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Is Bruce Berkowitz slipping?

Critics question whether he can manage growth - and an old timber company

By Jessica Toonkel
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During his years as an investment manager at such big firms as Smith Barney Inc. and Lehman Brothers Holdings Inc., Bruce Berkowitz learned firsthand the dangers of going along with the crowd. “You would have an investment meeting with 12 to 20 people around the table, and an idea would be discussed, and everyone would feel the need to add their input,” he said.

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“What would happen is that in any type of group, it dumbs down to the lowest common denominator. It's hard to achieve superior performance in that setting.”

That lesson has led Mr. Berkowitz to ask questions that no one else asks and invest in ways that others may question. While most portfolio managers or analysts come up with a thesis on a stock and try to find research to support it, Mr. Berkowitz will hire outside consultants to try to poke holes in his investment ideas, many of which center on troubled companies.

His unorthodox approach has paid off. His flagship fund, the $20 billion Fairholme Fund (FAIRX), has beaten all of its peers for the past five- and 10-year periods, and placed second for the past three-year period. Morningstar Inc. last year named him manager of the decade.

But some advisers worry that Mr. Berkowitz is headed for a fall. The Fairholme Fund is getting too big, a victim of its own success, they say. And in the past 15

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months, he has launched two new funds, the Focused Income Fund (FOCIX) and the Allocation Fund (FAAFX), leading critics to speculate that he might be spreading himself too thin. As of March 22, the Fairholme Fund trailed its category by 1.8% over the past 12-month period, according to Morningstar.

But it is his investment in the St. Joe Corp. that has received the most attention from investors. After buying nearly 30% of the Florida real estate company's shares, Mr. Berkowitz thrust himself into the management of the firm and has locked horns with David Einhorn, another well-known investor, who is shorting St. Joe's shares.

St. Joe, which started out as a timber company 75 years ago and is still one of the largest landowners in Florida, has been decimated by the real estate slump and has lost money for the past 11 quarters. Although it is not a top holding in the Fairholme Fund — it accounts for less than 3% of the fund's assets — -Mr. Berkowitz clearly believes the company has a future, while Mr. Einhorn believes its best days are behind it.

“This is the most interesting drama on Wall Street in 10 years — two brilliant guys in binary positions,” James Dahl, managing director of Rock Creek Capital, told Bloomberg News. “Only one can be right. There's no middle ground.” Mr. Dahl also is shorting St. Joe shares.

FLEEING WALL STREET

Four years ago, Mr. Berkowitz, 52, moved his 30-person firm, Fairholme Capital Management LLC, from Short Hills, N.J., to Miami — partially for the weather and the tax breaks, but more so to get away from “the noise” of Wall Street, he said.

Mr. Berkowitz concentrates his investments in a relatively small number of stocks so he can spend the time he thinks is necessary to produce the in-depth research he conducts before investing.

“One of the reasons we have such a focused portfolio is because of the complexities of these companies,” he said.

There are three questions Mr. Berkowitz asks himself before buying a stock. The first is,

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Can [the company] die a financial death? Second, he looks at what the "reasonable" expectations should be for the stock in terms of making money. Third, he looks at the price he would pay for the stock, compared with the amount of cash he expects it to generate.

"At the right price, a mediocre security can be great," Mr. Berkowitz said. "And at too high a price, a great company could be so-so."

For each security selection, Mr. Berkowitz hires consultants to try to disprove his thesis.

Mr. Berkowitz also is bullish on the financial sector. He has big positions in American International Group Inc., The Goldman Sachs Group Inc., Morgan Stanley Smith Barney LLC, Bank of America Corp. and Citigroup Inc.

While some people might be surprised that AIG, which required a massive government bailout during the financial crisis, is in his portfolio, Mr. Berkowitz cites the firm's strong balance sheet and low stock price. He has 9.2% of his assets invested in the giant insurer.

"Most people forget that AIG did a 1-to-20 reverse stock split, so the stock price isn't in the $40 range; it's more like $2," he said. "Their balance sheet looks better than anytime I can remember."

TOO BIG?

Even fans of Mr. Berkowitz ex-pressed concern that his flagship fund is getting too big.

"He has had great success, and as a result, his assets have grown substantially, but it may be hard to maintain that performance now," said Edward Kuresman, principal and portfolio manager at Madison Wealth Management, an advisory firm with $275 million in assets under management — $8 million of which is with Fairholme. "He can no longer go out and have the same stake in small-cap companies that he did when he managed $5 billion or $10 billion."

Mr. Berkowitz shakes off such concerns, noting that 22.4% of the fund is in cash, which has helped him take advantage of opportunities, as well as remain liquid.

As far as getting too big, he said, the new Allocation Fund is designed for investors who are

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worried about the size of the Fairholme Fund. The smaller fund, launched this year, has a similar strategy as the flagship fund, but because it has less money, it will be able to make small-cap bets, Mr. Berkowitz said.

Still, advisers worry about how much attention he will be able to give to each fund.

“We do have concerns that he might be stretching himself too thin,” said Bob Weiss, director of research at Heritage Financial Services Inc., which has $600 million in assets under management, $20 million of which is with Fairholme.

Mr. Berkowitz deflects such criticism, explaining that he already does the research required to select credit instruments for the Focused Income Fund as part of his research for selecting stocks for his other funds.

“When you invest in the equity of a company, you already had to analyze the credit structure of the company and the bonds and the bank debt, and the preferred stock, so the work was already done in most cases,” he said. “It's just that we found some very interesting instruments that we thought were very appropriate for an income fund.”

Even Mr. Kuresman acknowledges that Mr. Berkowitz still has a “huge incentive” to produce results for investors because he invests right alongside them. As of Feb. 28, Mr. Berkowitz and his second in command, Charles M. Fernandez, had $300 million invested across all three Fairholme funds.

The one thing that Mr. Berkowitz concedes may have taken up too much of his time is his activist position with St. Joe, whose stock Fairholme has owned for three years.

St. Joe is staking its future on real estate development. It owns nearly 600,000 acres on the Florida Panhandle, the majority of it within 15 miles of the Gulf of Mexico. But Florida was among the hardest-hit states in the country when the housing bubble burst, and it may be years before it regains its stride.

In October, the Fairholme Fund bought 136,000 shares of St. Joe after Mr. Einhorn said that he was shorting shares of the company. He has said that most of the company's best land, which is near the coast, already has been sold.

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"We went to the company after that and told them we could help them, so the company put Charlie [Fernandez] and me on the board at the beginning of the year," Mr. Berkowitz said.

Six weeks later, they resigned, citing differences with management.

"Management's first responsibility is with shareholders," Mr. Berkowitz said. "That means you can't waste shareholder money, it means pay for performance, and there should be an open and transparent process where shareholders can give their views."

In a Feb. 15 interview with *InvestmentNews*, Mr. Berkowitz said that he was finished acting as an activist shareholder with St. Joe. "It's clear in our minds that we can spend too much time on it," he said. "I have moved on."

But the next day, his firm filed to remove St. Joe's board. On Feb. 28, St. Joe's chief executive, Britt Greene, and three other board members announced they would resign. On March 4, Mr. Berkowitz was named chairman.

What changed? Mr. Berkowitz said after he resigned from the board, he spent 10 days in Asia, his fourth visit in the past seven months. "I believe what is happening there could happen at St. Joe," Mr. Berkowitz said, referring to the vast development going on in Asia. "If you saw the land — and the scope and size of it — you would understand what I am saying."

As chairman of St. Joe, Mr. Berkowitz won't be involved in the day-to-day business. "We wouldn't be spending time on it if we didn't think there was an opportunity for our shareholders," he said. "And we wouldn't spend time on it if we didn't have the time to spend. Some people take vacations; we decided to do extra work with St. Joe."

But it's not St. Joe or even the potential for another financial meltdown that keeps Mr. Berkowitz up at night. What worries him most is not having enough cash.

"The only fear I have is running out of cash and not having the flexibility to take the right actions," he said. "Would I be upset if we did well but were fired because we didn't do as well as others? No. Would I be upset if in hindsight we did something stupid and had to sell or run out of cash? Yes. That would have destroyed 30 years of hard work."

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