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## Nomad Investment Partnership

### Annual Letter

For the period ended December 31<sup>st</sup> 2009

To December 31 <sup>st</sup> 2009	<u>Nomad Investment Partnership</u>	<u>MSCI World Index (net) US\$</u>
Trailing:		
One year	+71.5%	+30.0%
Two years	-6.2	-22.9
Three years	+13.7	-16.0
Four years	+29.2	+0.9
Five years	+41.0	+10.5
Six years	+72.2	+26.7
Seven years	+209.3	+68.7
Eight years	+213.3	+35.1
Since inception (Sept 10 <sup>th</sup> 2001)	+245.0	+40.0
Annualized since inception		
Before performance fees	+16.1%	
After performance fees	+13.7%	+4.1%

The figures above are unaudited, presented on a cumulative basis and, as ever, are before fees. We present results in this way as Nomad's refundable performance fee and time dependent performance fee hurdle mean that the net-of-all-fees results will vary with subscription date and from investor to investor. Whilst investors will, therefore, have their own unique net-of-all fees experience of investing in Nomad, as a guide we have also detailed overleaf the net-of-all-fees result from one point in time, in this case since inception. An index is used in the table to place our results in context with a broad swathe of share prices from around the world. We do not feel strongly about the merits of the index we have chosen, and Partners may wish to use another. Whatever the yardstick, we ask only that Nomad be compared over the very long term. Below, the same pre-fee results are presented in discrete annual increments. In our opinion, it is the upper table that is most useful in assessing long term investment performance.

To December 31 <sup>st</sup> :	<u>Nomad Investment Partnership</u>	<u>MSCI World Index (net) US\$</u>
Calendar Year Results:		
2009	+71.5%	+30.0%
2008	-45.3	-40.7
2007	+21.2	+9.0
2006	+13.6	+20.1
2005	+9.2	+9.5
2004	+22.1	+14.7
2003	+79.6	+33.1
2002	+1.3	-19.9
2001 (inception Sept 10 <sup>th</sup> 2001)	+10.1	+3.6

The New Year brings Nomad's tenth calendar year of operations. Since we began, a dollar invested in Nomad at inception has grown to be worth \$2.90 net-of-all-fees as of January 1<sup>st</sup>, whilst a dollar invested over the same period in the average share, as reflected in the index above, would be worth around \$1.40. Put another way, net asset value has compounded at 13.7% per annum, whilst the index has managed 4.1%.

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### Trust and Thank You!

A sixteen percent per annum investment return (i.e. pre-fees) has been achieved without leverage, derivatives, options, selling short, contracts for difference, LYONs, PRIDES (a pride of lions, perhaps?), TYGRs, STRYPES (we are not making these names up) or any of the other exotica the investment industry uses but, instead, it has been achieved the old fashioned way, through stock-picking. However, Zak and I do not operate alone in our stock-picking efforts. There were two important events in the last few years where you, our Partners, meaningfully added to returns. The first was to vote in early 2008 for Nomad's delisting from the Irish Stock Exchange. This motion allowed us to make much larger single-company investments than had been the case up to that point. Today, net asset value is approximately twenty percent greater than had the size of our investments remained artificially capped by the stroke of a bureaucrat's pen. Bravo!

Second, last year you did not redeem. The return to date from that action alone will be in the order of seventy percent (and counting!). Trusting people is not easy, but even so, you have trusted us far more than I am aware occurs at any other fund management organisation, and we thank you. Do not dismiss the effect your calming influence has on the Nomad ecosystem. These results are yours, as much as ours. Indeed, given the parlous balance of the refundable performance fee account for our long -erm investors, they are all yours! Well, all yours in exchange for around twenty basis points in management fee. Bargain.

Even though it may be tempting to flatter oneself, it is the businesses we invest in that do almost all the heavy lifting in the wealth creating process. If Zak and I bring something to the investment party, and I may be stretching things a little here, it is to be more rational than other investors. At least, we hope that is the case. Your trust, in turn, allows us to invest in firms that are misunderstood by many. For example, we invest in firms that pay their employees 80% more than rival companies (Costco); firms that lower prices as an article of faith (Amazon.com); firms that force an equitable distribution of commissions in an industry

dominated by an eat-what-you-kill culture (Michael Page); a low-cost airline for the masses in a region served by airlines for the rich (AirAsia); and a company that thinks table top figurine games are cool, really, (Games Workshop). Isn't it wonderful that these firms are behaving in this way despite being misunderstood by the outside world? All the social pressure will be to conform with industry norm but these companies have a deep keel that keeps them upright.

Your trust allows us to make mistakes (Conseco, Fleetwood Enterprises – please don't point out they are from the same industry!) and change our mind quickly and without fear of rebuke (MBIA); invest in brilliant businesses (Amazon, Berkshire Hathaway, Costco et al) and so-so businesses (Stagecoach Group, Holcim Philippines, USG); invest with great concentration (Stagecoach, Amazon, Michael Page) and in baskets of several small holdings (four companies in Zimbabwe). We do these things because it is rational to invest that way and, if our results are a guide, it works! Nomad would be ranked in the top cohort of almost any peer group league table for our cumulative performance since inception.

### Careful what you wish for

In previous letters we have described the split that exists between Nomad's approach and that of the industry in terms of the principal-agent conflict, or manifestations thereof, such as short investment holding periods. I don't want to make too much of these as, in part, I do not think we are saying much that is new and I think it should also fall on the so-called "*professional fund management industry*" to defend its practices. Indeed, it seems to us that it is the industry that has to constantly say something new to keep the game going: new funds, new products, new investment stories, new "*aligned*" performance fees, new firms. Each new new thing is in turn supported with lots of marketing, perhaps in an attempt to give the new things extra oomph over the, now demoted, old things. At any rate, one cumulative effect of years of the industry's shouted marketing claims has been to elevate well-meaning concepts to the status of industry dogma. In part, this happens through the crowding out of contrary argument. For example, "*specialisation*" and "*diversification*" are at the heart of many marketing claims and sound wholesome and prudent enough, a little like motherhood and apple pie. However, such notions, if run to extremes, can be counter-productive. For example, a widely held view in the noughties mortgage market was that the risk of "*specialised*" lending to the less credit-worthy could be removed through "*diversification*". It was all sales talk, but it worked, in part, as the salesmen were able to promote their products as "*safe*" because specialisation and diversification were traits so highly prized by the rube investor. False traits, it turned out, as the products were not diversified and their complexity made them all but un-analysable. Specialised indeed! A US\$1 trillion case of 'careful what you wish for'. Such a ruse does not just exist in the credit markets: many equity portfolios are constructed using similar principles.

### The Locker Room Culture

The attitude of the builders and sellers of these new things may be akin to what Charlie Munger called the "*locker room culture*". This is an attitude whereby the players just have to win, and they are not too squeamish about the means. And if winning, for some, meant securing a bigger bonus than others, then, in the case of the mortgage market, any way to get people to buy expensive paper was just fine, and to hell with the consequences. This is a proud, manipulative, points-scoring orientation that manifests itself in all walks of life, but may be especially evident on Wall Street, although some salesmen, sportsmen, chief executives, politicians, warlords and hedge fund types are notably not exempt. It is perhaps

the dominant, get-ahead mindset of our times and it is inherently focused on vivid, short term outputs. Sales targets and profit margins achieved through cutting corners may be inherently worthless in the end, but they can dazzle for a while, and that is their value to the locker room set.

If we are honest, we have all been tricked by the unscrupulous salesman and his short-term promises. It is, perhaps, part of growing up. Zak and I have certainly responded, with order sheet and pen at the ready, to firms that have explicitly promised revenue and margins targets, without really considering how those targets were to be earned or whether they were sustainable. Oh dear! One-nil to the locker room set. In the end though, the sin and folly of the locker room culture, with its win at any costs attitude, does huge damage to us all.

A great deal has been penned on why the locker room mindset exists in listed businesses. However, it is interesting that the commentary has, to date, been almost deferential towards shareholders, who are cast more as victims of scandals rather than sowers of their own misfortune. We would argue a contrary view: if the shareholder base of a listed firm is dominated by, say, mutual funds that, in turn, are seeking short term performance, then that too will be what they will seek in their investments. An odd pact may, therefore, develop between the immediate business imperatives of the salesforce-controlled mutual fund and, say, the consumer goods company with earnings to hit. Both parties will care for short term outputs and will take from the long-term to meet their needs. All parties will invariably be in denial that this is the case, at least to their clients but, we ask, how are the incentives aligned? We would argue that not only do companies get the investors they deserve, but investors also get the companies they deserve.

Schlock begets schlock, as it were.

Operating inside the bubble, it is hard for many participants to see this. The author Upton Sinclair, commenting on the attitude of businessmen and almost one hundred years to the day before the current credit crisis, had it about right, "*it is difficult to get a man to understand something when his salary (or bonus) depends on his not understanding it*". So, the mindset is prevalent because it pays in the short term. But this does not make it the right thing to do, nor does it make it profitable over the long-term.

#### Doing what is right rather than what plays well

Zak and I far prefer a different approach. We would argue that locker room behaviour is more likely to be spotted by patient, generalist investors deploying common sense, as it helps to be outside the bubble to see the bubble. It may also aid one's thinking if the investor is prepared to make a meaningful, long term investment as this breaks the in-out, get-rich-quick spell of the salesman (and, let's face it, the salesman in one's own head!). Our anti-locker room disposition was echoed by the founder of one of Nomad's investee firms, who, in a private meeting, put it as follows: "*if you want to be successful, and we do, then you have to be willing to be misunderstood, and do things that do not seem sensible to most people*". For example, "*if you (employees) come into the office in the morning thinking how you are going to beat number one, two or three in the industry*" - how many times have we heard companies articulate that view? - "*then, our firm is the wrong place for you. We start with the customer and work backwards.*" Oh, sweet nectar! He continued that rather than set your standards by what others do, the firm benefited from a "*divine discontent*" with the status quo, which kept colleagues on their toes and the firm improving, irrespective of what the competition were

doing. In other words, his company had an internal compass with true north pointing to what was right for the customer.

This orientation strikes us as the antithesis of the locker room set.

### Character as a way of reducing reinvestment risk

Judging by our hit rate with companies interviewed, Zak and I would guesstimate that fewer than five percent of publicly listed firms do what they think is right, rather than what they think plays well with the outside world (media, Wall Street, investors). Even so, the vast majority of Nomad's firms do what is right long term. But I suspect we have a predilection for such people. Which brings us on to an important characteristic of Nomad today that we hope will affect results for years to come.

There are, broadly, two ways to behave as an investor. First, buy something cheap in anticipation of a rise in price, sell at a profit, and repeat. Almost everybody does this to some extent. And for some fund managers it requires, depending upon the number of shares in a portfolio and the time they are held, perhaps many hundred decisions a year. Alternatively, the second way to invest is to buy shares in a great business at a reasonable price and let the business grow. This appears to require just one decision (to buy the shares) but, in reality, it requires daily decisions not to sell the shares as well! Almost no one does this, in part because it requires patience - and the locker room set does not do patience - but also because inactivity is the enemy of high fees.

Regardless of how it may appear, Zak and I are drifting toward inactivity, at least as judged by our industry. As we have set out in earlier letters, in part this is because we realise through vicarious, and not so vicarious (!), experience that we do not know that much. We certainly do not have an opinion on many hundred shares, at least, not an opinion in which we would invest money. Second, we have learned or, rather, come to appreciate, that the character of a firm - call it the ability to resist locker room temptation - is far more important than first we realised. This is an important insight. In the long run it may be all that matters. And note,

Nomad is overwhelmingly invested in businesses of great character.

Third, if our firms can successfully grow, and we can resist the temptation to fiddle, then we can meaningfully reduce the reinvestment risk embedded in lots of share buying and selling. Finally, great businesses have been "on sale" and were, in our opinion, the investment opportunity of the credit crisis period. When we wrote to you a year ago, we said, "*It may not feel like it but for a long term investor this is the best of times not the worst...Take heart and look to the horizon.*" Today we have a portfolio of exceptional, iconoclastic businesses that we could own for many years.

This is investment heaven.

We wish you a very successful new decade.

Yours sincerely,

Nicholas Sleep

## Our Footnotes - “No Bamboozlement Here”

There is, we are told, a ticket kiosk at a railway station somewhere in India with a sign above the window that reads, “*No Bamboozlement Here*”. It is in the same spirit that we attempt these cautionary words. Disclaimers boil down to the following statement – if you choose to believe any of this, then you are on your own. It will be hard for us to escape this conclusion too, and it makes little sense for us to do anything but disclaim liability for errors, omissions and offer no warranties – please, check everything we say, let us know when we are wrong and forgive our errors. We do promise you this: we are human, we make mistakes, but our mistakes, we hope, are honest mistakes. Although we do not intend to mislead, we also cannot guarantee the information in these letters, or that some of our ideas may be interpreted in ways we do not intend. As investors we are trying to do as good a job as we can and we write these letters in good faith to inform and educate investors on our actions and thinking in the context of the Partnership. We hope that they will be read in the same spirit in which they are written. As authors we assert our copyright. However, we also understand that our letters are passed on. We ask only that you attribute our work to us.

Common sense tells you that the price and value of shares can vary greatly, and whilst we do not aim for this, we also recognize that permanent impairment of capital is possible. Our fund is concentrated, perhaps more than many other funds, and as such our results will be more volatile than many of our peers. Nomad is also a very long term fund. We do not think it is suitable for those with time frames less than five years. We also do not think Nomad is suitable for investors overly conflicted with principal-agent issues. If you are at all uncomfortable, then Nomad is not for you.

The Nomad Investment Partnership has had two General Partners, Marathon Asset Management for the period from inception in 2001 to September 2006, and Sleep, Zakaria and Company, Ltd. from September 2006 until the present day. Zak and I have been responsible for the investment management of the Partnership since inception, formerly as employees of Marathon and then at our own firm, which was set up for the purpose of managing Nomad. The adventure continues...

### Legal Footnotes

Performance numbers are produced by Phoenix Fund Services, Nomad’s administrator, and are audited by Ernst and Young in their annual audit, which follows publication of our letters.

In our letters we refer to both limited partners in the Partnership, and common shareholders in the Nomad Investment Company (feeder fund) as “Partners”. We do this to convey a relationship we seek in which our investors are partners in a shared experience and destiny, in which they too have something to contribute. We do not mean to suggest that there is a partnership, in the strict, legal, sense of the word, between the shareholders in the feeder fund and Nomad, or Sleep, Zakaria and Company, Ltd.

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