

FAIRX 2015 SEMI-ANNUAL REPORT

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
THE FAIRHOLME FUND**

JULY 2015

*“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.”*

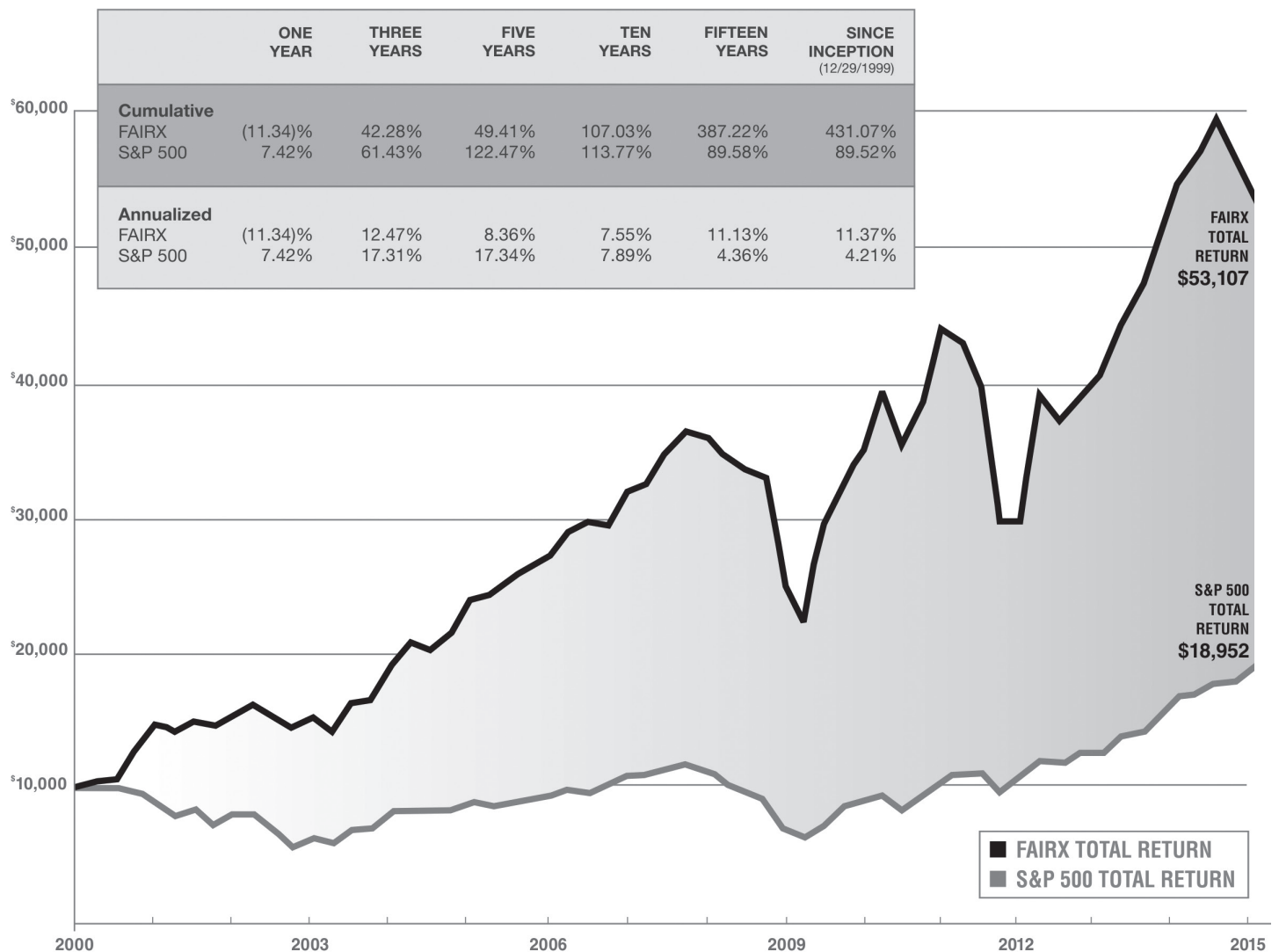
Benjamin Graham & David Dodd

Mutual fund investing involves risks, including loss of principal. The chart below covers the period from inception of The Fairholme Fund (December 29, 1999) to June 30, 2015. Past performance information quoted below does not guarantee 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 lower or higher than the performance information quoted below. Performance figures are after expenses and assume reinvestment of dividends and capital gains but do not reflect a 2.00% redemption fee on shares redeemed within 60 days of purchase. Most recent month-end performance and answers to any questions you may have can be obtained by calling Shareholder Services at 1.866.202.2263. The S&P 500 Index is a broad-based measurement of changes in the stock market, is used for comparative purposes only, and is not meant to be indicative of The Fairholme Fund's performance, asset composition, or volatility. The Fairholme Fund maintains a focused portfolio of investments in a limited number of issuers and does not seek to diversify its investments. This exposes The Fairholme Fund to the risk of unanticipated industry conditions and risks particular to a single company or the securities of a single company. The Fairholme Fund's performance may differ markedly from the performance of the S&P 500 Index in either up or down market trends. The performance of the S&P 500 Index is shown with all dividends reinvested and does not reflect any reduction in performance for the effects of transaction costs or management fees. Investors cannot invest directly in an index. The Fairholme Fund's total expense ratio reflected in its prospectus dated March 27, 2015, was 1.06%, which included acquired fund fees and expenses that are incurred indirectly by The Fairholme Fund as a result of investments in securities issued by one or more investment companies.

July 27, 2015

To the Shareholders and the Directors of The Fairholme Fund:

The Fairholme Fund (the "Fund" or "FAIRX") decreased 0.91% versus a 1.23% gain for the S&P 500 Index (the "S&P 500") for the six-month period that ended June 30, 2015. The following table compares the Fund's unaudited performance (after expenses) with that of the S&P 500, with dividends and distributions reinvested, for various periods ending June 30, 2015.



At June 30, 2015, the value of a \$10,000 investment in the Fund at its inception was worth \$53,107 (calculated by assuming reinvestment of distributions into additional Fund shares) compared to \$18,952 for the S&P 500. Of the \$53,107, the value of distributions reinvested was \$18,347.

The potential advantages of the Fund's long-term focused investment approach are most evident when evaluating performance over any consecutive 5-year period since the inception of FAIRX. The Fund has achieved 123 positive 5-year return periods and only 4 negative 5-year return periods, compared with 100 positive 5-year return periods and 27 negative 5-year return periods for the S&P 500. The Fund's average rolling 5-year return was 70.70% versus 35.09% for the S&P 500. The Fund has outperformed the S&P 500 in 96 of 127 5-year periods, calculated after each month's end. The Fund's worst 5-year-period return was (6.89)% versus (29.05)% for the S&P 500. In its best 5-year period, the Fund's return was 185.26% versus the S&P 500's best return of 181.57%.

Rolling 5-Year-Period Returns*

| | FAIRX | S&P 500 |
|---------------------------------------|----------|----------|
| Best | +185.26% | +181.57% |
| Worst | (6.89)% | (29.05)% |
| Average | +70.70% | +35.09% |
| Percentage of Positive Periods | 96.85% | 78.74% |

AlG is our biggest winner (common and warrants comprise 29.6% of the Fund portfolio), as our remaining stake has almost tripled from the Fund's average purchase price. Book value grew 12% year-over-year, and the company's equity-to-assets now exceeds 20%. Fewer adverse developments from past business, reduced operating expenses, and common stock buybacks should allow the opportunity for double-digit growth to continue toward and potentially surpass book value per share.

The same should be true for Bank of America (20.6% of the Fund portfolio), which today has over \$250 billion in shareholder's equity – more than any other company in any industry in the United States. A focus on growing revenues while reducing operating costs (particularly litigation-related expenses) should result in rising profitability. With a Tier 1 capital ratio well above stringent regulatory requirements and “global excess liquidity sources” that would sustain operations for 40 months, Bank of America has regained the financial strength to support much higher earnings, yet its stock price also remains below book value.

The market price of Sears Holdings Corporation (7.1% of the Fund portfolio) reflects intense skepticism about the company's net assets and ability to transform its operating business. Since the Fund initiated its investment, Sears has distributed \$31.85 to its shareholders via spin-offs and other corporate actions. Most recently, Sears sold 235 properties, plus joint venture interests in 31 additional properties, for \$3.1 billion in cash proceeds. While the market is still digesting the facts associated with this recent separation transaction, our updated sum-of-the-parts valuation exceeds \$125 per share fully diluted, net of debt. We expect the company's focus on “profitability instead of revenues” to result in operational efficiencies, expense reductions, and gross margin improvement.

Recently, one CNBC television personality highlighted the real estate assets of Macy's and Ethan Allen and challenged his own “pedestrian” focus on retail sales performance: “Instead of looking at the earnings per share and the estimates . . . [look] at the more valuable real estate underneath . . . Never going to look at [them] the same way . . . !” It remains unclear why he and others are not willing to apply that same logic to Sears.

The Fund's latest investment is Seritage Growth Properties (1.4% of the Fund portfolio), a newly formed real estate investment trust that purchased the 266 properties from Sears and began trading this month. Seritage and its joint venture partners – GGP, Macerich, and Simon Property Group – intend to reconfigure or redevelop a substantial portion of the properties acquired in order to generate additional operating income and diversify the tenant mix. A recent analyst report noted that “the demographic profile of the [Seritage] owned portfolio is surprisingly good, with 10-mile density and incomes of 692k and \$77k, respectively, slightly better than the mall REIT portfolio averages of 680k and \$77k.” We are bullish also based upon our independent assessment of real estate values, recent transaction data, and expected dividend increases as the company repositions properties to command higher rents from new tenants.

The St. Joe Company (6.7% of the Fund portfolio) recently announced that it received final approval from state and local agencies for its 110,000-acre Bay-Walton Sector Plan, with 170,000 residential units and more than 22 million square feet of retail, commercial, and industrial development. We believe that the company's nearly \$700 million in cash will enable it to implement the Sector Plan over time and simultaneously allocate the excess capital.

Today, shareholders of The Fairholme Fund collectively own \$3.4 billion liquidation value of Fannie Mae and Freddie Mac preferred stock. That means each shareholder effectively owns approximately \$25,000 (on average) of two of the most profitable franchises in America.

Yet for reasons that are not entirely understood, some in government apparently want their friends in the mortgage-industrial complex to take for free what you, the shareholders of these companies, paid for with cash. So we continue to search for the truth:

- Why did federal regulators design a financial support program for Fannie and Freddie on the basis of academic estimates of future performance rather than tried and true statutory accounting and claims-paying ability (which is the standard for all regulated mortgage insurers)?
- Why did federal regulators require Fannie and Freddie, while in conservatorship, to purchase \$40 billion per month in underperforming junk bonds from competitors?
- Why did federal regulators force Fannie and Freddie, while in conservatorship, to participate in Treasury's Home Affordable Modification Program (HAMP) and Home Affordable Refinance Program (HARP), which resulted in more than \$46 billion of losses that the companies would not have otherwise incurred?
- Why did mortgage-backed securities issued by Fannie and Freddie perform dramatically better than private label securities issued by big banks throughout the financial crisis?
- Why did federal regulators settle litigation cases initiated by Fannie and Freddie against major financial institutions for significantly less than what other similarly situated plaintiffs recovered?
- Why did federal regulators seize more than \$18 billion in litigation proceeds recovered by Fannie and Freddie to date?
- Why did federal regulators order Fannie and Freddie to delist their securities from the New York Stock Exchange in 2010?
- Why did federal regulators prohibit Fannie Mae from selling \$3 billion of Low Income Housing Tax Credits to third-party investors?
- Why were Fannie and Freddie, while in conservatorship, forced to divert billions of dollars in guaranty fees to Treasury to offset the cost of a payroll tax cut?
- Why did FHFA, as conservator, force Fannie and Freddie to gift all of their capital and all future earnings to Treasury in perpetuity?
- Why were Fannie and Freddie, while in conservatorship, forced to pay "voluntary" cash dividends to Treasury if funds were not available and the regulated entities were "not in capital compliance?"
- Why did FHFA force Fannie and Freddie, while in conservatorship, to issue debt in order to monetize their deferred tax assets and pay the proceeds to Treasury in 2013, particularly when FHFA had previously stated that deferred tax assets "[could] not be monetized?"
- Why did Fannie Mae CEO Tim Mayapoulos describe the Net Worth Sweep as a "positive change" with "a lot of good in it" in his August 2012 announcement to employees? Was he coerced by federal regulators?
- Why has the Securities and Exchange Commission permitted a single controlling shareholder (i.e., Treasury) and its affiliates to simultaneously act as director, regulator, conservator, supervisor, contingent capital provider, and preferred stock investor of two publicly traded companies?
- Why do some Treasury officials question the sustainability of Fannie and Freddie's earnings power in the years ahead, when Treasury's own 2014 Annual Report indicates that the companies will be consistently profitable for each of the next 25 years?
- Were certain federal government employees who crafted the Net Worth Sweep acting at the behest of crony capitalists seeking to displace Fannie and Freddie?

As owners, we demand answers to these and many other questions. Administration officials and their beneficiaries respond with alternative narratives that are wholly unsupported by the facts. They delay discovery and judicial proceedings at every opportunity. They deliberately conceal and withhold pertinent information. They conduct the business of government with little regard for the law.

In the Court of Federal Claims, the Federal Housing Finance Agency and United States Treasury produced "final" privilege logs listing 11,292 relevant documents (perhaps 100,000 pages of information) that they will not release – not to the public, not to the Fund's lawyers under a protective seal, not even to the Courts. The administration's sweeping effort to veil their conduct in secrecy has not gone unnoticed; *The New York Times* recently filed motions before the Court of Federal Claims requesting that various documents, which "have been improperly designated as Protected Information and kept confidential" by the government, be released to the public. In its motions, the *Times* noted that:

The courts have repeatedly recognized that disclosure of discovery is particularly appropriate when a lawsuit sheds light on the performance of governmental agencies and entities – which is precisely the case here . . . The public's interest in the underlying facts of this case is undeniable . . . The case directly addresses how the Government is going about recouping public funds used in the bailout and whether other investors are being treated lawfully. The Government should not be able to hide from the public – voters and taxpayers – the facts that were central to the decisions that the Government made as part of the far-reaching effort to safeguard the U.S. economy. To the contrary, access to the evidence will enable the public to understand more fully the decisions the Government has made in the public's name and to assess the wisdom and effect of those decisions . . . [The defendants'] disregard for the public interest is sadly of a piece with the Government's decision to make the depositions confidential in the first place. There is no reason that citizens should be denied the ability to effectively monitor this important lawsuit as it unfolds.

In the U.S. Court of Appeals (D.C. Circuit), the Fund's recently filed opening brief explains why the unprecedented and illegal 2012 Net Worth Sweep is antithetical to the fiduciary duties Congress imposed on FHFA as conservator of Fannie Mae and Freddie Mac – and should be vacated. The well-established duties of a conservator prohibit FHFA from running a ward for the government's exclusive enrichment, at the expense of all other interested parties and completely shielded from judicial review. Common sense dictates that a

conservator conserves. In imposing the Net Worth Sweep, the FHFA, as conservator, unlawfully acts as an “anti-conservator.” Eight briefs from various *amicus curiae* (“friends of the court”) support the Fund’s case. Here are a few highlights:

- Myron Steele, the former Chief Justice of the Delaware Supreme Court, persuasively argues that the Net Worth Sweep is “unenforceable and void *ab initio* under Section 151 of the Delaware General Corporation Law (“DGCL”). Preferred stock of a Delaware corporation cannot be given a cumulative dividend right equal to all the net worth of the corporation in perpetuity. The Net Worth Sweep is a flatly illegal term for any preferred stock instrument, whether or not held by the federal government . . . Preferred stockholders cannot have a perpetual claim on all the residual earnings of the Companies to the exclusion of common stockholders under Delaware law . . . Because the Net Worth Sweep diverts, in perpetuity, all of the net worth of the Companies (assets minus liabilities) to Treasury, it neither is paid at a ‘rate’ nor is it payable ‘in preference to’ or ‘in relation to’ the dividends payable to other classes or series of stock.”
- Thomas Vartanian, a former bank regulatory General Counsel for the federal government, emphasizes that “as a purported method of financing the operations of the companies, the net worth sweep bears no resemblance to any prior financing arrangement ever entered into by the FDIC as conservator. [T]he common and well-understood function of an FDIC conservator is to place the regulated entity into a sound and solvent condition, and to preserve and conserve its assets for the eventual benefit of all shareholders and creditors, so that the entity can be returned to the control of its board of directors and shareholders . . . not an evasion of statutory duties and an end-run around a legal capital structure.”
- Michael Krimminger, the former Deputy to the Chairman and General Counsel of the Federal Deposit Insurance Corporation, cogently articulates that, “Nothing in HERA authorizes the *de facto* nationalization of the Companies, such as occurred here, under the guise of a conservatorship. FHFA acted outside its authority as a conservator because it affirmatively acted to strip, rather than ‘preserve and conserve,’ the assets of the Companies and to bar any prospect that the Companies could return to a ‘sound and solvent’ condition.”
- Timothy Howard, the former Chief Financial Officer for Fannie Mae, explains that “unlike the rescues of various commercial and investment banks at around the same time, Treasury directed FHFA to place Fannie and Freddie into conservatorship not in response to any imminent threat of failure, but rather for policy reasons and over the objections of Fannie’s and Freddie’s boards. Once in conservatorship, the Companies’ managements had no role in negotiating the terms on which they would be offered assistance; Treasury and FHFA set these terms unilaterally. Treasury and FHFA [had] an extremely strong incentive to make accounting choices for the Companies that accelerated or exaggerated their expenses and greatly increased their losses, in order to create a large and permanent flow of revenue to Treasury . . . Treasury’s effective nationalization of Fannie and Freddie was a policy decision, and the compensation Treasury granted itself upon taking over Fannie and Freddie was grossly disproportionate to the true economic risk it faced, both at the time and subsequently.”
- A brief on behalf of the National Black Chamber of Commerce makes clear that the Net Worth Sweep forces Fannie and Freddie “to operate on the edge of insolvency – even though they would otherwise post billions of dollars in profits annually – until they are subsumed by the federal government . . . Fannie Mae and Freddie Mac play a vital role in minority communities by expanding access to credit and ensuring affordable housing. If allowed to stand, the Government’s ‘Net Worth Sweep’ and winding down of Fannie and Freddie will damage those communities by drying up credit and denying African-Americans and other minorities the opportunity – the dream – of homeownership.”

While common sense and the law are clearly on the Fund’s side, critics continue to obfuscate the facts. Freddie Mac CEO Donald Layton noted recently that the company “might actually begin to do things that would be GAAP-oriented rather than economically oriented.” This is a stunning admission that defies all logic, except in this unprecedented scenario whereby the company’s assets are drained *by its regulators*. The implications are clear: Fannie Mae and Freddie Mac are purposely being rendered less safe and less sound each quarter – in direct contravention to the conservator’s explicit mandate. Some may think that the regulators are simply suffering from cognitive dissonance given their feverish push for higher capital standards embodied in the Dodd-Frank Act, but there are clear indications of more disturbing elements at work – including greed, spite, and ulterior political motives. Thankfully, our constitutional system includes an independent judiciary.

Despite the progress that the Fund’s portfolio companies have made, price performance has been weak and the gulf between our estimates of intrinsic values and market prices has widened in recent months. History teaches us time and time again that investment prices can experience periods of underperformance before becoming “overnight successes.” Unfortunately, we are not proven market timers. Fortunately, we have high confidence in our company-specific analyses and ample liquidity (cash and cash equivalents comprise 14.3% of the Fund portfolio), and we recognize Mr. Market’s propensity for sudden mood swings.

Onward and upward,



Bruce R. Berkowitz
Chief Investment Officer
Fairholme Capital Management

* Represents the cumulative percentage total returns over a five-year rolling period (calculated after each month’s end) since inception through June 30, 2015. Monthly rolling 5-year performance is a period of 60 consecutive months determined on a rolling basis, with a new 60-month period beginning on the first day of each calendar month since the inception of the Fund.

The Portfolio Manager’s Report is not part of The Fairholme Fund’s Semi-Annual Report due to forward-looking statements that, by their nature, cannot be attested to, as required by regulation. The Portfolio Manager’s Report is based on calendar-year performance. A more formal Management Discussion and Analysis is included in the Semi-Annual Report. Opinions of the Portfolio Manager are intended as such, and not as statements of fact requiring attestation.

FAIRHOLME

Ignore the crowd.

The Fairholme Fund (FAIRX)

Seeking long-term growth of capital

Semi-Annual Report 2015

Managed by Fairholme Capital Management

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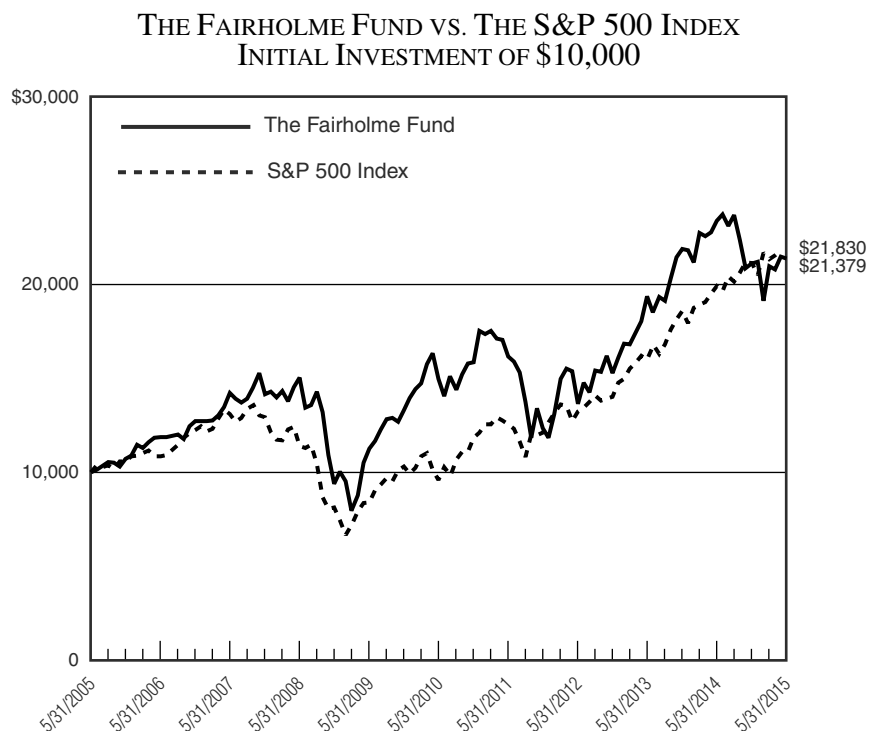
THE FAIRHOLME FUND

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May 31, 2015

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THE FAIRHOLME FUND

FUND PERFORMANCE (unaudited)
May 31, 2005 — May 31, 2015



The Fairholme Fund (the “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, 2015.

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 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 lower or higher than the performance quoted within. The performance information does not reflect the taxes an investor would pay on Fund distributions or upon redemption of Fund shares. Most recent month-end performance and answers to any questions you may have can be obtained by calling Shareholder Services at 1-866-202-2263.**

Data for both the S&P 500 Index and the 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 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.

THE FAIRHOLME FUND

MANAGEMENT DISCUSSION & ANALYSIS

For the Six Months Ended May 31, 2015

The Fairholme Fund (the “Fund”) shares outstanding and unaudited net asset value per share (“NAV”) at May 31, 2015, the end of the Fund’s second fiscal quarter of 2015, and per share NAVs at other pertinent dates, were as follows:

| <u>05/31/2015 Shares Outstanding</u> | <u>05/31/2015 NAV (unaudited)</u> | <u>11/30/2014 NAV (audited)</u> | <u>05/31/2014 NAV (unaudited)</u> |
|--|---|---|---|
| 157,895,608 | \$35.33 | \$37.96 | \$42.02 |

At June 30, 2015, the unaudited per share NAV of the Fund was \$34.76. Performance figures below are shown for the Fund’s semi-annual period ended May 31, 2015, and do not match calendar year figures for the period ended June 30, 2015, cited in the Portfolio Manager’s report.

| <u>Fund Performance to 05/31/2015</u> | <u>Six Months</u> | <u>One Year</u> | <u>Five Years</u> | <u>Ten Years</u> | <u>Fifteen Years</u> | <u>Since Inception 12/29/1999</u> |
|---|-----------------------|---------------------|-----------------------|----------------------|--------------------------|---|
| Cumulative: | | | | | | |
| Fund | 1.17% | (8.60)% | 42.81% | 113.79% | 381.51% | 439.77% |
| S&P 500 | 2.97% | 11.81% | 114.98% | 118.30% | 98.08% | 93.27% |
| Annualized: | | | | | | |
| Fund | | (8.60)% | 7.39% | 7.89% | 11.05% | 11.55% |
| S&P 500 | | 11.81% | 16.54% | 8.12% | 4.66% | 4.36% |

For the six months ended May 31, 2015, the Fund was outperformed by the S&P 500 Index (“S&P 500”) by 1.80 percentage points while over the last year the Fund was outperformed by the S&P 500 by 20.41 percentage points. From inception, the Fund outperformed the S&P 500 by 7.19 percentage points per annum or, on a cumulative basis, 346.50 percentage points over fifteen years and five months.

Fairholme Capital Management, L.L.C. (the “Manager”) believes performance over shorter periods is likely to be less meaningful than performance over longer periods. Investors are cautioned not to rely on short-term results. The fact that securities increase or decline in value does not always indicate that the Manager believes these securities to be more or less attractive — in fact, the Manager believes that some price increases present selling opportunities and some price declines present buying opportunities.

Further, shareholders should note that the S&P 500 is an unmanaged index incurring no fees, expenses, or tax effects and is shown solely to compare Fund performance to that of an unmanaged and diversified index of U.S. publicly traded corporation common stock.

Shareholders are also cautioned that it is possible that some securities mentioned in this discussion may no longer be held by the Fund subsequent to the end of the fiscal period and that the Fund may have made significant new purchases that are not yet required to be disclosed. It is the Fund’s general policy not to disclose portfolio holdings other than when required by relevant law or regulation. Portfolio holdings are subject to change without notice.

Not all Fund portfolio dispositions or additions are material, and, while the Fund 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 security and its issuer and its industry. However, certain strategies of the Manager in carrying out Fund policies may result in shorter holding periods.

The Manager invests Fund assets in securities to the extent it finds reasonable investment opportunities in accordance with its Prospectus and may invest a significant portion of Fund assets in liquid, low-risk securities or

THE FAIRHOLME FUND

MANAGEMENT DISCUSSION & ANALYSIS (continued)

For the Six Months Ended May 31, 2015

cash. The Manager views liquidity as a strategic advantage. At May 31, 2015, cash and cash equivalents (consisting of cash, commercial paper, deposit accounts, U.S. Treasury Bills, and money-market funds) represented 13.72% of total assets. Since inception, the Fund has 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 Fund liquidity.

The Fund is considered to be “non-diversified” under the Investment Company Act of 1940. The Fund can invest a greater percentage of assets in fewer securities than a diversified fund and may invest a significant portion of cash and liquid assets in one or more higher-risk securities at any time, particularly in situations where markets are weak or a particular security declines sharply. The Fund may also have a greater percentage of assets invested in a particular industry than a diversified fund, exposing the Fund to the risk of an unanticipated industry condition as well as risks specific to a single company or security. For the six months ended May 31, 2015, the Fund investments that performed the best were Sears Holdings Corp., American International Group, Inc., Leucadia National Corp., and Imperial Metals Corp. The biggest contributors to negative performance were investments in The St. Joe Co., Bank of America Corp., and Sears Canada, Inc. The following charts show the top holdings by issuer and sector in descending order of net assets as of May 31, 2015.

| The Fairholme Fund Top Holdings by Issuer* (% of Net Assets) | | The Fairholme Fund Top Sectors (% of Net Assets) | |
|--|--------------|--|--------------|
| American International Group, Inc. | 28.8% | Multi-Line Insurance | 28.8% |
| Bank of America Corp. | 19.2% | Diversified Banks | 19.2% |
| Sears Holdings Corp. | 10.9% | Cash and Cash Equivalents** | 13.7% |
| The St. Joe Co. | 6.6% | Retail Department Stores | 12.1% |
| Federal National Mortgage Association | 5.9% | Mortgage Finance | 11.1% |
| Federal Home Loan Mortgage Corp. | 5.2% | Real Estate Management & Development | 6.6% |
| Leucadia National Corp. | 4.7% | Diversified Holding Companies | 4.7% |
| Imperial Metals Corp. | 2.9% | Metals & Mining | 2.9% |
| Sears Canada, Inc. | 1.2% | | |
| | <u>85.4%</u> | | <u>99.1%</u> |

* Excludes cash, U.S. Treasury Bills, commercial paper, and money market funds.

** Includes cash, U.S. Treasury Bills, commercial paper, and money market funds.

The Manager views the ability to focus on fewer investments than a diversified fund as a strategic advantage. However, such a strategy may negatively influence short-term performance and there is no guarantee that long-term performance will not be negatively affected.

The Fund may invest in non-U.S. securities and securities of corporations domiciled outside of the United States, which may expose the Fund to adverse changes resulting from foreign currency fluctuations or other potential risks as described in the Fund’s Prospectus and Statement of Additional Information.

The Fund’s officers, the Board of Directors (the “Board” or the “Directors”), and the Manager are aware that large cash inflows or outflows may adversely affect Fund performance. Such flows are monitored and appropriate actions are contemplated for when such flows could negatively impact performance.

Since inception, the Fund has been advised by the Manager. Bruce Berkowitz, both the Managing Member of the Manager and Chairman of the Fund’s Board, continues to have a significant personal stake in the Fund, holding an aggregate 5,090,286 shares at May 31, 2015. While there is no requirement that Mr. Berkowitz own shares of the Fund, such holdings are believed to help align the interests of the Manager with the interests of the shareholders.

THE FAIRHOLME FUND

MANAGEMENT DISCUSSION & ANALYSIS (continued)
For the Six Months Ended May 31, 2015

The Board, including the Independent Directors, continues to believe that it is in the best interests of the Fund 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 Fund; the present constitution of Directors and policies; and current rules and regulations. A Director and Officers of the Fund are also Officers of the Manager. Nevertheless, at May 31, 2015, a majority of Directors were independent of the Manager, no stock option or restricted stock plans exist, Officers received no direct compensation from the Fund, and the Director affiliated with the Manager received no compensation for being a Director.

For more complete information about the Fund, or to obtain a current Prospectus, please visit www.fairholmefunds.com or call Shareholder Services at 1-866-202-2263.

THE FAIRHOLME FUND

EXPENSE EXAMPLE
For the Six Month Period from December 1, 2014
through May 31, 2015 (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 Fund shares redeemed within 60 days of purchase, and wire transfer fees. You also incur indirect, ongoing 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 Fund 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 Fund at December 1, 2014, and held for the entire six month period ending May 31, 2015.

Actual Expenses

The first line of the table 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 table provides information about hypothetical account values and hypothetical expenses based on the Fund’s actual expense ratio and an assumed rate of return of 5% per year before expenses, which is not the Fund’s actual return 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 Fund 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 table 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 table 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, 2014</u> | <u>Ending Account Value May 31, 2015</u> | <u>Annualized Expense Ratio</u> | <u>Expenses Paid During the Period December 1, 2014 Through May 31, 2015*</u> |
|---|---|--|---|---|
| Fund | | | | |
| Actual | \$1,000.00 | \$1,011.70 | 1.03% | \$5.17 |
| Hypothetical (5% return before expenses) | \$1,000.00 | \$1,019.80 | 1.03% | \$5.19 |

* Expenses are equal to the Fund’s annualized expense ratio, multiplied by the average account value over the period, multiplied by 182 days/365 days (to reflect the one-half year period).

THE FAIRHOLME FUND

SCHEDULE OF INVESTMENTS May 31, 2015 (unaudited)

| Shares | | Value | Shares | | Value |
|------------|--|----------------------|---------------|---|--------------------|
| | DOMESTIC EQUITY SECURITIES — 62.3% | | | DOMESTIC PREFERRED EQUITY SECURITIES — 9.8% | |
| | DIVERSIFIED BANKS — 19.2% | | | MORTGAGE FINANCE — 9.8% | |
| 64,864,015 | Bank of America Corp. | \$1,070,256,247 | | Federal Home Loan Mortgage Corp. | |
| | DIVERSIFIED HOLDING COMPANIES — 4.7% | | 46,458,500 | 7.875%, Series Z ^{(a)(d)} | \$ 192,802,775 |
| 10,548,750 | Leucadia National Corp. | 259,815,713 | 5,750,575 | 5.570%, Series V ^(a) | 20,414,541 |
| | MORTGAGE FINANCE — 1.3% | | 2,726,100 | 6.550%, Series Y ^(a) | 10,904,400 |
| 14,575,900 | Federal Home Loan Mortgage Corp. ^(a) | 35,856,714 | 1,614,250 | 0.680%, Series M ^{(a)(d)} | 9,281,937 |
| 13,801,100 | Federal National Mortgage Association ^(a) | 35,330,816 | 1,308,929 | 0.926%, Series B ^{(a)(d)} | 7,644,145 |
| | | 71,187,530 | 1,119,600 | 5.100%, Series H ^(a) | 7,333,380 |
| | MULTI-LINE INSURANCE — 19.6% | | 519,142 | 1.680%, Series L ^{(a)(d)} | 2,912,387 |
| 18,674,899 | American International Group, Inc. | 1,094,535,830 | 450,000 | 5.900%, Series U ^(a) | 1,588,500 |
| | REAL ESTATE MANAGEMENT & DEVELOPMENT — 6.6% | | 437,340 | 5.660%, Series W ^(a) | 1,793,094 |
| 23,136,502 | The St. Joe Co. ^{(a)(b)(c)} | 368,564,477 | 200,000 | 5.000%, Series F ^(a) | 1,262,000 |
| | RETAIL DEPARTMENT STORES — 10.9% | | | Federal National Mortgage Association | |
| 14,212,673 | Sears Holdings Corp. ^(c) | 610,434,305 | 54,015,019 | 7.750%, Series S ^{(a)(d)} | 224,162,329 |
| | TOTAL DOMESTIC EQUITY SECURITIES (COST \$3,125,129,611) | 3,474,794,102 | 5,172,343 | 7.000%, Series O ^{(a)(d)} | 39,051,190 |
| | FOREIGN EQUITY SECURITIES — 1.9% | | 3,558,097 | 4.500%, Series P ^{(a)(d)} | 13,698,674 |
| | CANADA — 1.9% | | 1,557,500 | 6.750%, Series Q ^(a) | 6,074,250 |
| | METALS & MINING — 0.7% | | 1,500,000 | 7.625%, Series R ^(a) | 5,850,000 |
| 4,914,300 | Imperial Metals Corp. ^{(a)(c)} | 39,161,075 | 256,000 | 0.400%, Series G ^{(a)(d)} | 1,850,880 |
| | RETAIL DEPARTMENT STORES — 1.2% | | | TOTAL DOMESTIC PREFERRED EQUITY SECURITIES (COST \$656,595,363) | 546,624,482 |
| 7,743,900 | Sears Canada, Inc. ^{(a)(c)} | 65,048,760 | | WARRANTS — 9.2% | |
| | TOTAL FOREIGN EQUITY SECURITIES (COST \$125,500,931) | 104,209,835 | | MULTI-LINE INSURANCE — 9.2% | |
| | | | 21,588,480 | American International Group, Inc., Vested, Strike Price \$45.00, Expire 01/19/2021 ^{(a)(c)} | 515,748,787 |
| | | | | TOTAL WARRANTS (COST \$351,676,339) | 515,748,787 |
| | | | | Principal | |
| | | | | FOREIGN CORPORATE BONDS — 2.2% | |
| | | | | CANADA — 2.2% | |
| | | | | METALS & MINING — 2.2% | |
| | | | \$124,904,000 | Imperial Metals Corp. 7.000%, 03/15/2019 ^{(c)(f)} | 123,030,440 |
| | | | | TOTAL FOREIGN CORPORATE BONDS (COST \$115,961,018) | 123,030,440 |

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

THE FAIRHOLME FUND

STATEMENT OF ASSETS & LIABILITIES
May 31, 2015 (unaudited)

Assets

Investments, at Fair Value:

| | |
|---|----------------------|
| Unaffiliated Issuers (Cost — \$3,474,821,749) | \$4,380,403,007 |
| Affiliated Issuers (Cost — \$1,724,719,055) | <u>1,206,239,057</u> |

| | |
|--|---------------|
| Total Investments, at Fair Value (Cost — \$5,199,540,804) | 5,586,642,064 |
|--|---------------|

| | |
|---------------------|-----------|
| Interest Receivable | 1,862,920 |
|---------------------|-----------|

| | |
|------------------------------------|----------------|
| Receivable for Capital Shares Sold | <u>693,466</u> |
|------------------------------------|----------------|

| | |
|--------------|----------------------|
| Total Assets | <u>5,589,198,450</u> |
|--------------|----------------------|

Liabilities

| | |
|-------------------------------------|-----------|
| Payable for Capital Shares Redeemed | 4,877,396 |
|-------------------------------------|-----------|

| | |
|-------------------------|-----------|
| Accrued Management Fees | 4,857,830 |
|-------------------------|-----------|

| | |
|------------------------|---------|
| Accrued Legal Expenses | 267,810 |
|------------------------|---------|

| | |
|-----------------------------------|----------------|
| Payable for Investments Purchased | <u>101,028</u> |
|-----------------------------------|----------------|

| | |
|-------------------|-------------------|
| Total Liabilities | <u>10,104,064</u> |
|-------------------|-------------------|

| | |
|-------------------|-------------------------------|
| NET ASSETS | <u><u>\$5,579,094,386</u></u> |
|-------------------|-------------------------------|

Net Assets Consist of:

| | |
|-----------------|-----------------|
| Paid-In Capital | \$4,444,710,488 |
|-----------------|-----------------|

| | |
|---------------------------------|-------------|
| Accumulated Net Investment Loss | (8,344,422) |
|---------------------------------|-------------|

| | |
|---|-------------|
| Accumulated Net Realized Gain on Investments and Foreign Currency Related Transactions | 755,627,060 |
|---|-------------|

| | |
|---|--------------------|
| Net Unrealized Appreciation on Investments and Foreign Currency Related Translations | <u>387,101,260</u> |
|---|--------------------|

| | |
|-------------------|-------------------------------|
| NET ASSETS | <u><u>\$5,579,094,386</u></u> |
|-------------------|-------------------------------|

| | |
|--|--------------------|
| Shares of Common Stock Outstanding* (\$0.0001 par value) | <u>157,895,608</u> |
|--|--------------------|

| | |
|--|------------------------|
| Net Asset Value, Offering and Redemption Price Per Share (\$5,579,094,386 / 157,895,608 shares) | <u><u>\$ 35.33</u></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)

| | For the Six Months Ended May 31, 2015 (Unaudited) |
|---|--|
| Investment Income | |
| Dividends — Unaffiliated Issuers | \$ 17,497,345 |
| Interest — Affiliated Issuers | 4,052,541 |
| Interest — Unaffiliated Issuers | <u>914,924</u> |
| Total Investment Income | <u>22,464,810</u> |
| Expenses | |
| Management Fees | 30,051,201 |
| Legal Expenses | 743,600 |
| Miscellaneous Expense | <u>14,431</u> |
| Total Expenses | <u>30,809,232</u> |
| Net Investment Loss | <u>(8,344,422)</u> |
| Realized and Unrealized Gain (Loss) on Investments and Foreign Currency Related Transactions | |
| Net Realized Gain on Investments and Foreign Currency Related Transactions | |
| Unaffiliated Issuers | 764,947,200 |
| Affiliated Issuers | 191,651 |
| Net Change in Unrealized Appreciation (Depreciation) on Investments and Foreign Currency Related Transactions | <u>(707,134,963)</u> |
| Net Realized and Unrealized Gain (Loss) on Investments and Foreign Currency Related Transactions | <u>58,003,888</u> |
| NET INCREASE IN NET ASSETS FROM OPERATIONS | <u><u>\$ 49,659,466</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, 2015 (Unaudited) | For the Fiscal Year Ended November 30, 2014 |
|--|--|---|
| CHANGES IN NET ASSETS | | |
| From Operations | | |
| Net Investment Loss | \$ (8,344,422) | \$ (39,531,846) |
| Net Realized Gain on Investments and Foreign Currency Related Transactions | 765,138,851 | 594,237,348 |
| Net Change in Unrealized Appreciation (Depreciation) on Investments and Foreign Currency Related Translations | <u>(707,134,963)</u> | <u>(805,928,580)</u> |
| Net Increase (Decrease) in Net Assets from Operations | <u>49,659,466</u> | <u>(251,223,078)</u> |
| From Dividends and Distributions to Shareholders | | |
| Net Realized Capital Gains from Investment Transactions | <u>(538,060,707)</u> | <u>(690,418,532)</u> |
| Net Decrease in Net Assets from Dividends and Distributions | <u>(538,060,707)</u> | <u>(690,418,532)</u> |
| From Capital Share Transactions | | |
| Proceeds from Sale of Shares | 171,669,967 | 553,078,572 |
| Shares Issued in Reinvestment of Dividends and Distributions | 475,825,341 | 612,192,862 |
| Redemption Fees | 196,890 | 263,247 |
| Cost of Shares Redeemed | <u>(1,357,081,516)</u> | <u>(2,236,856,973)</u> |
| Net Decrease in Net Assets from Shareholder Activity | <u>(709,389,318)</u> | <u>(1,071,322,292)</u> |
| NET ASSETS | | |
| Net Decrease in Net Assets | (1,197,790,559) | (2,012,963,902) |
| Net Assets at Beginning of Period | <u>6,776,884,945</u> | <u>8,789,848,847</u> |
| Net Assets at End of Period | <u>\$ 5,579,094,386</u> | <u>\$ 6,776,884,945</u> |
| Accumulated Net Investment Loss at End of Period | <u>\$ (8,344,422)</u> | <u>\$ —</u> |
| SHARES TRANSACTIONS | | |
| Issued | 4,936,425 | 13,903,282 |
| Reinvested | 13,456,741 | 15,689,206 |
| Redeemed | <u>(39,004,695)</u> | <u>(56,657,870)</u> |
| Net Decrease in Shares | <u>(20,611,529)</u> | <u>(27,065,382)</u> |
| Shares Outstanding at Beginning of Period | <u>178,507,137</u> | <u>205,572,519</u> |
| Shares Outstanding at End of Period | <u>157,895,608</u> | <u>178,507,137</u> |

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

THE FAIRHOLME FUND

FINANCIAL HIGHLIGHTS

| | For the | For the Fiscal Year Ended November 30, | | | | |
|---|----------------------------------|--|-------------------------|---------------------|----------------------|--------------|
| | Six Months Ended May 31, 2015 | 2014 | 2013 | 2012 | 2011 | 2010 |
| | (unaudited) | | | | | |
| PER SHARE OPERATING PERFORMANCE | | | | | | |
| NET ASSET VALUE, BEGINNING OF PERIOD | \$37.96 | \$42.76 | \$29.89 | \$25.10 | \$34.19 | \$28.90 |
| Investment Operations | | | | | | |
| Net Investment Income (Loss) ⁽¹⁾ | (0.05) | (0.19) | (0.10) | 0.15 | (0.07) | 0.33 |
| Net Realized and Unrealized Gain (Loss) on Investments | 0.50 | (1.21) | 12.97 | 5.55 | (6.95) | 5.22 |
| Total from Investment Operations | 0.45 | (1.40) | 12.87 | 5.70 | (7.02) | 5.55 |
| Dividends and Distributions | | | | | | |
| From Net Investment Income | — | — | — | (0.70) | (0.39) | (0.27) |
| From Realized Capital Gains | (3.08) | (3.40) | — | — | (1.69) | — |
| From Return of Capital | — | — | — | (0.21) | — | — |
| Total Dividends and Distributions | (3.08) | (3.40) | — | (0.91) | (2.08) | (0.27) |
| Redemption Fees ⁽¹⁾ | 0.00 ⁽²⁾ | 0.00 ⁽²⁾ | 0.00 ⁽²⁾ | 0.00 ⁽²⁾ | 0.01 | 0.01 |
| NET ASSET VALUE, END OF PERIOD | \$35.33 | \$37.96 | \$42.76 | \$29.89 | \$25.10 | \$34.19 |
| TOTAL RETURN | 1.17% ⁽³⁾ | (3.50)% | 43.06% | 23.69% | (22.10)% | 19.37% |
| Ratio/Supplemental Data | | | | | | |
| Net Assets, End of Period (in 000's) | \$5,579,094 | \$6,776,885 | \$8,789,849 | \$6,992,078 | \$8,015,294 | \$16,847,081 |
| Ratio of Expenses to Average Net Assets | 1.03% ⁽⁴⁾⁽⁵⁾ | 1.06% ⁽⁶⁾ | 1.02% ⁽⁷⁾⁽⁸⁾ | 1.00% | 1.01% ⁽⁹⁾ | 1.00% |
| Ratio of Net Investment Income (Loss) to Average Net Assets | (0.28)% ⁽⁴⁾ | (0.48)% | (0.29)% | 0.52% | (0.22)% | 1.02% |
| Portfolio Turnover Rate | 4.46% ⁽³⁾ | 1.62% | 15.59% | 1.57% | 43.95% | 88.74% |

⁽¹⁾ Based on average shares outstanding.

⁽²⁾ Redemption fees represent less than \$0.01.

⁽³⁾ Not Annualized.

⁽⁴⁾ Annualized.

⁽⁵⁾ 0.03% is attributable to legal expenses incurred outside of the 1.00% management fee and less than 0.01% is attributable to miscellaneous expenses incurred outside of the 1.00% management fee.

⁽⁶⁾ 0.04% is attributable to legal expenses incurred outside of the 1.00% management fee and 0.02% is attributable to miscellaneous expenses incurred outside of the 1.00% management fee.

⁽⁷⁾ 0.02% is attributable to legal expenses incurred outside of the 1.00% management fee.

⁽⁸⁾ Less than 0.01% is attributable to interest expenses incurred outside of the 1.00% management fee.

⁽⁹⁾ 0.01% is attributable to legal expenses incurred outside of the 1.00% management fee.

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 (the “Fund”). The Fund is a non-diversified fund. The Fund may have a greater percentage of its assets invested in particular securities than a diversified fund, exposing the Fund to the risk of unanticipated industry conditions as well as risks specific to a single company or the securities of a single company. 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 Fund’s investment objective is to provide long-term growth of capital. Under normal circumstances, the Fund seeks to achieve its investment objective by investing in a focused portfolio of equity and fixed-income securities. The proportion of the 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 Fund may invest in, and may shift frequently among, the asset classes and market sectors. The equity securities in which the 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 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 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 (including U.S. Treasury bills), 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 Fund may invest in fixed-income securities regardless of maturity or the rating of the issuer of the security. The 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 Fund normally holds a focused portfolio of equity and fixed-income securities, the 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 Fund.

There is no guarantee that the Fund will meet its objective.

Note 2. Significant Accounting Policies

As an investment company, the Fund follows the investment company accounting and reporting guidance, which is part of U.S. generally accepted accounting principles (“GAAP”). The Fund’s investments are reported at fair value as defined by U.S. GAAP. The Fund calculates its net asset value as soon as practicable following the close of regular trading on the New York Stock Exchange (currently 4:00 p.m. Eastern Time) on each day the New York Stock Exchange is open.

A description of the valuation techniques applied to the Fund’s 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. If these securities are not actively traded, they are classified in Level 2. The Manager may also employ other valuation methods which the Manager believes would provide a more

THE FAIRHOLME FUND

NOTES TO FINANCIAL STATEMENTS (continued)
May 31, 2015 (unaudited)

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.

Fixed-income securities (U.S. government obligations, corporate bonds, convertible bonds, and asset backed securities): The fair value of fixed-income 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) long-term fixed income securities will be fair valued in good faith following consideration by, and conclusion of, the Manager's Valuation Committee. As of May 31, 2015, fixed income securities are valued by the Manager utilizing valuations from independent pricing services. Although fixed-income securities are classified in Level 2 of the fair value hierarchy at May 31, 2015, in instances where lower relative weight is placed on transaction prices, quotations, or similar observable inputs, they would be 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 which subsequently are within sixty days of maturity, shall be valued at prices supplied by an independent pricing source or by one of the Fund's pricing agents based on broker or dealer supplied valuations or matrix pricing. 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 any level of the fair value hierarchy.

Warrants: The Fund 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 are classified as Level 2 or Level 3 of the fair value hierarchy depending on the observability of the inputs used.

The Fund uses several recognized industry third-party pricing services (TPPS) - approved by the Board and unaffiliated with the Manager - to value some of its securities. It also uses other independent market trade data sources (such as TRACE, the FINRA developed mandatory reporting of over-the-counter secondary market transactions), as well as broker quotes provided by market makers. The data within these feeds is ultimately sourced from major stock exchanges and trading systems where these securities trade. If a price obtained from the pricing source is deemed unreliable, it may be discarded and/or challenged. In these cases the pricing decision is made by reference to the reliable market data from the other market data sources.

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

THE FAIRHOLME FUND

NOTES TO FINANCIAL STATEMENTS (continued)
May 31, 2015 (unaudited)

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. Among the factors to be considered to fair value a security are recent prices of comparable securities that are publicly traded, reliable prices of securities not publicly traded, the use of valuation models, current analyst reports, valuing the income or cash flow of the issuer, or cost if the preceding factors do not apply. The circumstances of Level 3 securities are frequently monitored to determine if fair valuation measures continue to apply.

The Manager reports quarterly to the Board the results of the application of fair valuation policies and procedures.

The inputs and valuation techniques used to measure fair value of the Fund's 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, quoted prices in inactive markets for identical 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 level of risk associated with investing in those investments. The summary of the Fund's investments by inputs used to value the Fund's investments as of May 31, 2015, is as follows:

| | Valuation Inputs | | Total Fair Value at 5/31/15 |
|---------------------------------------|----------------------------|---|-----------------------------------|
| | Level 1 – Quoted Prices | Level 2 – Other Significant Observable Inputs | |
| ASSETS: | | | |
| INVESTMENTS (Fair Value): | | | |
| Domestic Equity Securities* | \$3,474,794,102 | — | \$3,474,794,102 |
| Foreign Equity Securities* | 104,209,835 | — | 104,209,835 |
| Domestic Preferred Equity Securities* | 536,178,222 | \$ 10,446,260 | 546,624,482 |
| Warrants* | 515,748,787 | — | 515,748,787 |
| Foreign Corporate Bonds* | — | 123,030,440 | 123,030,440 |
| Commercial Paper* | — | 301,751,801 | 301,751,801 |
| U.S. Government Obligations | — | 399,907,400 | 399,907,400 |
| Money Market Funds | 64,901,975 | — | 64,901,975 |
| Miscellaneous Investments | 55,673,242 | — | 55,673,242 |
| TOTAL INVESTMENTS | <u>\$4,751,506,163</u> | <u>\$835,135,901</u> | <u>\$5,586,642,064</u> |

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

During the six months ended May 31, 2015, the Fund did not have material transfers between Level 1 and Level 2. The Fund's policy is to recognize transfers among Levels as of the beginning of the reporting period.

There were no Level 3 investments at May 31, 2015, or November 30, 2014.

Warrants: The Fund's investments in warrants as of May 31, 2015, are presented within the Schedule of Investments.

The Fund's warrant positions during the six months ended May 31, 2015, had an average monthly market value of approximately \$502,086,364.

As of May 31, 2015, the value of warrants with equity risk exposure of \$515,748,787 is included with Investments at Fair Value on the Statement of Assets and Liabilities. For the six months ended May 31, 2015, the effect of the net change in

THE FAIRHOLME FUND

NOTES TO FINANCIAL STATEMENTS (continued)
May 31, 2015 (unaudited)

unrealized depreciation of warrants with equity risk exposure of \$431,770 is included with the Net Change in Unrealized Appreciation (Depreciation) on Investments and Foreign Currency Related Translations on the Statement of Operations.

Dividends and Distributions: The Fund records dividends and distributions to shareholders on the ex-dividend date. The Fund intends to distribute substantially all of its net investment income (if any) as dividends to its shareholders on an annual basis in December. The Fund intends 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 Fund 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 Fund does 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 Fund 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 Fund assesses a 2% fee on the proceeds of the Fund shares that are redeemed within 60 days of their purchase. The redemption fee is paid to the Fund as applicable, for the benefit of remaining shareholders and is recorded as paid-in capital. The redemption fees retained by the Fund during the six months ended May 31, 2015 and fiscal year ended November 30, 2014, amounted to \$196,890 and \$263,247, respectively.

Other: The Fund accounts 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 Fund 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 Fund paid certain fees and expenses during the year, including legal and miscellaneous expenses, in connection with its investments in the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation.

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, the 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 the Fund. The Manager is responsible pursuant to each Investment Management Agreement for paying the Fund's 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. The Manager is not responsible for paying for the following costs and expenses of the Fund: commissions, brokerage fees, issue and transfer taxes, and other costs chargeable to the Fund in connection with securities transactions or in connection with

THE FAIRHOLME FUND

NOTES TO FINANCIAL STATEMENTS (continued)
May 31, 2015 (unaudited)

securities owned by the Fund, taxes, interest, acquired fund fees and related expenses, expenses in connection with litigation by or against the Fund, and any other extraordinary expenses.

The Manager earned \$30,051,201 from the Fund for its services during the six months ended May 31, 2015.

Affiliates of the Manager held in aggregate 5,090,286 shares at May 31, 2015.

A Director and Officers of the Fund are also Officers of the Manager or its affiliates.

Note 4. Investments

For the six months ended May 31, 2015, aggregated purchases and sales of investment securities other than short-term investments and U.S. government obligations were as follows:

| <u>Purchases</u> | <u>Sales</u> |
|------------------|-----------------|
| \$240,081,121 | \$1,892,311,437 |

Note 5. Tax Matters

Federal Income Taxes: The 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, the 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 appreciation of investments at May 31, 2015, were as follows:

| <u>Cost</u> | <u>Gross Unrealized Appreciation</u> | <u>Gross Unrealized Depreciation</u> | <u>Net Unrealized Appreciation</u> |
|-----------------|--|--|--|
| \$5,209,054,182 | \$1,051,037,779 | \$(673,449,897) | \$377,587,882 |

The difference between book basis and tax basis net unrealized appreciation is attributable to the tax deferral of losses on wash sales and capitalized cost.

The Fund’s 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 for the fiscal year ended November 30, 2015.

The Manager has analyzed the Fund’s tax positions taken on 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 Fund’s 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 prior three years) are subject to examination by the Internal Revenue Service and state departments of revenue. Additionally, the Fund is not aware of any tax position for which it is reasonably possible that the total amounts of unrecognized tax benefits will change materially in the next twelve months.

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 FAIRHOLME FUND

NOTES TO FINANCIAL STATEMENTS (continued)
May 31, 2015 (unaudited)

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

| | For the Six Months Ended May 31, 2015 | For the Fiscal Year Ended November 30, 2014 |
|---|--|--|
| Dividends and Distributions paid from: | | |
| Ordinary Income* | \$ 6,221,868 | — |
| Long-Term Capital Gain | <u>531,838,839</u> | <u>\$690,418,532</u> |
| | <u>\$538,060,707</u> | <u>\$690,418,532</u> |

* Inclusive of short-term capital gains

Note 7. Transactions in Shares of Affiliates

Portfolio companies in which the Fund owns 5% or more of the outstanding voting securities of the issuer are considered affiliates of the Fund. The aggregate fair value of all securities of affiliates held in the Fund as of May 31, 2015, amounted to \$1,206,239,057 representing approximately 21.62% of the Fund's net assets.

Transactions in the Fund during the six months ended May 31, 2015, in which the issuer was an affiliate are as follows:

| | November 30, 2014 | Gross Additions | Gross Deductions | May 31, 2015 | | Realized Gain (Loss) | Investment Income |
|--|------------------------------|------------------------------|------------------------------|------------------------------|------------------------|---------------------------------|------------------------------|
| | Shares/ Par Value | Shares/ Par Value | Shares/ Par Value | Shares/ Par Value | Fair Value | | |
| Imperial Metals Corp. | 4,795,100 | 119,200 | — | 4,914,300 | \$ 39,161,075 | \$ — | \$ — |
| Sears Holdings Corp. | 14,212,673 | — | — | 14,212,673 | 610,434,305 | — | — |
| Sears Canada, Inc. ^(a) | 5,078,700 | 2,665,200 | — | 7,743,900 | 65,048,760 | — | — |
| The St. Joe Co. | 23,136,502 | — | — | 23,136,502 | 368,564,477 | — | — |
| Imperial Metals Corp. 7.000%, 03/15/2019 | — | \$129,994,000 | \$5,090,000 | \$124,904,000 | <u>123,030,440</u> | <u>191,651</u> | <u>4,052,541</u> |
| Total | | | | | <u>\$1,206,239,057</u> | <u>\$191,651</u> | <u>\$4,052,541</u> |

^(a) Company was not an "affiliated company" at November 30, 2014.

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 Fund. In the normal course of business the Company or the Fund enters into contracts that contain a variety of representations and customary indemnifications. The Fund's maximum exposure under these arrangements is unknown as this would involve future claims that may be made against the Fund that have not yet occurred. However, based on its experience to date, the Fund expects 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 the Fund's portfolio. A description of these policies and procedures, and records of how the Fund voted proxies relating to their portfolio securities during the most recent twelve month period ended June 30, 2014, 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 or visiting our website at fairholmefunds.com. They may also be obtained by visiting the Securities and Exchange Commission ("SEC") website at 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 Fund's 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 the Fund's portfolio investments are available on the SEC's website at 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 of Fairholme Funds, Inc.

BRUCE R. BERKOWITZ
President

FERNANDO M. FONT
Vice President

WAYNE KELLNER
Treasurer

PAUL R. THOMSON
Chief Compliance Officer & Secretary

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HOWARD S. FRANK

STEVEN J. GILBERT, *Esq.*

AVIVITH OPPENHEIM, *Esq.*

LEIGH WALTERS, *Esq.*

Investment Manager

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