

CASE STUDY III

FAIRHOLME

Ignore the crowd.

This presentation uses Sears Holdings Corporation (“Sears” or the “Company”) as a case study to illustrate Fairholme Capital Management’s investment strategy for the Fairholme Fund. In the pages that follow, we show Fairholme Fund shareholders why we “Ignore the crowd” with regard to our portfolio positions that are currently out of favor in the market.

However, nothing in this presentation should be taken as a recommendation to anyone to buy, hold, or sell certain securities or any other investment mentioned herein. Our opinion of a company’s prospects should not be considered a guarantee of future events. **Investors are reminded that there can be no assurance that past performance will continue, and that a mutual fund’s current and future portfolio holdings always are subject to risk.** As with all mutual funds, investing in the Fairholme Fund involves risk including potential loss of principal. Opinions expressed are those of the author and/or Fairholme Capital Management, L.L.C. and should not be considered a forecast of future events, a guarantee of future results, nor investment advice.

The Fairholme Fund’s holdings and sector weightings are subject to change. As of May 31, 2012, Sears securities comprised 10% of the Fairholme Fund’s total net assets. The Fairholme Fund’s portfolio holdings are generally disclosed as required by law or regulation on a quarterly basis through reports to shareholders or filings with the SEC within 60 days after quarter end. A complete list of the Fairholme Fund’s top ten holdings is available on our website at www.fairholmefunds.com.

The Fairholme Fund is non-diversified, which means that it invests in a smaller number of securities when compared to more diversified funds. Therefore, the Fairholme Fund is exposed to greater individual security volatility than diversified funds. The Fairholme Fund can invest in foreign securities which may involve greater volatility and political, economic, and currency risks and differences in accounting methods. The Fairholme Fund may also invest in “special situations” to achieve its objectives. These strategies may involve greater risks than other fund strategies. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Lower-rated and non-rated securities present greater loss to principal than higher-rated securities.

The Fairholme Fund’s investment objectives, risks, charges, and expenses should be considered carefully before investing. The Prospectus contains this and other important information about the Fairholme Fund, and may be obtained by calling shareholder services at (866) 202-2263 or by visiting our website at www.fairholmefunds.com. Read it carefully before investing.

Fairholme Distributors, LLC (08/12)

CASE STUDY III

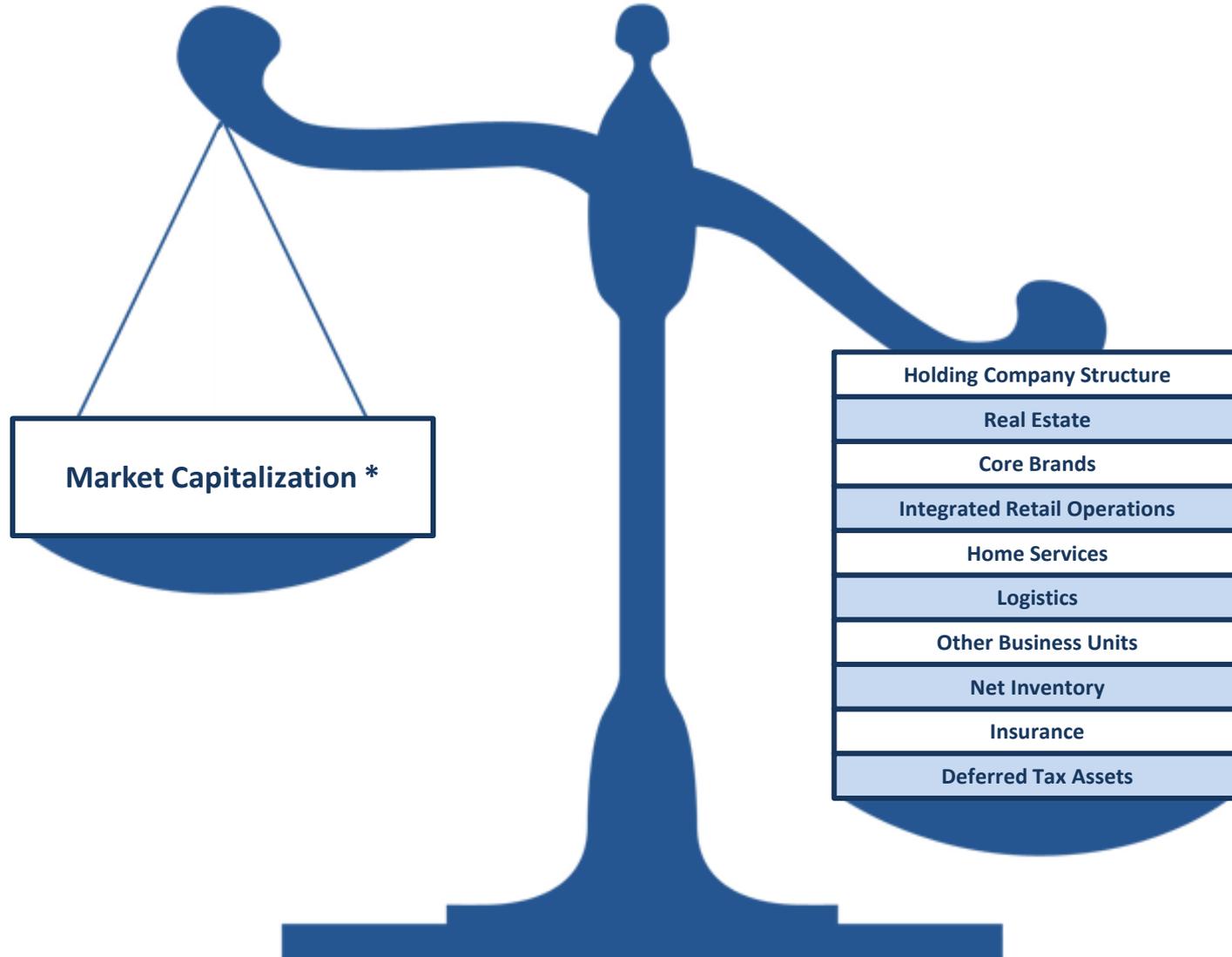
sears

“Sears Holdings has over \$20 billion of assets on our balance sheet. In some cases, the fair market values of our assets are not reflected on the balance sheet due to GAAP convention, such as the value of our owned real estate and many of our below market leases. [...] We have a portfolio of businesses and assets that deserve to generate substantial value for our shareholders.”

– Edward S. Lampert, Chairman, February 23, 2012

RECENT MARKET PRICE \neq INTRINSIC VALUE *

*“Investing is all about what you give versus what you get.” ***



KEY PIECES

REAL ESTATE

*Vast Property Portfolio
Carried at Low Cost*

OPERATIONS

*Increasing Cash Flows
Through Greater Efficiencies
and Cost Reductions*

TOP BRANDS

*Revenue Beyond
Sears and Kmart*

LEADERSHIP

*New Team With
Proven Success*

LIQUIDITY

*Ample to Meet All
Liabilities and Opportunities*

CATALYSTS

Changing Winds

“Many despair that Sears seems unable to regain past retail glory, despite a conservative balance sheet and many valuable assets. In searching for instant gratification, most are missing key points.”

– **Bruce R. Berkowitz**, FAIRHOLME, January 10, 2008

REAL ESTATE

“MARGIN OF SAFETY” *

Recent commercial real estate market dynamics and retail industry trends provide even greater embedded value in SHLD’s property portfolio when evaluated on a stand-alone basis. Factors include:

- ✓ *National retailers are accelerating expansion plans and store counts.*
- ✓ *Limited construction has constrained new supply of retail real estate.*
- ✓ *Metropolitan locations are increasingly in vogue given urbanization trend.*
- ✓ *Sears and Kmart leases often exceed 50 years with no rent escalators.*
- ✓ *Kmart retains the right of first refusal on potential purchases of its leased properties.*
- ✓ *Sears typically occupies the most favorable mall-based anchor locations.*
- ✓ *Sears and Kmart properties have few, if any, operating covenants or restrictions remaining.*
- ✓ *Sears and Kmart possess negotiating leverage due to co-tenancy clauses of adjacent retailers.*
- ✓ *Accounting rules did not require Kmart to revalue its real estate after it merged with Sears.*

“SHC Realty (the real estate business unit of Sears Holdings) is one of the largest corporate real estate organizations in the world, with a portfolio of retail locations that is second to none.”

– www.SHCRealty.com

* “Margin of Safety” is a term popularized by Benjamin Graham meaning the difference between the market price and intrinsic value of the underlying business.

REAL ESTATE

OVER 250 MILLION SQUARE FEET OF RETAIL SPACE

- ✓ Significant value in low cost owned properties and long-term below-market leased sites
- ✓ Diverse mall-based and freestanding locations across North America



KMART

SEARS DOMESTIC

SEARS CANADA

Full-Line Properties	1,305	867	122
% Owned	16%	60%	11%
% Leased	84%	40%	89%
Average Square Feet Per Unit	95 k	133 k	128 k
Total Square Feet	125 mm	116 mm	16 mm

REAL ESTATE

PROPERTY PORTFOLIOS IN PERSPECTIVE



Total Square Feet	256+ mm	245 mm	144 mm	138 mm
Market Capitalization *	\$6.0 bn	\$47.8 bn	\$18.7 bn	\$8.1 bn

"Sears Holdings has one of the most diverse and valuable real estate portfolios in the country and I look forward to helping create additional value for the company by enhancing and repositioning selected parts of its real estate portfolio."

– David R. Lukes, President of Real Estate Development, March 20, 2012

* Please see last slide for definition and terms.
Sources: SEC Filings, Bloomberg

REAL ESTATE

BEYOND FULL-LINE STORES



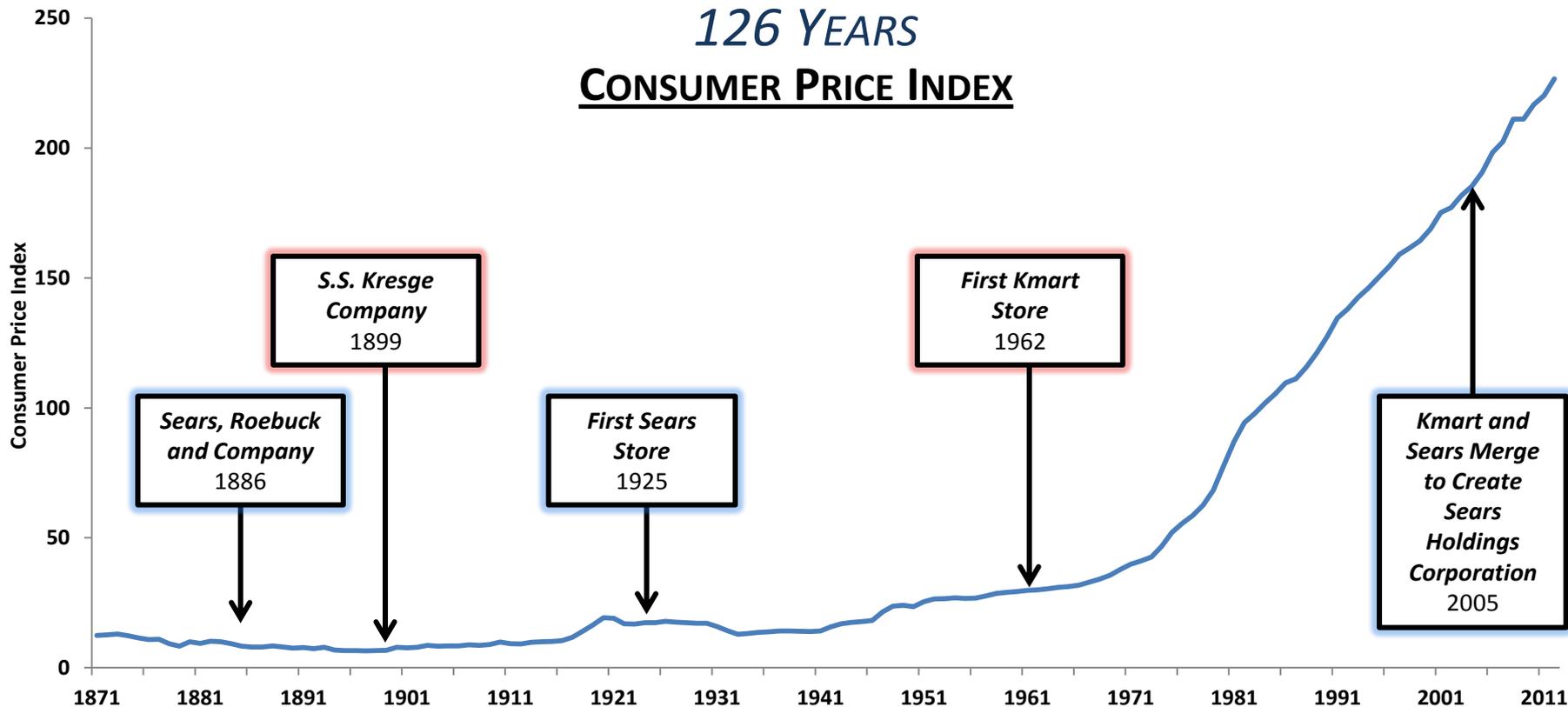
✓ Hoffman Estates Headquarters	2 million square feet
✓ Sears Hometown Stores	944 locations averaging 8,500 square feet *
✓ Sears Home Appliance Showrooms	76 locations averaging 5,000 square feet *
✓ Sears Outlet Stores	122 locations
✓ Sears Hardware Stores	96 locations averaging 28,000 square feet
✓ Distribution Centers	44 locations
✓ Auto Centers	809 locations
✓ Service Facilities	465 locations

* Includes independently owned and operated stores.

REAL ESTATE

126 YEARS

CONSUMER PRICE INDEX



	1890	1909	1948	1967	1985	Today
Movie	n/a	n/a	\$0.36	\$1.22	\$3.55	\$7.93
Car	n/a	\$850	\$1,550	\$3,209	\$11,246	\$23,608
House	\$5,382	\$6,032	\$16,963	\$24,825	\$79,595	\$181,500

“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.”

– **Bruce R. Berkowitz**, FAIRHOLME, June 30, 2012

The Consumer Price Index base year is 1983.
Sources: Bureau of Labor Statistics, Various Industry Sources

OPERATIONS

*CLOSE TO HALF OF AMERICA SHOPPED IN A SEARS OR KMART LAST YEAR **



KCD IP, LLC



SEGMENTS ANNOUNCED FOR SPIN-OFF OR DIVIDEND DISTRIBUTION



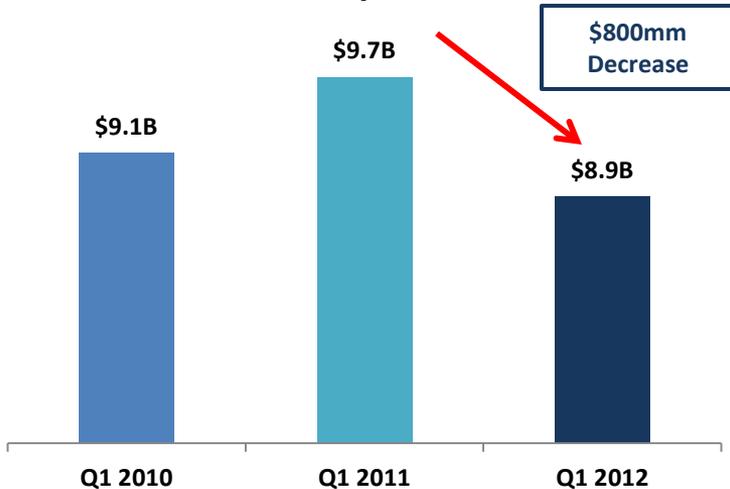
“The Board of Directors and I look at and evaluate Sears Holdings as a portfolio of businesses, with different market positions, strengths and opportunities.”

– Edward S. Lampert, Chairman, February 23, 2012

OPERATIONS

INCREASING EFFICIENCIES AND REDUCING COSTS

Inventory Balance



DRIVERS OF COST SAVINGS

- ✓ *Transitioning from Product Driven to Customer Driven*
- ✓ *Altering Buying Strategies*
- ✓ *Refining Marketing Spend*
- ✓ *Rightsizing Store Fleet*
- ✓ *Reduction in Force*

<i>Inventory Productivity</i>	<i>\$400 million</i>
<i>Store Closures</i>	<i>\$200 million</i>
<i>Annual Cost Reductions</i>	<i>\$200 million</i>
<i>Operational Cash Benefit *</i>	<i>\$800 million</i>

Inventory Efficiency	Q1 2010	1Q 2011	1Q 2012
Inventory Turnover	3.20x	2.99x	3.11x
Days-On-Hand	114	122	117

"[We] need a relentless focus on cost optimization.

This is about profitability and value, not just cost reduction."

– Rajan Penkar, Senior Vice President and President of Supply Chain, March 15, 2012

TOP BRANDS

TRADE NAMES VALUED AT \$5.6 BILLION IN EARLY 2005



#1
*Kenmore is the Leader
in Major Appliances*



#1
*Craftsman is the Leader
in Tools*



#1
*Sears is the Leader
in Major Exercise Equipment*

Sears' collection of brands have significant inherent value when evaluated on a stand-alone basis. Factors include:

- ✓ *Sears remains the leading home appliance retailer and a leader in tools, lawn and garden, and automotive repair and maintenance.*
- ✓ *Sears' purchase price allocation of its brands differs from fair market value and may significantly understate what they are worth.*
- ✓ *Kenmore, Craftsman, and DieHard are leaders in their respective markets with burgeoning opportunities for product adjacencies and cross-merchandising.*
- ✓ *Lands' End is a leading direct merchant with untapped potential in increasing its domestic and international retail store presence.*
- ✓ *Recently appointed global licensing agent to extend brands to broader geographic markets and create new revenue streams*
- ✓ *Merchants including Costco and Ace Hardware have demonstrated success selling Sears branded products, which has also driven higher traffic to Sears platforms for additional purchases.*

"I joined Sears because I felt the company had enormous untapped potential in its brands, in its vendor relationships, in its real estate, in its people, and in its members."

– Ron Boire, Chief Merchandising Officer, February 23, 2012

PROVEN LEADERSHIP

SENIOR HIRES SINCE 2011



Lou D'Ambrosio (February 2012)

Chief Executive Officer

Experience at Avaya, IBM



Ronald Boire (January 2012)

Executive Vice President, Chief Merchandising Officer, and President, Sears and Kmart Formats

Experience at Brookstone, Toys R Us, Best Buy



Donald Eames (January 2012)

Senior Vice President, Retail Stores

Experience at Brookstone, Best Buy, May Department Stores, Federated



Margaret Gramann (March 2012)

Senior Vice President, Sales Capability

Experience at PepsiCo (15 years)



Steven Haber (March 2012)

Senior Vice President and President, Home Appliances

Experience at Sony (20 years)



David Lukes (March 2012)

President, Real Estate Development

Experience at Mall Properties, Kimco Realty, Kohn Pedersen Fox Architects



Not Available

Paul Walsh (January 2012)

Vice President and General Manager, Commerce Services and Sears Marketplace

Experience at Amazon, Quest Software, Microsoft



Sam Solomon (May 2011)

Senior Vice President and President, Tools

Experience at Coleman Company, SPX Corporation, Kidde, Proctor & Gamble, Coca-Cola



Edgar Huber (August 2011)

CEO and President, Lands' End

Experience at Liz Claiborne, Juicy Couture, L'Oreal



Rajan Penkar (September 2011)

Senior Vice President and President, Supply Chain

Experience at UPS (24 years)

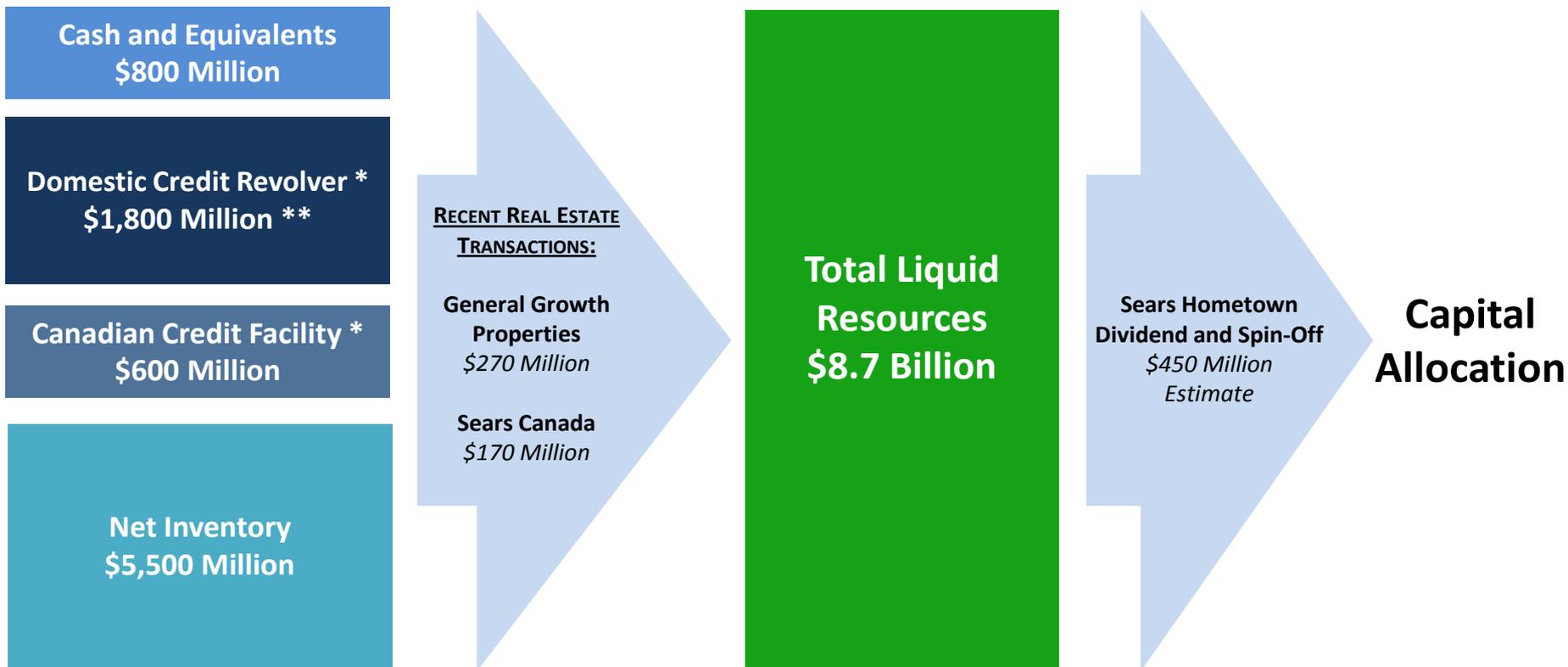


Scott Huckins (June 2012)

Vice President and Corporate Treasurer

Experience at RSC Holdings, Koch Industries, FINOVA Capital

LIQUIDITY



“Putting various sources of liquidity together, you get a sense of some of the levers that the company has to meet its obligations and to generate long-term value.”

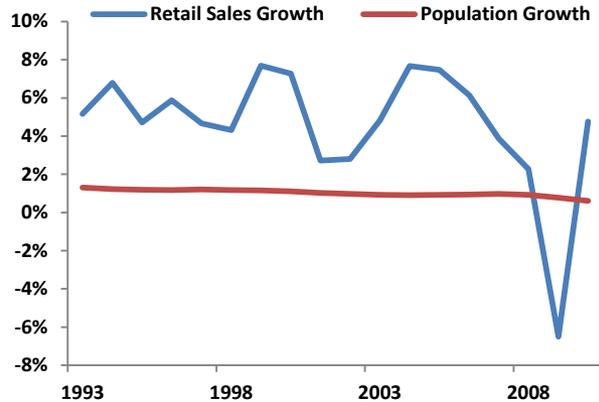
– Edward S. Lampert, Chairman, February 23, 2012

* Please see last slide for definition and terms.

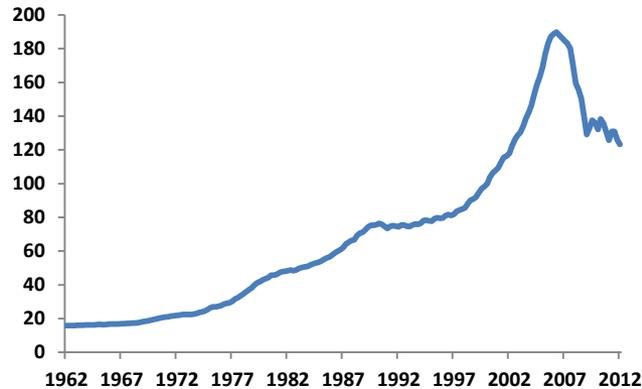
** \$1.8 billion remaining out of total facility capacity of \$3.3 billion, does not include an accordion feature that provides the option to obtain an aggregate amount of up to \$1.0 billion in additional borrowing capacity.

CATALYSTS?

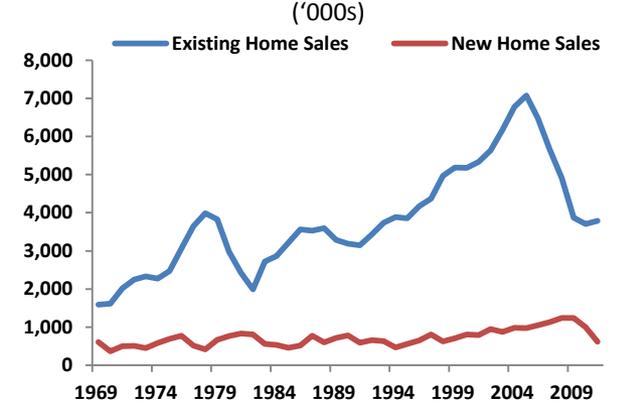
POPULATION AND RETAIL SALES GROWTH



CASE-SHILLER INDEX *

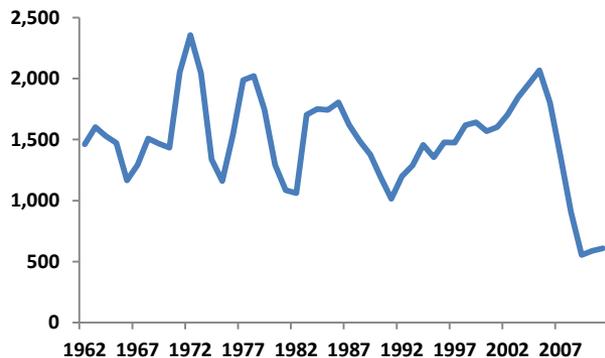


HOME SALES



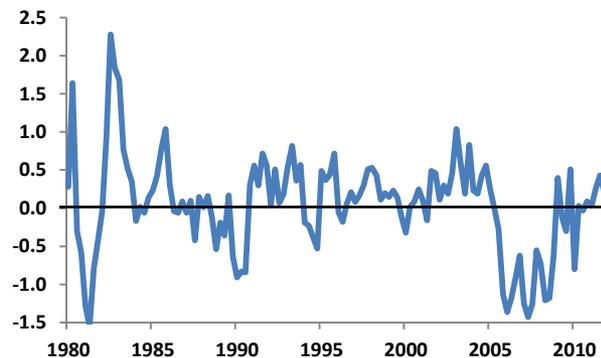
HOUSING STARTS

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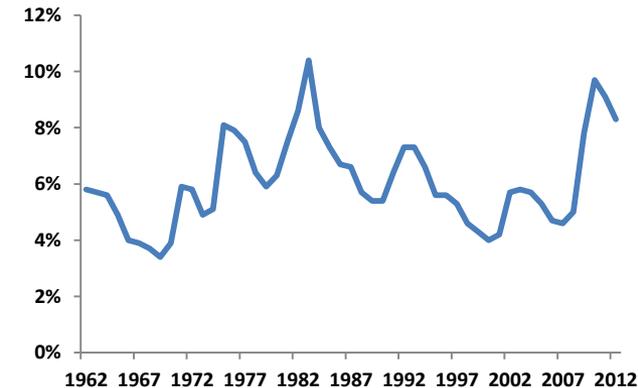


RESIDENTIAL INVESTMENT

% Contribution to GDP Growth



UNEMPLOYMENT RATE



* Please see last slide for definition and terms.

Sources: U.S. Census, Case-Shiller, Bureau of Labor Statistics, Bureau of Economic Analysis
All charts reference U.S. data.

THE ROAD AHEAD

“We made it through the financial crisis and the housing crisis. Now we intend to make it through our current challenges and restore confidence in the company ... we do not intend to sit idly by and have it be business as usual.”

Edward S. Lampert
Chairman's Letter
February 23, 2012

Intrinsic Value: The value of a security based on an underlying analysis of all aspects of the business distinct from market value.

Market Capitalization: The total value of a company's publicly-traded shares outstanding.

S&P / Case-Shiller U.S. National Home Price Index: Composite of single-family home price indices for the nine U.S. Census divisions.

Credit Facility: A type of loan made to a business or corporation. Types of credit facilities include: revolving credit, term loans, committed facilities, and letter of credit.

Credit Revolver: Line of credit that can be drawn down or repaid until the maturity of the agreement.