71	\$10.70	\$10.00
<b>Investment Operations</b>			
Net Investment Income <sup>(2)</sup>	0.48	0.64	0.45
Net Realized and Unrealized Gain (Loss) on Investments	0.27	(0.95)	0.45
Total from Investment Operations	0.75	(0.31)	0.90
<b>Dividends and Distributions</b>			
From Net Investment Income	(0.48)	(0.64)	(0.20)
From Realized Capital Gains	—	(0.04)	—
Total Dividends and Distributions	(0.48)	(0.68)	(0.20)
<b>NET ASSET VALUE, END OF PERIOD</b>	<u>\$9.98</u>	<u>\$9.71</u>	<u>\$10.70</u>
<b>TOTAL RETURN</b>	7.71% <sup>(3)</sup>	(3.24)%	9.05% <sup>(3)</sup>
<b>Ratio/Supplemental Data</b>			
Net Assets, End of Period (in 000's)	\$279,873	\$299,224	\$364,235
Ratio of Expenses to Average Net Assets:			
Before Expenses Waived	1.00% <sup>(4)</sup>	1.00%	1.00% <sup>(4)</sup>
After Expenses Waived	0.83% <sup>(4)</sup>	0.67%	0.50% <sup>(4)</sup>
Ratio of Net Investment Income to Average Net Assets	9.30% <sup>(4)</sup>	5.96%	4.69% <sup>(4)</sup>
Portfolio Turnover Rate	7.35% <sup>(3)</sup>	91.67%	77.03% <sup>(3)</sup>

<sup>(1)</sup> The Income Fund commenced operations on December 31, 2009.

<sup>(2)</sup> Based on average shares outstanding.

<sup>(3)</sup> Not Annualized.

<sup>(4)</sup> Annualized.

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



# THE FAIRHOLME ALLOCATION FUND

SCHEDULE OF INVESTMENTS  
May 31, 2012 (unaudited)

Shares	Value	Shares	Value
<b>DOMESTIC EQUITY SECURITIES — 67.6%</b>		<b>WARRANTS — 16.9%</b>	
<b>CAPITAL MARKETS — 5.3%</b>		<b>DIVERSIFIED BANKS — 14.3%</b>	
975,000	Jefferies Group, Inc. \$ 13,026,000	5,570,428	Bank of America Corp., Vested, Strike Price \$13.30, Expire 01/16/2019 <sup>(a)(b)</sup> \$ 18,549,525
<b>DIVERSIFIED HOLDING COMPANIES — 5.1%</b>		484,700	JPMorgan Chase & Co., Vested, Strike Price \$42.42, Expire 10/28/2018 <sup>(a)(b)</sup> 4,677,355
612,100	Leucadia National Corp. 12,437,872	1,280,495	Wells Fargo & Co., Vested, Strike Price \$34.01, Expire 10/28/2018 <sup>(a)(b)</sup> 11,844,578
<b>MULTI-LINE INSURANCE — 18.3%</b>			
1,532,900	American International Group, Inc. <sup>(a)</sup> 44,730,022		
<b>RETAIL DEPARTMENT STORES — 9.5%</b>		<b>MULTI-LINE INSURANCE — 2.6%</b>	
472,100	Sears Holdings Corp. <sup>(a)</sup> 23,321,740	507,515	American International Group, Inc., Vested, Strike Price \$45.00, Expire 01/19/2021 <sup>(a)(b)</sup> 5,176,653
<b>SPECIALTY RETAIL-HOME IMPROVEMENT — 0.1%</b>		114,900	Hartford Financial Services Group, Inc., Vested, Strike Price \$9.649, Expire 06/26/2019 <sup>(a)(b)</sup> 1,114,530
8,070	Orchard Supply Hardware Stores Corp., Class A <sup>(a)</sup> 135,987		
<b>SURETY INSURANCE — 29.3%</b>			
7,982,400	MBIA, Inc. <sup>(a)</sup> 71,602,128		
<b>TOTAL DOMESTIC EQUITY SECURITIES (COST \$174,103,562)</b>		<b>TOTAL WARRANTS (COST \$40,214,650)</b>	
	165,253,749		41,362,641
<b>DOMESTIC PREFERRED EQUITY SECURITIES — 0.0%</b>		<b>Principal</b>	
<b>SPECIALTY RETAIL-HOME IMPROVEMENT — 0.0%</b>		<b>DOMESTIC CORPORATE BONDS — 4.3%</b>	
8,070	Orchard Supply Hardware Stores Corp., Preferred, Zero Coupon, Series A <sup>(a)</sup> 12,509	\$11,400,000	<b>REGIONAL BANKS — 4.3%</b> Emigrant Bancorp, Inc. 6.250%, 06/15/2014 <sup>(c)</sup> 10,514,220
<b>TOTAL DOMESTIC PREFERRED EQUITY SECURITIES (COST \$14,067)</b>		<b>TOTAL DOMESTIC CORPORATE BONDS (COST \$10,493,849)</b>	
	12,509		10,514,220

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

# THE FAIRHOLME ALLOCATION FUND

SCHEDULE OF INVESTMENTS (continued)  
May 31, 2012 (unaudited)

<u>Shares</u>	<u>Value</u>		<u>Value</u>
		<b>MONEY MARKET FUNDS — 6.4%</b>	
15,557,686		Fidelity Institutional Money Market Funds - Money Market Portfolio, 0.240% <sup>(d)</sup>	
	\$ 15,557,686		
<b>TOTAL MONEY MARKET FUNDS</b>	<u>15,557,686</u>		
		<b>MISCELLANEOUS INVESTMENTS — 4.7%<sup>(e)</sup></b>	
		(COST \$16,046,952)	\$ 11,625,251
		<b>TOTAL INVESTMENTS — 99.9%</b>	
		(COST \$256,430,766)	244,326,056
		<b>OTHER ASSETS IN EXCESS OF LIABILITIES</b>	
		— 0.1%	209,918
		<b>NET ASSETS — 100.0%</b>	<u>\$ 244,535,974</u>

<sup>(a)</sup> Non-income producing security.

<sup>(b)</sup> Warrants have terms and conditions based on dividends paid and other events that may lower the strike price and raise the shares per warrant conversion ratio. Reported strike prices and conversion ratios are as of the date of this report. All share-to-warrant conversion ratios are currently 1:1.

<sup>(c)</sup> Security fair valued under procedures approved by the Directors. The procedures may include: a) utilizing the average bid of independent broker/dealer quotes, b) utilizing the average bid of independent broker/dealer quotes and observable market prices on the day of valuation, and c) using simulation models. The value of this security totals \$10,514,220, which represents 4.30% of The Allocation Fund's net assets. Such securities may be classified as Level 2 measurements if the determination of fair value is based primarily on the use of significant observable inputs.

<sup>(d)</sup> Annualized based on the 1-day yield as of May 31, 2012.

<sup>(e)</sup> Represents previously undisclosed unrestricted securities, which The Allocation Fund has held for less than one year.

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

# THE FAIRHOLME ALLOCATION FUND

## STATEMENT OF ASSETS & LIABILITIES May 31, 2012 (unaudited)

### Assets

Investments, at Fair Value (Cost — \$256,430,766)	\$244,326,056
Receivable for Capital Shares Sold	362,483
Dividends and Interest Receivable	330,828
Total Assets	<u>245,019,367</u>

### Liabilities

Payable to Custodian	183,212
Payable for Capital Shares Redeemed	75,224
Accrued Management Fees	224,957
Total Liabilities	<u>483,393</u>

### NET ASSETS

\$244,535,974

### Net Assets Consist of:

Paid-In-Capital	\$271,838,551
Accumulated Net Investment Loss	(843,515)
Net Accumulated Realized Loss on Investments and Foreign Currency Related Transactions	(14,354,352)
Net Unrealized Depreciation on Investments and Foreign Currency Related Translations	<u>(12,104,710)</u>

### NET ASSETS

\$244,535,974

Shares of Common Stock Outstanding* (\$0.0001 par value)	<u>27,969,187</u>
Net Asset Value, Offering and Redemption Price Per Share (\$244,535,974 / 27,969,187 shares)	<u>\$ 8.74</u>

\* 200,000,000 shares authorized in total.

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

# THE FAIRHOLME ALLOCATION FUND

## STATEMENT OF OPERATIONS (unaudited)

	<b>For the Six Months Ended May 31, 2012</b>
<b>Investment Income</b>	
Interest	\$ 575,286
Dividends	<u>262,762</u>
Total Investment Income	<u>838,048</u>
<b>Expenses</b>	
Management Fees	<u>1,395,943</u>
Less: Management Fees Waiver	<u>(225,673)</u>
Net Expenses	<u>1,170,270</u>
Net Investment Loss	<u>(332,222)</u>
<b>Realized and Unrealized Gain on Investments and Foreign Currency Related Transactions</b>	
Net Realized Gain on Investments	1,230,977
Net Change in Unrealized Appreciation on Investments and Foreign Currency Related Transactions	<u>10,848,439</u>
Net Realized and Unrealized Gain on Investments and Foreign Currency Related Transactions	<u>12,079,416</u>
<b>NET INCREASE IN NET ASSETS FROM OPERATIONS</b>	<u><u>\$11,747,194</u></u>

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

# THE FAIRHOLME ALLOCATION FUND

## STATEMENTS OF CHANGES IN NET ASSETS

	<b>For the Six Months Ended May 31, 2012 (unaudited)</b>	<b>For the Period Ended November 30, 2011<sup>(1)</sup></b>
<b>CHANGE IN NET ASSETS</b>		
<b>From Operations</b>		
Net Investment Loss	\$ (332,222)	\$ (511,267)
Net Realized Gain (Loss) on Investments and Foreign Currency Related Transactions	1,230,977	(15,585,355)
Net Change in Unrealized Appreciation (Depreciation) on Investments and Foreign Currency Related Translations	<u>10,848,439</u>	<u>(22,953,149)</u>
Net Increase (Decrease) in Net Assets from Operations	<u>11,747,194</u>	<u>(39,049,771)</u>
<b>From Capital Share Transactions</b>		
Proceeds from Sale of Shares	88,642,821	308,704,162
Redemption Fees	13,450	71,160
Cost of Shares Redeemed	<u>(67,989,401)</u>	<u>(57,603,641)</u>
Net Increase in Net Assets from Shareholder Activity	<u>20,666,870</u>	<u>251,171,681</u>
<b>NET ASSETS</b>		
Net Increase in Net Assets	32,414,064	212,121,910
Net Assets at Beginning of Period	<u>212,121,910</u>	<u>—</u>
Net Assets at End of Period	<u>\$244,535,974</u>	<u>\$212,121,910</u>
Accumulated Net Investment Loss at End of Period	<u>\$ (843,515)</u>	<u>\$ (511,293)</u>
<b>SHARES TRANSACTIONS</b>		
Issued	9,543,059	32,332,438
Redeemed	<u>(7,157,395)</u>	<u>(6,748,915)</u>
Net Increase in Shares	2,385,664	25,583,523
Shares Outstanding at Beginning of Period	<u>25,583,523</u>	<u>—</u>
Shares Outstanding at End of Period	<u>27,969,187</u>	<u>25,583,523</u>

<sup>(1)</sup> The Allocation Fund commenced operations on December 31, 2010.

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

# THE FAIRHOLME ALLOCATION FUND

## FINANCIAL HIGHLIGHTS

	For the Six Months Ended May 31, 2012 (unaudited)	For the Period Ended November 30, 2011 <sup>(1)</sup>
<b>NET ASSET VALUE, BEGINNING OF PERIOD</b>	\$8.29	\$10.00
<b>Investment Operations</b>		
Net Investment Loss <sup>(2)</sup>	(0.01)	(0.02)
Net Realized and Unrealized Gain (Loss) on Investments	0.46	(1.69)
Total from Investment Operations	0.45	(1.71)
<b>Redemption Fees<sup>(2)</sup></b>	0.00 <sup>(3)</sup>	0.00 <sup>(3)</sup>
<b>NET ASSET VALUE, END OF PERIOD</b>	\$8.74	\$8.29
<b>TOTAL RETURN</b>	5.43% <sup>(4)</sup>	(17.10)% <sup>(4)</sup>
Ratio/Supplemental Data		
Net Assets, End of Period (in 000's)	\$244,536	\$212,122
Ratio of Expenses to Average Net Assets:		
Before Expenses Waived	1.00% <sup>(5)</sup>	1.00% <sup>(5)</sup>
After Expenses Waived	0.84% <sup>(5)</sup>	0.75% <sup>(5)</sup>
Ratio of Net Investment Loss to Average Net Assets	(0.24)% <sup>(5)</sup>	(0.30)% <sup>(5)</sup>
Portfolio Turnover Rate	10.88% <sup>(4)</sup>	41.60% <sup>(4)</sup>

<sup>(1)</sup> The Allocation Fund commenced operations on December 31, 2010.

<sup>(2)</sup> Based on average shares outstanding.

<sup>(3)</sup> Redemption fees represent less than \$0.01.

<sup>(4)</sup> Not Annualized.

<sup>(5)</sup> Annualized.

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

**Note 1. Organization**

Fairholme Funds, Inc. (the “Company”), a Maryland corporation, is registered under the Investment Company Act of 1940, as amended (the “1940 Act”), as an open-end management investment company. The Company’s Articles of Incorporation permit the Board of Directors of the Company (the “Board” or the “Directors”) to issue 1,100,000,000 shares of common stock at \$.0001 par value. 700,000,000 shares have been allocated to The Fairholme Fund, 200,000,000 shares have been allocated to The Fairholme Focused Income Fund (“The Income Fund”), and 200,000,000 shares have been allocated to The Fairholme Allocation Fund (“The Allocation Fund”). The Fairholme Fund, The Income Fund, and The Allocation Fund (each a “Fund” and collectively the “Funds”) are non-diversified funds. The Funds may have a greater percentage of their assets invested in particular securities than a diversified fund, exposing the Funds to the risk of unanticipated industry conditions as well as risks specific to a single company or the securities of a single company. Each Fund has different objectives, capitalizations, and considerations that may or may not lead to differing compositions of issuers, securities within an issuer, and cash levels within each Fund. The Board 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.

The Fairholme Fund’s investment objective is to provide long-term growth of capital. Under normal circumstances, The Fairholme Fund seeks to achieve its investment objective by investing in a focused portfolio of equity and fixed-income securities. The proportion of The Fairholme Fund’s assets invested in each type of asset class will vary from time to time based upon Fairholme Capital Management, L.L.C.’s (the “Manager”) assessment of general market and economic conditions. The Fairholme Fund may invest in, and may shift frequently among, the asset classes and market sectors. The equity securities in which The Fairholme Fund may invest include common and preferred stock (including convertible preferred stock), partnership interests, business trust shares, interests in real estate investment trusts (“REITs”), rights and warrants to subscribe for the purchase of equity securities, and depository receipts. The Fairholme Fund may invest in equity securities without regard to the jurisdictions in which the issuers of the securities are organized or situated and without regard to the market capitalizations or sectors of such issuers. The fixed-income securities in which The Fairholme Fund may invest include U.S. corporate debt securities, non-U.S. corporate debt securities, bank debt (including bank loans and participations), U.S. government and agency debt securities, short-term debt obligations of foreign governments, and foreign money market instruments. Except for its investments in short-term debt obligations of foreign governments, The Fairholme Fund may invest in fixed-income securities regardless of maturity or the rating of the issuer of the security. The Fairholme Fund may also invest in “special situations” to achieve its objective. “Special situation” investments may include equity securities or fixed-income securities, such as corporate debt, which may be in a distressed position as a result of economic or company specific developments. Although The Fairholme Fund normally holds a focused portfolio of equity and fixed-income securities, The Fairholme Fund is not required to be fully invested in such securities and may maintain a significant portion of its total assets in cash and securities generally considered to be cash equivalents. The Manager serves as investment adviser to The Fairholme Fund.

The Income Fund’s investment objective is to seek current income, other forms of cash distributions, and capital preservation. Under normal circumstances, The Income Fund seeks to achieve its investment objective by investing in a focused portfolio of cash distributing securities. To maintain maximum flexibility, the securities in which The Income Fund may invest include corporate debt securities of issuers in the U.S. and foreign countries, bank debt (including bank loans and loan participations), government and agency debt securities of the U.S. and foreign countries, convertible bonds and other convertible securities and equity securities, including preferred and common stock and interests in REITs. Although The Income Fund normally holds a focused portfolio of securities, The Income Fund is not required to be fully invested in such securities and may maintain a significant portion of its total assets in cash and securities generally considered to be cash equivalents. The Manager serves as investment adviser to The Income Fund.

The Allocation Fund’s investment objective is to seek long-term total return from capital appreciation and income. Under normal circumstances, The Allocation Fund seeks to achieve its investment objective by investing opportunistically in a focused portfolio of investments in the equity, fixed-income and cash, and cash-equivalent asset classes. The proportion of The Allocation Fund’s portfolio invested in each asset class will vary from time to time based on the Manager’s assessment

of relative fundamental values of securities and other investments in the asset class, the attractiveness of investment opportunities within each asset class, general market and economic conditions, and expected future returns of other investment opportunities. The Allocation Fund seeks to capitalize on anticipated fluctuations in the financial markets by changing the mix of The Allocation Fund's holdings in the targeted asset classes. The Allocation Fund uses the Manager's focused value-based approach. The Allocation Fund is not required to be fully invested in such securities and may maintain a significant portion of its total assets in cash and securities generally considered to be cash equivalents. The Manager serves as investment adviser to The Allocation Fund.

There is no guarantee that the Funds will meet their objectives.

**Note 2. Significant Accounting Policies**

The Funds' investments are reported at fair value as defined by U.S. Generally Accepted Accounting Principles ("U.S. GAAP"). The Funds generally determine their net asset value as of approximately 4:00 p.m. Eastern Time each day the New York Stock Exchange is open.

A description of the valuation techniques applied to the Funds' securities measured at fair value on a recurring basis follows:

*Security Valuation:*

Equity securities (common and preferred stocks): Securities traded on a national securities exchange or reported on the NASDAQ national market are generally valued at the official closing price, or at the last reported sale price on the exchange or market on which the securities are traded, as of the close of business on the day the securities are being valued or, lacking any sales, at the last available bid price. To the extent these securities are actively traded and valuation adjustments are not applied, they are classified in Level 1 of the fair value hierarchy. The Manager may also employ other valuation methods which the Manager believes would provide a more accurate indication of fair value. In these situations, if the inputs are observable, the valuation will be classified in Level 2 of the fair value hierarchy, otherwise they would be classified in Level 3. As of May 31, 2012 equity investments of The St. Joe Co. valued at \$358,405,239 (5.09% of net assets) in The Fairholme Fund are fair valued by the Manager due to a trading restriction. The value is calculated by applying a discount to the official closing price on the day of valuation. These investments are reflected as being fair valued under procedures approved by the Board in the Schedules of Investments.

Fixed-income securities (corporate bonds, convertible bonds, and asset backed securities): The fair value of corporate bonds, convertible bonds, and asset backed securities is estimated using market quotations when readily available, but may also be estimated by various methods when no such market quotations exist and when the Manager believes these other methods reflect the fair value of such securities. These methods may consider recently executed transactions in securities of the issuer or comparable issuers and market price valuations from independent pricing services and/or brokers (where observable). Where the Manager deems it appropriate to do so (such as when independent prices are unavailable or not deemed to be representative of fair value) fixed income securities will be fair valued in good faith. As of May 31, 2012, fixed income investments valued at \$18,068,068 (0.26% of net assets), \$164,696,771 (58.85% of net assets), and \$10,514,220 (4.30% of net assets) in The Fairholme Fund, The Income Fund, and The Allocation Fund, respectively, are valued by the Manager utilizing the average bid of independent broker/dealer quotes or the average bid of independent broker/dealer quotes and observable market prices on the day of valuation. These investments are reflected as being fair valued pursuant to procedures approved by the Board in the Schedules of Investments. Although most corporate bonds are classified in Level 2 of the fair value hierarchy, in instances where lower relative weight is placed on transaction prices, quotations, or similar observable inputs, they are classified in Level 3.

Open-end mutual funds: Investments in open-end mutual funds including money market funds are valued at their closing net asset value each business day and are classified in Level 1 of the fair value hierarchy.

Short-term securities: Investments in securities with maturities of less than sixty days when acquired or long-term securities, which are within sixty days of maturity are estimated by using the amortized cost method of valuation, which the Manager



and the Board have determined will approximate fair value. To the extent the inputs are observable and timely, the values would be classified in Level 2 of the fair value hierarchy.

Restricted securities: Depending on the relative significance of valuation inputs, these instruments may be classified in either Level 2 or Level 3 of the fair value hierarchy.

Warrants: The Funds may invest in warrants, which may be acquired either through a direct purchase, included as part of a private placement, or pursuant to corporate actions. Warrants entitle, but do not obligate, the holder to buy equity securities at a specific price for a specific period of time. Warrants may be considered more speculative than certain other types of investments in that they do not entitle a holder to dividends or voting rights with respect to the underlying securities that may be purchased nor do they represent any rights in the assets of the issuing company. Also, the value of a warrant does not necessarily change with the value of the underlying securities and a warrant ceases to have value if it is not exercised prior to its expiration date. Warrants traded on a security exchange are valued at the official closing price on the valuation date and are classified as Level 1 of the fair value hierarchy. Over the counter (OTC) warrants are valued using simulation models utilizing market value of the underlying security, expiration date of the warrants, volatility of the underlying security, strike price of the warrants, risk-free interest rate at the valuation date, and other inputs are classified as Level 3 of the fair value hierarchy.

The Manager may determine the fair valuation of a security when market quotations are insufficient or not readily available, when securities are determined to be illiquid or restricted, or when in the judgment of the Manager the prices or values available do not represent the fair value of the instrument. Factors which may cause the Manager to make such a judgment include the following: (a) only a bid price or an asked price is available; (b) the spread between bid and asked prices is substantial; (c) the liquidity of the securities; (d) the frequency of sales; (e) the thinness of the market; (f) the size of reported trades; (g) actions of the securities markets, such as the suspension or limitation of trading; and (h) bona fide bids or offers made to the Manager by independent third parties.

The inputs and valuation techniques used to measure fair value of the Funds' investments are summarized into three levels as described in the hierarchy below:

- Level 1 — quoted prices in active markets for identical securities;
- Level 2 — other significant observable inputs (including quoted prices for similar securities, interest rates, prepayment speeds, credit risk, etc.); and
- Level 3 — significant unobservable inputs (including the Manager's determination as to the fair value of investments).

The inputs or methodology used for valuing investments are not necessarily an indication of the risk associated with investing in those investments. The summary of the Funds' investments by inputs used to value the Funds' investments as of May 31, 2012 is as follows:

# FAIRHOLME FUNDS, INC.

NOTES TO FINANCIAL STATEMENTS (continued)  
May 31, 2012 (unaudited)

	Valuation Inputs			Total Fair Value at 05/31/2012
	Level 1 – Quoted Prices	Level 2 – Other Significant Observable Inputs	Level 3 - Significant Unobservable Inputs	
<b>THE FAIRHOLME FUND</b>				
<b>ASSETS:</b>				
<b>INVESTMENTS (Fair Value):</b>				
Domestic Equity Securities				
Real Estate Management & Development	\$ —	\$358,405,239	\$ —	\$ 358,405,239
Other*	4,581,654,980	—	—	4,581,654,980
Foreign Equity Securities*	621,783,059	—	—	621,783,059
Domestic Preferred Equity Securities*	932,625	—	—	932,625
Warrants				
Multi-Line Insurance	220,202,496	—	—	220,202,496
Real Estate Investment Trusts	—	—	440,025,388	440,025,388
Real Estate Management & Development	—	—	47,663,315	47,663,315
Domestic Corporate Bonds	—	39,298,743	—	39,298,743
Commercial Paper	—	50,000,000	—	50,000,000
U.S. Government Obligations	—	124,985,683	—	124,985,683
Money Market Funds	332,264,012	—	—	332,264,012
<b>TOTAL INVESTMENTS</b>	<u>\$5,756,837,172</u>	<u>\$572,689,665</u>	<u>\$487,688,703</u>	<u>\$6,817,215,540</u>
<b>THE INCOME FUND</b>				
<b>ASSETS:</b>				
<b>INVESTMENTS (Fair Value):</b>				
Domestic Preferred Equity Securities*	\$ 2,781,546	\$ —	\$ —	\$ 2,781,546
Warrants				
Multi-Line Insurance	236,762	—	—	236,762
Real Estate Investment Trusts	—	—	4,733,009	4,733,009
Real Estate Management & Development	—	—	512,685	512,685
Domestic Corporate Bonds	—	224,743,825	—	224,743,825
Commercial Paper	—	10,000,000	—	10,000,000
Money Market Funds	20,810,805	—	—	20,810,805
Miscellaneous Investments	—	8,680,436	—	8,680,436
<b>TOTAL INVESTMENTS</b>	<u>\$ 23,829,113</u>	<u>\$243,424,261</u>	<u>\$ 5,245,694</u>	<u>\$ 272,499,068</u>
<b>THE ALLOCATION FUND</b>				
<b>ASSETS:</b>				
<b>INVESTMENTS (Fair Value):</b>				
Domestic Equity Securities*	\$ 165,253,749	\$ —	\$ —	\$ 165,253,749
Domestic Preferred Equity Securities*	12,509	—	—	12,509
Warrants*	41,362,641	—	—	41,362,641
Domestic Corporate Bonds	—	10,514,220	—	10,514,220
Money Market Funds	15,557,686	—	—	15,557,686
Miscellaneous Investments	10,565,928	1,059,323	—	11,625,251
<b>TOTAL INVESTMENTS</b>	<u>\$ 232,752,513</u>	<u>\$ 11,573,543</u>	<u>\$ —</u>	<u>\$ 244,326,056</u>

\* Industry classifications for these categories are detailed in the Schedules of Investments.

The Funds had no significant transfers between Level 1 and Level 2 during the period ended May 31, 2012.

The following is a reconciliation of Level 3 investments for which significant unobservable inputs were used to determine fair value:

<b>THE FAIRHOLME FUND</b>			
<b>Assets:</b>			
<b>Investments (Fair Value)</b>			
<b>Warrants</b>			
	<b>Real Estate Investment Trusts</b>	<b>Real Estate Management &amp; Development</b>	<b>Total Level 3 Investments</b>
Balance as of 11/30/2011	\$339,268,437	\$35,943,608	\$375,212,045
Change in unrealized appreciation <sup>(1)</sup>	100,756,951	11,719,707	112,476,658
Purchases	—	—	—
Sales	—	—	—
Transfers into Level 3 <sup>(2)</sup>	—	—	—
Transfers out of Level 3 <sup>(2)</sup>	—	—	—
Balance as of 05/31/2012	<u>\$440,025,388</u>	<u>\$47,663,315</u>	<u>\$487,688,703</u>
Net change in unrealized appreciation during the period on Level 3 investments held at 05/31/2012 <sup>(1)</sup>	<u>\$100,756,951</u>	<u>\$11,719,707</u>	<u>\$112,476,658</u>
<b>THE INCOME FUND</b>			
<b>Assets:</b>			
<b>Investments (Fair Value)</b>			
<b>Warrants</b>			
	<b>Real Estate Investment Trusts</b>	<b>Real Estate Management &amp; Development</b>	<b>Total Level 3 Investments</b>
Balance as of 11/30/2011	\$3,649,245	\$386,623	\$4,035,868
Change in unrealized appreciation <sup>(1)</sup>	1,083,764	126,062	1,209,826
Purchases	—	—	—
Sales	—	—	—
Transfers into Level 3 <sup>(2)</sup>	—	—	—
Transfers out of Level 3 <sup>(2)</sup>	—	—	—
Balance as of 05/31/2012	<u>\$4,733,009</u>	<u>\$512,685</u>	<u>\$5,245,694</u>
Net change in unrealized appreciation during the period on Level 3 investments held at 05/31/2012 <sup>(1)</sup>	<u>\$1,083,764</u>	<u>\$126,062</u>	<u>\$1,209,826</u>

<sup>(1)</sup> Net change in unrealized appreciation on investments is included in the related amounts in the Statement of Operations.

<sup>(2)</sup> The Income Fund's policy is to recognize transfers into and transfers out of Level 3 as of the beginning of the reporting period.

**Recent Accounting Standards:** In May 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-04 "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards ("IFRS)". ASU No. 2011-04 includes common requirements for measurement of and disclosure about fair value between U.S. GAAP and IFRS. ASU No. 2011-04 will require reporting entities to disclose the following information for fair value measurements classified within Level 3 of the fair value hierarchy: quantitative information about the unobservable inputs used in the fair value measurement; the valuation processes used by the reporting entity; and a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs and the interrelationships between those unobservable inputs. In addition, ASU No. 2011-04 will require reporting entities to make disclosures about amounts and reasons for all transfers in and out of Level 1 and Level 2 fair value measurements. The new and revised disclosures are effective for interim and annual reporting periods beginning after December 15, 2011. Management is evaluating the impact of ASU No. 2011-04 on the financial statements and disclosures.

In December 2011, FASB issued ASU No. 2011-11, "Disclosures about Offsetting Assets and Liabilities". ASU 2011-11 requires disclosures to make financial statements that are prepared under U.S. GAAP more comparable to those prepared under IFRS. The new disclosure requirements mandate that entities disclose both gross and net information about instruments and transactions eligible for offset in the statement of assets and liabilities as well as instruments and transactions subject to

an agreement similar to a master netting arrangement. In addition, ASU 2011-11 requires disclosure of collateral received and posted in connection with master netting agreements or similar arrangements. New disclosures are required for annual reporting periods beginning on or after January 1, 2013 and interim periods within those annual periods. Management is evaluating the impact of ASU 2011-11 on the financial statements and disclosures.

*Warrants:* The Funds' investments in warrants as of May 31, 2012, are presented within the Schedules of Investments.

The Fairholme Fund's, The Income Fund's, and The Allocation Fund's warrant positions during the six months ended May 31, 2012 had an average monthly market value of approximately \$642,099,544, \$5,132,173, and \$37,936,223, respectively.

As of May 31, 2012, the value of warrants with equity risk exposure is \$707,891,199, \$5,482,456, and \$41,362,641 for The Fairholme Fund, The Income Fund, and The Allocation Fund, respectively, and is included with Investments at Fair Value on the Statement of Assets and Liabilities. For the six months ended May 31, 2012, the effect of the net change in unrealized appreciation of warrants with equity risk exposure held of \$200,557,757, \$1,304,531, and \$7,385,210, for The Fairholme Fund, The Income Fund, and The Allocation Fund, respectively, is included with the Net Change in Unrealized Appreciation on Investments and Foreign Currency Related Translations on the Statements of Operations.

*Dividends and Distributions:* The Fairholme Fund and The Allocation Fund intend to distribute substantially all of their net investment income (if any) as dividends to their respective shareholders on an annual basis in December. The Income Fund intends to declare and pay net investment income distributions, if any, quarterly in March, June, September, and December. The Fairholme Fund, The Income Fund, and The Allocation Fund intend to distribute any net long-term capital gains and any net short-term capital gains at least once a year. If the total dividends and distributions made in any tax year exceeds net investment income and accumulated realized capital gains, a portion of the total distribution may be treated as a tax return of capital.

*Foreign Currency Translation:* The books and records of the Funds are maintained in U.S. dollars. Foreign currency amounts are translated into U.S. dollars on the following basis: (i) fair value of investment securities, assets, and liabilities at the current rate of exchange; and (ii) purchases and sales of investment securities, income, and expenses at the relevant rates of exchange prevailing on the respective dates of such transactions. The Funds do not isolate that portion of gains and losses on investment securities which is due to changes in the foreign exchange rates from that which is due to changes in the market prices of such securities.

*Estimates:* The preparation of financial statements in conformity with U.S. GAAP requires the Funds to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of both contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

*Redemption Fee:* The Fairholme Fund and The Allocation Fund assess a 2% fee on the proceeds of The Fairholme Fund and The Allocation Fund shares that are redeemed within 60 days of their purchase. The redemption fee is paid to The Fairholme Fund and The Allocation Fund, as applicable, for the benefit of remaining shareholders and is recorded as paid-in capital. The redemption fees retained by The Fairholme Fund during the six months ended May 31, 2012 and the fiscal year ended November 30, 2011 amounted to \$364,520 and \$2,714,993, respectively. The redemption fees retained by The Allocation Fund during the six months ended May 31, 2012 and the period ended November 30, 2011 amounted to \$13,450 and \$71,160, respectively.

*Other:* The Funds account for security transactions on the trade date for financial statement purposes. 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 net of foreign taxes withheld where recovery is uncertain and interest income is recorded on an accrual basis. Discounts and premiums on securities purchased are amortized over the life of the respective securities using the effective yield method. Securities denominated in currencies other than U.S. dollars are subject to changes in value due to fluctuation in exchange rates. The Funds may invest in countries that require governmental approval for the repatriation of

investment income, capital, or the proceeds of sales of securities by foreign investors. In addition, if there is deterioration in a country's balance of payments or for other reasons, a country may impose temporary restrictions on foreign capital remittances abroad.

The Funds paid commissions, other brokerage fees, and security registration expenses during the period.

**Note 3. Related Party Transactions**

The Manager is a Delaware limited liability company and is registered with the Securities and Exchange Commission as an investment adviser. The Manager's principal business and occupation is to provide investment management and advisory services to individuals, corporations, and other institutions throughout the world. Pursuant to an Investment Management Agreement, each Fund pays a management fee to the Manager for its provision of investment advisory and operating services to the Fund. Subject to applicable waivers or limitations, the management fee is paid at an annual rate equal to 1.00% of the daily average net assets of each of the Funds. Under the Investment Management Agreements, the Manager is responsible for paying all of the Funds' expenses, including expenses for the following services: transfer agency, fund accounting, fund administration, custody, legal, audit, compliance, directors' fees, call center, fulfillment, travel, insurance, rent, printing, postage, and other office supplies, except for commissions, brokerage fees, and other transaction costs, taxes, interest, litigation expenses, and related expenses, and other extraordinary expenses.

Effective March 29, 2012, the Manager's contractual management fee waiver/expense reimbursement for The Income Fund and The Allocation Fund expired. Prior to March 29, 2012, the Manager had contractually agreed to waive a portion of its management fee and/or limit each Fund's operating expenses (excluding taxes, interest, brokerage commissions, acquired fund fees and expenses, expenses incurred in connections with any merger or reorganization and extraordinary expenses such as litigation) so that the Fund's operating expenses, after such waiver or limitation payment, would not exceed an annual rate of 0.75% of the Fund's daily average net assets for the period March 30, 2011 to March 29, 2012 for The Income Fund and for the period December 29, 2010 to March 29, 2012 for The Allocation Fund. With regard to The Income Fund only and for the period December 31, 2009 to March 30, 2011, the Manager had contractually agreed to waive a portion of its management fee and/or limit the Fund's operating expenses (excluding those expenses noted above) so that the Fund's operating expenses, after such waiver or limitation payment, would not exceed an annual rate of 0.50% of the Fund's daily average net assets. The Manager may be reimbursed for fee waivers and/or expense limitation payments made in any fiscal year of The Income Fund and The Allocation Fund over the following three fiscal years of such Fund. Any such reimbursement is subject to the Board's review and approval. A reimbursement may be requested by the Manager if the aggregate amount paid by the Fund for operating expenses for such fiscal year, taking into account any reimbursement, does not exceed the fee waiver/expense limitation in place at the time of the initial waiver or reimbursement of the amount by the Manager. For the six months ended May 31, 2012, the Manager may request reimbursement of up to the following:

	<u>The Income Fund</u>	<u>The Allocation Fund</u>
For the period ended November 30, 2010, expiring November 30, 2013:	\$1,033,925	\$ —
For the period ended November 30, 2011, expiring November 30, 2014:	1,399,457	424,124
For the period ended May 31, 2012, expiring November 30, 2015:	<u>249,582</u>	<u>225,673</u>
	<u>\$2,682,964</u>	<u>\$649,797</u>

The Manager earned \$38,858,723 from The Fairholme Fund, \$1,501,572 from The Income Fund, and \$1,395,943 from The Allocation Fund for its services during the six months ended May 31, 2012. The Manager waived \$249,582 and \$225,673 of the amount of the management fees earned from The Income Fund and The Allocation Fund, respectively.

Certain Directors and Officers of the Funds are also Members and Officers of the Manager or its affiliates.

# FAIRHOLME FUNDS, INC.

NOTES TO FINANCIAL STATEMENTS (continued)  
May 31, 2012 (unaudited)

## Note 4. Investments

For the six months ended May 31, 2012, aggregated purchases and sales of investment securities other than short-term investments were as follows:

	<u>Purchases</u>	<u>Sales</u>
The Fairholme Fund	\$ —	\$1,889,463,424
The Income Fund	19,904,952	67,598,274
The Allocation Fund	44,005,110	26,930,934

## Note 5. Tax Matters

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

For U.S. federal income tax purposes, the cost of securities owned, gross unrealized appreciation, gross unrealized depreciation, and net unrealized depreciation of investments at May 31, 2012 were as follows:

	<u>Cost</u>	<u>Gross Unrealized Appreciation</u>	<u>Gross Unrealized Depreciation</u>	<u>Net Unrealized Depreciation</u>
The Fairholme Fund	\$7,500,300,976	\$759,306,673	\$(1,442,392,109)	\$(683,085,436)
The Income Fund	290,190,830	5,897,332	(23,589,094)	(17,691,762)
The Allocation Fund	256,515,536	5,315,457	(17,504,937)	(12,189,480)

The difference between book basis and tax basis net unrealized depreciation, if any, is primarily attributable to the tax deferral of losses on wash sales.

The Funds’ tax basis capital gains are determined only at the end of each fiscal year. Therefore, the components of distributable earnings will be included in the Annual Report dated November 30, 2012.

The Manager has analyzed the Funds’ tax positions taken on federal income tax returns for all open tax years (current and prior three tax years) and has concluded that there are no uncertain tax positions that require recognition of a tax liability. The Funds’ federal and state income and federal excise tax returns for tax years for which the applicable statutes of limitations have not expired (the current year and the prior year) are subject to examination by the Internal Revenue Service and state departments of revenue.

## Note 6. Dividends and Distributions to Shareholders

Ordinary income and capital gain distributions are determined in accordance with federal income tax regulations, which may differ from U.S. GAAP.

The tax character of dividends and distributions paid by the Funds were as follows:

	<u>The Fairholme Fund</u>		<u>The Income Fund</u>	
	<u>For the Six Months Ended May 31, 2012</u>	<u>For the Fiscal Year Ended November 30, 2011</u>	<u>For the Six Months Ended May 31, 2012</u>	<u>For the Fiscal Year Ended November 30, 2011</u>
<b>Dividends and Distributions paid from:</b>				
Ordinary Income*	\$ —	\$ 199,071,043	\$14,119,037	\$26,068,485
Long-Term Capital Gain	—	834,276,106	—	—
Return of Capital	276,800,371	—	—	—
	<u>\$276,800,371</u>	<u>\$1,033,347,149</u>	<u>\$14,119,037</u>	<u>\$26,068,485</u>

\* Inclusive of short-term capital gains

# FAIRHOLME FUNDS, INC.

NOTES TO FINANCIAL STATEMENTS (continued)  
May 31, 2012 (unaudited)

There were no dividends or distributions paid by The Allocation Fund during the six months ended May 31, 2012 or during the period ended November 30, 2011.

## Note 7. Transactions in Shares of Affiliates

Portfolio companies in which a Fund owns 5% or more of the outstanding voting securities of the company are considered affiliates of the Fund. The aggregate fair value of all securities of affiliates held in The Fairholme Fund as of May 31, 2012 amounted to \$1,748,367,466, representing 24.82% of the Fund's net assets. There were no affiliates of The Income Fund or The Allocation Fund as of May 31, 2012.

Transactions in The Fairholme Fund during the six months ended May 31, 2012 in which the issuer was an affiliate are as follows:

The Fairholme Fund	November 30, 2011	Gross Additions	Gross Deductions	May 31, 2012			
	Shares/ Par Value	Shares/ Par Value	Shares/ Par Value	Shares/ Par Value	Fair Value	Realized Gain (Loss)	Investment Income
CIT Group, Inc.	16,358,129	—	2,761,100	13,597,029	\$ 464,882,422	\$(14,248,872)	\$ —
MBIA, Inc.	20,501,100	—	—	20,501,100	183,894,867	—	—
Orchard Supply Hardware Stores Corp., Class A <sup>(a)</sup>	—	641,893	36,600	605,293	10,199,192	(2,784,099)	—
Sears Holdings Corp.	14,212,673	—	—	14,212,673	702,106,046	—	—
The St. Joe Co.	23,136,502	—	—	23,136,502	358,405,239	—	—
Orchard Supply Hardware Stores Corp., Preferred, Zero Coupon, Series A <sup>(a)</sup>	—	641,893	40,200	601,693	932,625	(42,630)	—
MBIA, Inc. 7.000%, 12/15/2025	\$17,932,000	\$ —	\$ —	\$17,932,000	12,014,440	—	696,353
MBIA, Inc. 7.150%, 07/15/2027	\$13,859,000	\$ —	\$ —	\$13,859,000	9,216,235	—	530,952
MBIA, Inc. 5.700%, 12/01/2034	\$11,580,000	\$ —	\$ —	\$11,580,000	6,716,400	—	355,275
Total					<u>\$1,748,367,466</u>	<u>\$(17,075,601)</u>	<u>\$1,582,580</u>

<sup>(a)</sup> Security received in spin-off from Sears Holdings Corp. Security was not held in the portfolio at November 30, 2011.

## Note 8. Indemnifications

Under the Company's organizational documents, its Officers and Directors are indemnified against certain liabilities arising out of the performance of their duties to the Funds. In the normal course of business the Company or the Funds enter into contracts that contain a variety of representations and customary indemnifications. The Funds' maximum exposure under these arrangements is unknown as this would involve future claims that may be made against the Funds that have not yet occurred. However, based on their experience to date, the Funds expect the risk of loss to be remote.

**Proxy Voting Policies, Procedures and Records (unaudited)**

The Company has adopted policies and procedures that provide guidance and set forth parameters for the voting of proxies relating to securities held in each Fund's portfolio. A description of these policies and procedures, and records of how the Funds voted proxies relating to their portfolio securities during the most recent twelve month period ended June 30, 2011, are available to you upon request and free of charge by writing to the Fairholme Funds, Inc., c/o BNY Mellon Investment Servicing (US) Inc., P.O. Box 9692, Providence, RI, 02940 or by calling Shareholder Services at 1-866-202-2263. They may also be obtained by visiting the Securities and Exchange Commission ("SEC") website at [www.sec.gov](http://www.sec.gov). The Company shall respond to all shareholder requests for records within three business days of its receipt of such request by first-class mail or other means designed to ensure prompt delivery.

**N-Q Filing (unaudited)**

The Company files a complete schedule of the Funds' portfolio holdings on Form N-Q for the fiscal quarters ending February 28 (February 29 during leap year) and August 31. The Form N-Q filing must be made within 60 days of the end of the quarter. The Forms N-Q relating to each Fund's portfolio investments are available on the SEC's website at [www.sec.gov](http://www.sec.gov), or may be reviewed and copied at the SEC's Public Reference Room in Washington, DC (call 1-800-732-0330 for information on the operation of the Public Reference Room).









# FAIRHOLME FUNDS

## OFFICERS

- Bruce R. Berkowitz  
*President*
- Wayne Kellner  
*Treasurer*
- Paul R. Thomson  
*Chief Compliance Officer and Secretary*

## BOARD OF DIRECTORS

- Cesar L. Alvarez, Esq.
- Terry L. Baxter
- Bruce R. Berkowitz
- Howard S. Frank
- Avivith Oppenheim, Esq.
- Leigh Walters, Esq.

### ▪ **Investment Manager**

Fairholme Capital Management, L.L.C.  
4400 Biscayne Boulevard  
Miami, FL 33137

### ▪ **Dividend Paying Agent Transfer Agent**

BNY Mellon Investment Servicing (US) Inc.  
760 Moore Road  
King of Prussia, PA 19406

### ▪ **Custodian**

The Bank of New York Mellon  
1 Wall Street  
New York, NY 10286

### ▪ **Independent Registered Public Accounting Firm**

Deloitte & Touche LLP  
1700 Market Street  
Philadelphia, PA 19103

### ▪ **Legal Counsel**

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