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Keith D. Trauner, Secretary & Treasurer

**Investment Adviser**

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**Custodian**

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Public Accounting Firm**

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Philadelphia, PA 19103

**Fund Counsel**

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Washington, D.C. 20005

This report is provided for the general information of the shareholders of The Fairholme Fund. This report is not intended for distribution to prospective investors in the Fund, unless preceded or accompanied by an effective prospectus, which contains more information on fees, charges, and other expenses and should be read carefully before investing or sending money. Past performance is not a guarantee of future results.

**FAIRHOLME**

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**SEMI-ANNUAL REPORT**

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**THE FAIRHOLME FUND**

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***A No-Load Capital Appreciation Fund***

*For the Six Months Ended:*

**May 31, 2005**

**www.fairholmefunds.com**  
**(866) 202-2263**

# THE FAIRHOLME FUND

## MANAGEMENT DISCUSSION & ANALYSIS

For the Six Months Ended May 31, 2005

At May 31, 2005, the end of the second fiscal quarter of 2005, the unaudited net asset value (NAV) attributable to the 27,114,336 shares outstanding of the The Fairholme Fund (the "Fund") was \$23.74 per share. This compares with an audited net asset value of \$22.36 per share at November 30, 2004, and an unaudited net asset value of \$19.73 per share at May 31, 2004 (stated NAVs reflect any distributions to shareholders). At June 30, 2005, the unaudited net asset value was \$24.12 per share.

	<b>Six Months Ended <u>5/31/05</u></b>	<b>One Year Ended <u>5/31/05</u></b>	<b>Three Years Ended <u>5/31/05</u></b>	<b>Five Years Ended <u>5/31/05</u></b>	<b>Since Inception 12/29/1999 to <u>5/31/2005</u></b>
<b>The Fairholme Fund (Cumulative)</b>	<b>8.93%</b>	<b>23.45%</b>	<b>51.76%</b>	<b>125.22%</b>	<b>152.47%</b>
<b>S&amp;P 500 Index (Cumulative)</b>	<b>2.42%</b>	<b>8.24%</b>	<b>17.75%</b>	<b>-9.26%</b>	<b>-11.47%</b>
<b>The Fairholme Fund (Annualized)</b>		<b>23.45%</b>	<b>14.92%</b>	<b>17.63%</b>	<b>18.62%</b>
<b>S&amp;P 500 Index (Annualized)</b>		<b>8.24%</b>	<b>5.59%</b>	<b>-1.93%</b>	<b>-2.22%</b>

In the opinion of the Fund's advisor, performance over short intervals is likely to be less meaningful than a comparison of longer periods.

Portfolio holdings are subject to change without notice. Below is a chart disclosing the top ten holdings of the Fund listed by their percentage of net assets as well as a chart detailing the top ten categories in which the Fund holds securities, listed by the aggregate percentage of net assets in each of these categories.

<b>Top Ten Holdings*</b> (% of Net Assets)	
Berkshire Hathaway, Inc.	18.94%
Leucadia National Corp.	14.79%
MCI, Inc.	9.60%
EchoStar Communications Corp.	4.75%
USA Mobility, Inc.	4.68%
Canadian Natural Resources Ltd.	4.61%
Mercury General Corp.	2.63%
Penn West Petroleum Ltd.	2.36%
AT&T Corp.	2.35%
Ethan Allen Interiors, Inc.	1.97%
	<u>66.68%</u>

<b>Top Ten Categories</b> (% of Net Assets)	
Diversified Holding Company	33.73%
U.S. Government and Agency Obligations	24.77%
Telephone	16.63%
Canada - Oil and Gas Exploration	6.98%
Money Market Funds	5.26%
Satellite	4.75%
Property and Casualty Insurance	3.35%
Home Furnishings	1.97%
United Kingdom - Investment Trust	1.43%
Miscellaneous Investments	1.18%
	<u>100.05%</u>

\* Excludes cash, money-market funds and U.S. Treasury bills

During the six months beginning December 1st and ending May 31st, the Fund purchased the following securities that were not owned at December 1, 2004 and which are listed as portfolio investments at May 31, 2005:

- NONE

# THE FAIRHOLME FUND

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## MANAGEMENT DISCUSSION & ANALYSIS (Continued) For the Six Months Ended May 31, 2005

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It is worth noting that the Fund substantially increased its investments in several existing portfolio holdings, although such changes may not appear obvious as a result of the growth of Fund assets through new subscriptions during the six month period ended May 31, 2005. Among the significant increases were additions to the Fund's investments in Berkshire Hathaway, Inc., Leucadia National Corp., USA Mobility, Inc., Echostar Communications Corp., and Canadian Natural Resources Ltd.

Also, during the six months ended May 31, 2005, the Fund disposed of positions listed at November 30, 2004 and for which no shares were held on May 31, 2005 as follows:

- Alleghany Corp.
- Canadian Oil Sands Trust
- Capital Southwest Corp.
- Gladstone Capital Corp.
- Gladstone Commercial Corp.
- Health Management Associates, Inc.
- Rinker Group Ltd.

Shareholders are cautioned that not all additions or dispositions to the portfolio are material, and that while the Fund and its adviser have long-term objectives, it is possible that a security purchased or sold in one period may be sold or purchased in a subsequent period. Generally, the Fund's adviser determines to buy and sell based on its estimates of the intrinsic values and fundamental dynamics of a particular company and its industry, and not on short-term price movements. However, certain strategies of the adviser in carrying out the Fund's investment policies may result in shorter holding periods. Investors are further cautioned not to rely on short-term results, both with respect to profits and losses on any individual investment in the Fund, as well as with respect to Fund shares themselves.

Securities whose gains most affected the Fund's portfolio (including realized and unrealized gains) for the period included the following:

- MCI, Inc.
- Leucadia National Corp.
- Canadian Natural Resources Ltd.

In the opinion of the Fund's investment adviser, the following factors had a bearing on the change in value of the above securities (although other unmentioned factors may have also contributed to price changes): MCI became the subject of a takeover battle between Verizon and Qwest which played out over several months in 2005. At May 31, 2005, Verizon appeared to have won the battle with a bid valued at approximately \$26 per MCI share, sharply higher than the Fund's average cost of between \$16 and \$17 per share. Leucadia's stock price fell sharply in early 2005 following SBC's bid for AT&T and its intention to transfer SBC's business with Leucadia's WilTel division to AT&T. The Fund significantly increased its investment in Leucadia during 2005 and the stock price rebounded moderately prior to the end of the period. Subsequent to May 31, 2005, Leucadia reached a favorable settlement with SBC regarding SBC's contract with WilTel. Canadian Natural Resources' stock price increased significantly, also during a period in which the Fund's ownership increased by a substantial amount. The stock price gain reflected sharply higher prices for oil and gas, as well as a positive reception to the company's announcement that it was proceeding with a large oil sands project in Alberta.

# THE FAIRHOLME FUND

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MANAGEMENT DISCUSSION & ANALYSIS (Continued)  
For the Six Months Ended May 31, 2005

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Securities whose declines most affected the Fund's portfolio (including realized and unrealized losses) for the period included the following:

- USA Mobility, Inc.
- Echostar Communications Corp.

In the opinion of the Fund's investment adviser, the following factors had a bearing on the change in value of the above securities (although other unmentioned factors may have also contributed to price changes): USA Mobility declined as some investors exhibited concerns regarding whether the company could deliver on promised synergies expected to result from the merger of predecessor companies, Arch Wireless and Metrocall. Echostar declined due to concerns that growth could slow amid a more competitive environment for pay television. The fact that certain securities declined in value does not indicate that the investment adviser believes these securities to be less attractive — in fact the investment adviser believes that some price declines may present significant buying opportunities.

In the six months ended May 31, 2005, significant cash inflows were recorded by the Fund, largely from new shareholder subscriptions believed to have resulted from positive performance and publicity received by the Fund. Although the Fund has a policy of normally investing 75% of its assets in U.S. common stocks, at May 31, 2005 the Fund had a lower percentage of assets invested in U.S. common stocks and there is no guarantee that the Fund's U.S. common stock investments will be above 75% in the next six months. The adviser invests Fund assets in common stocks to the extent it finds sensible investment opportunities and the Fund may, for defensive purposes, have a significant portion of its assets invested in liquid low-risk securities or cash. During the period ended May 31, 2005, the Fund's liquidity (consisting of cash, money-market funds, and U.S. Treasury bills) was somewhat higher than average and represented a significant portion of Fund assets. It should be noted that since inception, the Fund has held nearly 20% of assets in liquid low-risk securities or cash without impacting performance, although there is no guarantee that future performance will not be negatively affected by the Fund's liquidity.

The Fund continues to be advised by Fairholme Capital Management, L.L.C. Certain directors and officers of Fairholme Funds, Inc. are also members and officers of Fairholme Capital Management, L.L.C. For more complete information about the Fund and its adviser, or to obtain a current prospectus, please visit [www.fairholmefunds.com](http://www.fairholmefunds.com), or call 1-866-202-2263.

# THE FAIRHOLME FUND

EXPENSES  
May 31, 2005 (Unaudited)

As a shareholder of the Fund, you incur two types of costs: direct costs, which may include but are not limited to, transaction fees at some broker-dealers, custodial fees for retirement accounts, redemption fees (on shares redeemed within 60 days of purchase), and wire transfer fees. As a shareholder, you also incur indirect costs, such as the management and administration fees paid to the adviser of the Fund.

The example below 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 below is based on an investment of \$1,000 invested in the Fund at December 1, 2004 and held for the entire six month period ending May 31, 2005.

## 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 account 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. Therefore, the second line of the table is useful in comparing ongoing costs only, does not reflect any direct costs, 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, 2004</u>	<u>Ending Account Value May 31, 2005</u>	<u>Expenses Paid During the Period* December 1, 2004 Through May 31, 2005</u>
Actual	\$1,000.00	\$1,089.30	\$5.21
Hypothetical (5% return before expenses)	\$1,000.00	\$1,020.00	\$5.04

\* Expenses are equal to the Fund’s annualized expense ratio of 1.00%, multiplied by the average account value over the period, multiplied by 182 days/365 days (to reflect the one-half year period). The Fund’s ending account value on the first line in the table is based on its actual total return of 8.93% for the six month period of December 1, 2004, to May 31, 2005.

# THE FAIRHOLME FUND

## SCHEDULE OF INVESTMENTS May 31, 2005 (Unaudited)

<u>Shares</u>		<u>Market Value</u>
	<b>DOMESTIC COMMON STOCKS - 60.98%</b>	
	<b>DIVERSIFIED HOLDING COMPANY - 33.73%</b>	
1,045	Berkshire Hathaway, Inc.* Class A	\$ 87,884,500
12,100	Berkshire Hathaway, Inc.* Class B	34,001,000
2,386,337	Leucadia National Corp.	95,190,983
		<u>217,076,483</u>
	<b>ENERGY SERVICES - 0.04%</b>	
10,000	Duke Energy Corp.	<u>274,800</u>
	<b>HOME FURNISHINGS - 1.97%</b>	
405,600	Ethan Allen Interiors, Inc.	<u>12,654,720</u>
	<b>NEWSPAPERS: PUBLISHING AND PRINTING - 0.21%</b>	
35,674	Daily Journal Corp.*	<u>1,355,612</u>
	<b>PROPERTY AND CASUALTY INSURANCE - 2.63%</b>	
306,800	Mercury General Corp.	<u>16,935,360</u>
	<b>REAL ESTATE OPERATIONS - 1.02%</b>	
103,768	Homefed Corp.	<u>6,589,268</u>
	<b>SATELLITE - 4.75%</b>	
1,045,551	EchoStar Communications Corp.	<u>30,561,456</u>
	<b>TELEPHONE - 16.63%</b>	
805,300	AT&T Corp.	15,131,587
2,410,889	MCI, Inc.	61,766,976
1,138,011	USA Mobility, Inc.*	30,111,771
		<u>107,010,334</u>
<b>TOTAL DOMESTIC COMMON STOCKS (COST \$339,985,593)</b>		<u><u>392,458,033</u></u>
	<b>FOREIGN COMMON STOCKS - 9.13%</b>	
	<b>BERMUDA - 0.72%</b>	
	<b>PROPERTY AND CASUALTY INSURANCE - 0.72%</b>	
7,000	White Mountains Insurance Group Ltd.	<u>4,651,500</u>
	<b>CANADA - 6.98%</b>	
	<b>OIL AND GAS EXPLORATION - 6.98%</b>	
1,018,000	Canadian Natural Resources Ltd.	29,695,060
228,300	Penn West Petroleum Ltd.	15,195,735
		<u>\$ 44,890,795</u>

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

# THE FAIRHOLME FUND

SCHEDULE OF INVESTMENTS (Continued)  
May 31, 2005 (Unaudited)

<u>Shares</u>		<u>Market Value</u>
	<b>UNITED KINGDOM - 1.43%</b>	
	<b>INVESTMENT TRUST - 1.43%</b>	
3,400,000	JZ Equity Partners PLC	\$ 9,233,778
<b>TOTAL FOREIGN COMMON STOCKS (COST \$44,940,809) .....</b>		<b>58,776,073</b>
	<b>MISCELLANEOUS INVESTMENTS - 1.18%<sup>(a)</sup></b>	
<b>TOTAL MISCELLANEOUS INVESTMENTS (COST \$8,002,383) .....</b>		<b>7,570,925</b>
 <b><u>Principal</u></b>		
	<b>U.S. GOVERNMENT AND AGENCY OBLIGATIONS - 24.77%</b>	
10,000,000	T-Bill 1.28% <sup>(b)</sup> , 06/02/2005	9,999,297
10,000,000	T-Bill 2.33% <sup>(b)</sup> , 06/09/2005	9,994,240
10,000,000	T-Bill 2.42% <sup>(b)</sup> , 06/16/2005	9,989,417
15,000,000	T-Bill 2.48% <sup>(b)</sup> , 06/30/2005	14,969,469
15,000,000	T-Bill 2.55% <sup>(b)</sup> , 06/23/2005	14,975,370
15,000,000	T-Bill 2.56% <sup>(b)</sup> , 07/07/2005	14,961,160
15,000,000	T-Bill 2.58% <sup>(b)</sup> , 07/14/2005	14,953,506
15,000,000	T-Bill 2.60% <sup>(b)</sup> , 07/28/2005	14,935,230
15,000,000	T-Bill 2.68% <sup>(b)</sup> , 07/21/2005	14,943,330
15,000,000	T-Bill 2.84% <sup>(b)</sup> , 08/11/2005	14,917,425
15,000,000	T-Bill 2.89% <sup>(b)</sup> , 08/25/2005	14,899,230
10,000,000	T-Bill 2.98% <sup>(b)</sup> , 09/08/2005	9,920,390
<b>TOTAL U.S. GOVERNMENT AND AGENCY OBLIGATIONS (COST \$159,459,616)</b>		<b>159,458,064</b>
 <b><u>Shares</u></b>		
	<b>MONEY MARKET FUNDS - 5.26%</b>	
33,837,584	UMB Money Market, 1.44% <sup>(b)</sup>	33,837,584
<b>TOTAL MONEY MARKET FUNDS (COST \$33,837,584) .....</b>		<b>33,837,584</b>
<b>TOTAL INVESTMENTS (COST \$586,225,985)<sup>(c)</sup> - 101.32%</b>		<b>652,100,679</b>
	<b>LIABILITIES IN EXCESS OF OTHER ASSETS, NET (1.32)%</b>	<b>(8,494,857)</b>
<b>NET ASSETS - 100.00%</b>		<b>\$643,605,822</b>

\* Non-income producing securities.

<sup>(a)</sup> Represents previously undisclosed securities which the Fund has held for less than one year.

<sup>(b)</sup> Rates shown are the effective yield as of May 31, 2005.

<sup>(c)</sup> See note 5.

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

# THE FAIRHOLME FUND

## STATEMENT OF ASSETS & LIABILITIES May 31, 2005 (Unaudited)

### Assets

Investments, at Market Value (Cost - \$586,225,985*)	\$652,100,679
Cash	6,270,451
Dividends and Interest Receivable	31,285
Receivable for Capital Shares Purchased	<u>15,621,897</u>
Total Assets	<u>674,024,312</u>

### Liabilities

Payable for Investments Purchased	29,801,740
Payable for Capital Shares Redeemed	157,602
Accrued Management Fees	<u>459,148</u>
Total Liabilities	<u>30,418,490</u>

### Net Assets

Paid-In Capital	569,209,396
Accumulated Undistributed Net Investment Income	1,417,014
Net Accumulated Realized Gain on Investments	7,104,718
Net Unrealized Appreciation on Investments*	<u>65,874,694</u>

### NET ASSETS

\$643,605,822

Shares of Common Stock Outstanding** (\$0.0001 par value)	<u>27,114,336</u>
Net Asset Value, Offering and Redemption Price Per Share (\$643,605,822 / 27,114,336 shares)	<u>\$ 23.74</u>

\* Certain items have been adjusted due to a dividend reclassification from the prior fiscal year.

\*\* 75,000,000 shares authorized in total.

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



# THE FAIRHOLME FUND

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## STATEMENT OF OPERATIONS (Unaudited)

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	<b>For the Six Months Ended May 31, 2005</b>
<b>Investment Income</b>	
Interest	\$ 962,683
Dividends* (net of \$71,171 foreign taxes withheld)	<u>2,800,843</u>
Total Investment Income	<u>3,763,526</u>
<b>Expenses</b>	
Management Fees (Note 3)	<u>1,766,468</u>
Total Expenses	<u>1,766,468</u>
Net Investment Income	<u>1,997,058</u>
<b>Realized and Unrealized Gain on Investments</b>	
Net Realized Gain on Investments	7,134,172
Net Change in Unrealized Appreciation on Investments*	<u>21,821,682</u>
Net Realized and Unrealized Gain on Investments	<u>28,955,854</u>
<b>NET INCREASE IN NET ASSETS FROM OPERATIONS</b>	<u><u>\$30,952,912</u></u>

\* Certain items have been adjusted due to a dividend reclassification from the prior fiscal year.

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, 2005 (Unaudited)	For the Fiscal Year Ended November 30, 2004
<b>CHANGE IN NET ASSETS</b>		
<b>From Operations</b>		
Net Investment Income	\$ 1,997,058	\$ 77,465
Net Realized Gain on Investments	7,134,172	5,736,069
Net Change in Unrealized Appreciation on Investments	<u>21,821,682*</u>	<u>26,076,288</u>
Net Increase in Net Assets from Operations	<u>30,952,912</u>	<u>31,889,822</u>
<b>From Distributions to Shareholders</b>		
Net Investment Income	(657,509)	—
Net Realized Capital Gains from Security Transactions	<u>(5,736,115)</u>	<u>(29,409)</u>
Net Decrease in Net Assets from Distributions	<u>(6,393,624)</u>	<u>(29,409)</u>
<b>From Capital Share Transactions</b>		
Proceeds from Sale of Shares	406,215,799	137,270,864
Shares Issued in Reinvestment of Dividends	6,203,572	29,186
Cost of Shares Redeemed	<u>(28,390,920)</u>	<u>(23,110,744)</u>
Net Increase in Net Assets from Shareholder Activity	<u>384,028,451</u>	<u>114,189,306</u>
<b>NET ASSETS</b>		
Net Increase in Net Assets	408,587,739	146,049,719
Net Assets at Beginning of Period	<u>235,018,083</u>	<u>88,968,364</u>
Net Assets at End of Period	<u>\$643,605,822</u>	<u>\$235,018,083</u>
Accumulated Undistributed Net Investment Income	<u>\$ 1,417,014</u>	<u>\$ 77,465</u>
<b>SHARES TRANSACTIONS</b>		
Issued	17,572,549	6,740,137
Reinvested	274,859	1,600
Redeemed	<u>(1,245,187)</u>	<u>(1,150,583)</u>
Net Increase in Shares	16,602,221	5,591,154
Shares Outstanding at Beginning of Period	<u>10,512,115</u>	<u>4,920,961</u>
Shares Outstanding at End of Period	<u>27,114,336</u>	<u>10,512,115</u>

\* Certain items have been adjusted due to a dividend reclassification from the prior fiscal year.

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

# THE FAIRHOLME FUND

## FINANCIAL HIGHLIGHTS

	For the Six Months Ended May 31, 2005 (Unaudited)	For the Fiscal Year Ended November 30, 2004	For the Fiscal Year Ended November 30, 2003	For the Fiscal Year Ended November 30, 2002	For the Fiscal Year Ended November 30, 2001	December 29, 1999* to November 30, 2000
<b>NET ASSET VALUE, BEGINNING OF PERIOD</b>	<u>\$22.36</u>	<u>\$18.08</u>	<u>\$15.14</u>	<u>\$14.99</u>	<u>\$13.55</u>	<u>\$10.00</u>
<b>Investment Operations</b>						
Net Investment Income/(Loss)	0.13	0.01	(0.02)	0.01	0.05	0.05
Net Realized and Unrealized Gain on Investments	<u>1.84</u>	<u>4.28</u>	<u>3.09</u>	<u>0.26</u>	<u>1.67</u>	<u>3.50</u>
Total from Investment Operations	<u>1.97</u>	<u>4.29</u>	<u>3.07</u>	<u>0.27</u>	<u>1.72</u>	<u>3.55</u>
<b>Distributions</b>						
From Net Investment Income In Excess of Investment Income**	(0.06)	—	(0.00)***	(0.03)	(0.04)	—
From Realized Capital Gains	<u>(0.53)</u>	<u>(0.01)</u>	<u>(0.10)</u>	<u>(0.09)</u>	<u>(0.24)</u>	—
Total Distributions	<u>(0.59)</u>	<u>(0.01)</u>	<u>(0.13)</u>	<u>(0.12)</u>	<u>(0.28)</u>	—
<b>NET ASSET VALUE, END OF PERIOD</b>	<u>\$23.74</u>	<u>\$22.36</u>	<u>\$18.08</u>	<u>\$15.14</u>	<u>\$14.99</u>	<u>\$13.55</u>
<b>TOTAL RETURN</b>	8.93%	23.71%	20.50%	1.77%	12.75%	35.50%
<b>Ratios/Supplemental Data</b>						
Net Assets, End of Period (in 000's)	\$643,606	\$235,018	\$88,968	\$47,809	\$28,753	\$13,910
Ratio of Expenses to Average Net Assets	1.00% <sup>(a)</sup>	1.00%	1.00%	1.00%	1.00%	1.00% <sup>(a)</sup>
Ratio of Net Investment Income/(Loss) to Average Net Assets	1.13% <sup>(a)</sup>	0.05%	(0.13)%	0.05%	0.24%	0.46% <sup>(a)</sup>
Portfolio Turnover Rate	9.33%	23.33%	12.66%	47.68%	29.40%	45.88% <sup>(a)</sup>

\* Commencement of Operations.

\*\* See note 6.

\*\*\* Represents less than \$0.01.

<sup>(a)</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, 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 100,000,000 shares of common stock at \$.0001 par value. 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 shares not issued with the respect to such series. 75,000,000 shares of one series have been authorized, which shares constitute the interests in the The Fairholme Fund (the “Fund”), a non-diversified fund. The Fund’s investment objective is to provide long-term growth of capital. The Fund seeks to achieve its objective by investing in common stocks without restrictions regarding market capitalization. The Fund will normally invest at least 75% of total net assets in U.S. common stocks and intends to hold a focused portfolio of no more than 25 stocks under normal circumstances. Fairholme Capital Management, L.L.C. (the “Adviser”) serves as investment adviser to the Fund.

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

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

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

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

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

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

# THE FAIRHOLME FUND

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NOTES TO FINANCIAL STATEMENTS (Continued)  
May 31, 2005 (Unaudited)

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*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) market 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.

*Estimates:* The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of 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.

*Other:* The Fund follows industry practice and 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 and interest income is recorded on an accrued basis. Discounts and premiums on securities purchased are amortized over the life of the respective securities. 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.

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

The Adviser is a Delaware limited liability company and is registered with the Securities and Exchange Commission as an investment adviser. The Adviser's principal business and occupation is to provide financial management and advisory services to individuals, corporations, and other institutions throughout the world. The Fund pays the Adviser for its advisory and administrative services, an annualized management fee equal to 1.00% (0.50% of which are investment advisory fees and 0.50% for administrative and other services) of the average net assets of the Fund, such fees to be computed daily based upon the daily average net assets of the Fund. Pursuant to an Operating Services agreement, the Fund's Adviser is responsible for paying all the Fund's expenses except commissions and other brokerage fees, taxes, interest, litigation expenses and other extraordinary expenses. The Fund paid commissions and other brokerage fees, but did not incur any extraordinary Other Expenses during the period. The Adviser received \$1,766,468 for their services during the six month period ended May 31, 2005. Certain directors and officers of Fairholme Funds, Inc. are also members and officers of Fairholme Capital Management, L.L.C.

The beneficial ownership, either directly or indirectly, of more than 25% of the voting securities of a fund creates a presumption of control of the fund, under section 2 (a) (9) of the Investment Company Act of 1940. As of May 31, 2005, National Financial Services Corp., a division of Fidelity Global Brokerage Group, Inc., a wholly-owned subsidiary of FMR Corp., for the benefit of its customers, owned approximately 33% of the Fund.

### **Note 4. Investments**

For the six month period ended May 31, 2005, purchases and sales of investment securities, other than short-term investments, aggregated \$250,890,878, and \$26,223,865, respectively.

# THE FAIRHOLME FUND

NOTES TO FINANCIAL STATEMENTS (Continued)  
May 31, 2005 (Unaudited)

## Note 5. Tax Matters

For U.S. federal income tax purposes, the cost of securities owned, gross appreciation, gross depreciation, and net unrealized appreciation/(depreciation) of investments at May 31, 2005 was as follows:

	<u>Cost</u>	<u>Gross Unrealized Appreciation</u>	<u>Gross Unrealized Depreciation</u>	<u>Net Unrealized Appreciation/ (Depreciation)</u>
The Fairholme Fund. . . . .	\$586,232,435	\$69,246,810	\$3,378,566	\$65,868,244

The difference between book basis and tax basis net unrealized appreciation/(depreciation) is attributable primarily to the tax deferral of losses on wash sales.

The Funds' tax basis capital gains and losses are determined only at the end of each fiscal year. As of November 30, 2004, the components of distributable earnings on a tax basis were as follows:

	<u>Value</u>
Undistributed Ordinary Income	\$ 77,465
Undistributed Capital Gain	5,706,660
Unrealized Appreciation	44,053,012
	<u>\$49,837,137</u>

## Note 6. Distribution to Shareholders

Income and long-term capital gain distributions are determined in accordance with Federal income tax regulations, which may differ from accounting principles generally accepted in the United States of America.

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

	For the Six Months Ended May 31, 2005 (Unaudited)	2004	2003*
Distributions paid from:			
Ordinary Income	\$ 657,509	\$ —	\$ 9,564
Long-Term Capital Gain	4,864,654	29,409	349,811
Short-Term Capital Gain	871,461	—	—
Return of Capital	—	—	63,005
	<u>\$6,393,624</u>	<u>\$29,409</u>	<u>\$422,380</u>

\* Tax character change from 2003 due to a reclassification as a result of a return of capital.

## **Note 7. Subsequent Event**

On April 11, 2005 MCI, Inc. announced that two distributions paid to shareholders in calendar year 2004 should have been treated as taxable dividends rather than non-taxable returns of capital. Since the Fund is required to calculate and distribute its net investment income prior to December 31st of each year, the Fund calculated its required distribution for 2004 relying on MCI's then current characterizations that its 2004 payments to shareholders were returns of capital.

As a direct consequence of MCI's recharacterization of these distributions in 2005, the Fund did not distribute the correct amount of net investment income for 2004. Consequently, the Fund has consulted with its accounting and tax advisers and determined subsequent to May 31, 2005 that it will be required to file an amended tax return for 2004, pay an excise tax to the government, and pay a "spillover" distribution to shareholders prior to August 15, 2005. The Fund currently estimates that the excise tax will not exceed \$25,000 and that the distribution to shareholders, which reflects the net impact to the Fund of the recharacterization of the MCI distributions, will not exceed \$550,000 and will be reported to shareholders on their 2005 Form 1099-DIV or 2005 Form 1042-S, whichever is appropriate.

Expenses relating to MCI's income recharacterization as well as the excise tax (including any required interest or penalties, if any) will be characterized as extraordinary expenses to be borne directly by the Fund.

# THE FAIRHOLME FUND

ADDITIONAL INFORMATION  
May 31, 2005 (Unaudited)

## Board of Directors (unaudited)

The Board Of Directors has overall responsibility for conduct of the Company's affairs. The day-to-day operations of the Fund are managed by the Adviser, subject to the Bylaws of the Company and review by the Board. The Directors, including those Directors who are also officers of the Company, are listed below.

Name, Age & Address	Position(s) Held with the Company	Term of Office & Length of Time Served	Principal Occupation(s) During Past 5 Years	Funds Overseen by Director	Other Directorships Held by Director
Bruce R. Berkowitz* Age 46 51 JFK Parkway Short Hills, NJ 07078	Director, President	Each Director serves for an indefinite term. Mr. Berkowitz has served as a director of the Fund since the Fund's inception on December 29, 1999.	Managing Member, Fairholme Capital Management, L.L.C., a registered investment adviser, since October 1997.	1	Deputy Chairman and a Director of Olympus Re Holdings, Ltd., a Trustee of First Union Real Estate, a Director of TAL International Group, Inc., and a Director of White Mountains Insurance Group, Ltd.
Keith D. Trauner* Age 47 51 JFK Parkway Short Hills, NJ 07078	Director, Treasurer/ Secretary	Each Director serves for an indefinite term. Mr. Trauner was appointed by the Board to replace an outgoing director in January 2002.	Chief Financial Officer, Fairholme Capital Management L.L.C., a registered investment adviser, employed since February 1999, previously, President, Circle Asset Management, Inc., a registered investment advisory subsidiary of Emigrant Bancorp.	1	None
Joel L. Uchenick Age 56 217 Rowley Bridge Road Topsfield, MA 01983	Independent Director	Each Director serves for an indefinite term. Mr. Uchenick has served as a director of the Fund since the Fund's inception on December 29, 1999.	General Partner, Sherbrooke Capital, a private equity firm, since November 1998. Previously, Senior Partner, Sherbrooke Associates Inc.	1	Director and Chairman of the Board, Oregon Chai Inc.; Board Member and Chief Financial Officer of Cooke PH, Inc.
Avivith Oppenheim, Esq. Age 54 211 Mountain Avenue Springfield, NJ 07081	Independent Director	Each Director serves for an indefinite term. Ms. Oppenheim has served as a director of the Fund since the Fund's inception on December 29, 1999.	Attorney-at-Law (private practice).	1	None
Leigh Walters, Esq. Age 59 1 Cleveland Place Springfield, NJ 07081	Independent Director	Each Director serves for an indefinite term. Mr. Walters has served as a director of the Fund since the Fund's inception on December 29, 1999.	Vice-President and Director, Valcor Engineering Corporation. Attorney-at-Law.	1	Director, Valcor Engineering Corporation

\* Indicates an interested person as defined in the 1940 Act.



## **Other Information (unaudited)**

The Company has adopted policies and procedures which provide guidance and set forth parameters for the voting of proxies relating to securities held in the Fund's portfolio. These policies and procedures are available to you upon request and free of charge by writing to Fairholme Funds, Inc., c/o Citco Mutual Fund Services, Inc., P.O. Box C1100, Southeastern, PA 19398-1100, or by calling the Company toll free at 1-866-202-2263, or by visiting the Company's website at [www.fairholmefunds.com](http://www.fairholmefunds.com). The Company's proxy voting policies, procedures, and records may also be obtained by visiting the Securities and Exchange Commission website at [www.sec.gov](http://www.sec.gov). The Company shall respond to all shareholder requests for records within three business days of such request by first-class mail or other means designed to ensure prompt delivery.

## **N-Q Filing (unaudited)**

The SEC has adopted the requirement that all Funds file a complete schedule of investments with the SEC for their first and third fiscal quarters on Form N-Q for fiscal quarters ending after July 9, 2004. For The Fairholme Fund, this would be 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 Fairholme Fund Form N-Q will be available on the SEC's website at <http://sec.gov>, or they 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).

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