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Nomad Investment Partnership

Annual Letter

For the period ended December 31st, 2011

To December 31 st , 2011:	<u>Nomad Investment Partnership</u>	<u>MSCI World Index (net) US\$</u>
Trailing:	%	%
One year	-9.9	-5.5
Two years	29.7	5.7
Three years	122.5	37.3
Four years	21.7	-18.6
Five years	47.5	-11.2
Six years	67.6	6.6
Seven years	83.0	16.7
Eight years	123.4	33.9
Nine years	301.3	78.2
Ten years	306.5	42.8
Since inception (Sept 10 th , 2001)	347.6	47.9
Annualized since inception:	%	%
Before performance fees	15.7	3.9
After performance fees	13.6	

The figures above are unaudited, presented on a cumulative, percentage gain 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 means that the net-of-all- fees results will vary with subscription date and so from investor to investor. Partners will, therefore, each have their own, unique, net-of-all fees experience of investing in Nomad. As a guide, we have also detailed the net-of-all-fees results 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, however, it is probably the table overleaf that is most useful in assessing long-term investment performance.

To December 31 st :	<u>Nomad Investment</u> <u>Partnership</u>	<u>MSCI World</u> <u>Index (net) US\$</u>
Calendar Year Results:	%	%
2011	-9.9	-5.5
2010	43.9	11.8
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 th , 2001)	10.1	3.6

A US dollar invested in Nomad at inception has grown to be worth \$3.71, after fees, as of January 1st, 2012, whilst a dollar invested over the same period in the average share, as reflected in the index above, would be worth around \$1.48. Put another way, net asset value (i.e. after fees) has compounded at 13.6% per annum, whilst the index has managed 3.9%.

As a young(er) investment analyst, I once met with the CFO of a large US West Coast bank. I was anxious beforehand, it is not easy for a young man to hold his own with a senior executive of any business, let alone one as opaque as a bank. I forget which question I asked, no doubt it was cloaked in the latest management buzzwords of the day but, at any rate, it was so overly complicated that it elicited the following response,

“Look, son, at the end of the day it is all about cash-in, and cash-out”.

Oh dear! Well, the put down could have been worse, and probably deserved to be worse. That was a lesson learnt: keep it simple, it is all about cash-in, and cash-out.

Zak and I run a single partnership that has long-term investments in the shares of, for all that matters, ten companies, all paid for with cash. We own the investment advisor that manages the partnership and, ordinarily, we are closed to incremental subscriptions and so free of marketing obligations. That’s it. It is terribly, terribly simple, but it is not easy. It is not easy because there are so many distractions: news items, the soap opera of the stock market, macro-economic events, politics, currencies, interest rates, principal/agent temptations, regulation, compliance, administration and so on - this list is not exhaustive! It is all too easy to make things more complicated than they need to be or, to invert, it is not easy to maintain discipline. One trick that Zak and I use when sieving the data that passes over our desks is to ask the question: does any of this make a meaningful difference to the relationship our businesses have with their customers? This bond (or not!) between customers and companies is one of the most important factors in determining long-term business success. Recognising this can be very helpful to the long-term investor.

For example, what investors needed to understand, and attribute sufficient weight to, in order to hold Colgate-Palmolive shares for the last thirty years, and so enjoy the fifty-fold uplift in share price, was the economics of incremental products (often referred to as “line extensions”, from the first “Winterfresh” blue minty gel in 1981 to “Total Advanced Whitening” today)

and the psychology of advertising. Other items were important too, discipline in capital spending in particular, and there were lots of other things that seemed important along the way (stock market crises, country crises, management crises and so on) but it was the success and economics of line extensions and advertising that, in our opinion, was what the long-term investor really needed to embrace. A similar story can be told at Nike and Coca-Cola (manufacturing savings funneled into dominant advertising) or Wal-Mart and Costco (scale savings shared with the customer). Recognising and correctly weighing this information in spite of the latest news flow is a matter of discipline, and it is that discipline that is so richly rewarded in the end.

The simple deep reality for many of our firms is the virtuous spiral established when companies keep costs down, margins low and in doing so share their growing scale with their customers. In the long run this will be more important in determining the destination for our firms than the distractions of the day. Jeff Bezos, founder of Amazon, made the following point in a recent interview in Wired magazine:

“There are two ways to build a successful company. One is to work very, very hard to convince customers to pay high margins [the Colgate, Nike, Coca-Cola model alluded to above]. The other is to work very, very hard to be able to offer customers low margins [the Wal-Mart, Costco, AirAsia, Amazon, Asos model]. They both work. We’re firmly in the second camp. It’s difficult – you have to eliminate defects and be very efficient. But it’s also a point of view. We’d rather have a very large customer base and low margins than a small customer base and higher margins.”

Although Mr. Bezos does not mention it, one reason he prefers Amazon to be a large company with small margins is that if he shares the efficiency benefits that come with growth with his customers, he turns size, frequently an anchor on business performance, into an asset. In other words, the moat surrounding the firm deepens as the firm grows. So, having shared low costs with their customers, how are our firms’ relationships with their customers going? One way to look at this is revenue growth. The weighted average revenue growth of Nomad’s firms is currently over thirty percent per annum. Note: this is organic growth with, if anything, falling prices and no acquisitions in a time of austerity and little economic growth. It would appear to us that the company – customer relationship is in rude health. That’s the cash-in. And the cash-out? Keeping it simple again: return on capital at Nomad’s firms is over twice that of competing businesses.

The real risks are not those in the newspapers

It is not that the garden will always be rosy. There are lots of ways that our firms could drain the moats that surround them. One example might be wide-scale credit card fraud following the loss of customer information (perhaps say after a careless employee left a laptop in a taxi). Yikes! If the neglectful firm made light of the situation, pretending it was a small loss and no harm was done, then they had better be telling the truth. Making light of a far more serious situation, perhaps as News International may be finding out today, risks breaking even a long-standing bond of trust. So, in our opinion, it won’t be the on-line fraud, per se, or, heaven forbid, an airplane crash at AirAsia, that could ruin our firms, but a disingenuous response to a problem.

One of the lovely aspects of human nature is the ability to forgive. If, for example in our hypothetical on-line fraud situation, the firm comes clean, is candid in explaining the problem,

learns its lesson, makes good on the losses and say, puts twenty dollars into each of its customer's accounts, or buys them chocolates or roses, then the long-term relationship with the customers has probably not been harmed too much and, if done properly, may even have been enhanced. When we asked the founder of AirAsia what he would do if his firm put a plane in a swamp (!), he raised both hands in a gesture of having nothing to hide. That response strikes us as very healthy.

Indeed, a greater risk to our businesses may come as a by-product of success – be it bubble valuations in the stock market and/or, political risk in the form of anti-trust like pressures. For example, as retailing moves increasingly on-line what is the probability of an on-line retailing tax? Or an on-line retailing tax that is higher than VAT or GST? This is conjecture, of course, but we mention this to illustrate that the long-term risks our companies face are not those that dominate the newspapers and headlines today (credit crises, housing crises, budget crises, Euro crises and so on) but those events that could prevent them from reaching their potential. It is these risks that Zak and I try to identify and understand.

Black Arrow and Accounting

Eagle-eyed investors may have noticed that Black Arrow Group plc, a firm valued at nil in the Partnership, has recently declared a dividend of one pence per share. A one-penny dividend from a worthless holding means that, in accounting terms, we have created money out of nothing! The Alchemists were not that good, so what has been going on? Black Arrow was founded and continues to be run by the octogenarian Arnold brothers, who own or control around eighty-eight percent of the shares outstanding. The shares were de-listed from AIM (a UK stock exchange) in February 2010. At the time, book value approximated one pound per share, although the last traded share price was fifty-two pence. There is no market for the shares, and no prospect of a market for the shares as the brothers do not wish to own more (we have tried), and so the investment has been valued at nil in the Partnership (with a paper loss of around one tenth of one percent of net asset value). Zak and I know the business is troubled but it is also not worth nothing; then again to assign a positive value would be just as arbitrary as we could not give you cash for your shares either - so zero it is. Almost all valuations are wrong, in effect, and in the case of Black Arrow, although de-listed and in poor health, the firm has continued to operate with the resultant one pence dividend. Enjoy it whilst it lasts. We remain hopeful, but not optimistic, that the dividend alchemy will continue.

Accountants

Nomad has had the same accountants for eleven years. As with many outsourced relationships the quality of service has a tendency to decline with the passing of time, even as the price charged rises with the years. In the end the rubber snaps, and we have recently appointed a senior partner at a new accounting firm for approximately two-thirds of the money we were paying for the services of the old accounting firm. You should expect the Nomad accounts to be with you in late March as usual and, as we have retained the incumbent accountant for the US and UK tax filings, these should also run as normal.

A Word on Education

Readers may recall that a few years ago I became involved in a failed school in South East London. Academic standards at the school had slipped to the point that the government had taken back control of the school from the local education authority and handed its running to

an independent foundation. The school's new status as an "academy" has allowed it to be governed relatively free from constraints and with the result that, now in its fourth year, the eighty-five percent exam failure rate that was inherited, will soon be turned into an eighty-five percent pass rate. The UK school inspectorate recently awarded the school an "outstanding" rating. I don't think they knew what to do with me as a governor, and so I was put in charge of the finance committee (type-cast again). From this vantage point I can see that the turnaround has been achieved with no extra funding – the school's revenues this year match that of its failed predecessor. It can be tempting to think that more money is the answer to problems but it strikes us that it is not the money you have, but the choices you make, that count.

Keep your eyes on the horizon.

It is not the easiest time to be an equity investor. The factors that have led to the devaluation of equities relative to almost all other investment possibilities (perhaps with the exception of housing) have little to do with how well companies have been managed. Be that as it may, Nomad's firms are, on average, so cost advantaged compared to many of their competitors that the worse it gets for the economy, the better it gets for our firms from a competitive position. The trick to being a good investor, over the long-term, is to maintain your long-term oriented discipline. Bezos again:

"Our first shareholder letter, in 1997, was entitled, "It's all about the long-term". If everything you do needs to work on a three-year time horizon, then you're competing against a lot of people. But if you are willing to invest on a seven-year time horizon, you're now competing against a fraction of those people, because very few companies are willing to do that. Just by lengthening the time horizon, you can engage in endeavours that you could never otherwise pursue. At Amazon we like things to work in five to seven years. We're willing to plant seeds, let them grow – and we're very stubborn. We say we are stubborn on the vision and flexible on the details".

The uniqueness of Nomad's ecosystem is the look-through consistency of approach of its participants, from Mr. Bezos and the good folks that run Nomad's other businesses, to Zak and me and on to our investing partners. We are all choosing to see the world in the same way. It is very simple and, because it is the road-less-travelled, it is also very valuable, but it is not always easy. Please, never underestimate the importance of your role in the ecosystem. It is for that reason we named Nomad a Partnership, not a fund.

We wish you a very Happy New Year

Yours sincerely

Nicholas Sleep

Our footnotes

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. Yikes! 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 are honest ones. 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 partners 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.

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 Partnership is concentrated in relatively few investments, perhaps more concentrated than many others, and as such our results will be more volatile than many of our peers. Nomad is also a very long-term Partnership. We do not think it is suitable for investors 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, we suspect, 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 from September 2006 until the present day. Zak and I have been responsible for the investment decisions 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...

Some notes on housekeeping (stay awake at the back!)

This is the annual letter and, combined with the interim letter sent to investors in July, is the main format we use to communicate to our partners. In these letters we have tried to honestly and thoroughly provide all the information we would seek if the tables were turned and we were investors in someone else's fund. We own shares for very long periods and we are conscious that more frequent or detailed reporting may be unnecessary and even counterproductive. A copy of our magnum opus, the full Collection of Letters, is available upon request from Amanda at Galactic HQ (amanda@sleepzakaria.co.uk). Lots of coffee required. Partners in Nomad will also receive a full copy of our Schedule of Investments by separate post, every six months, which lists all of our investments in detail. In addition, in the Spring you will receive Nomad's annual accounts, audited by our new accountant Grant Thornton. Each month statements of account are sent to you by Nomad's administrator (not us!), Phoenix Financial Services in Dublin, Eire. Please call Gavin Gray and his team (+353 18 45 8161) with your statement queries. As should taxable US investors as Gavin and his team prepare their tax certificates (1099s) as well.

Clients should always consider Zak and me to be available at the end of the phone and our (somewhat shabby) front door open to visitors. And whilst we welcome your company, please don't be too disappointed if we don't have much that is new to say: we hope it is in these letters already.

Legal footnotes

Performance numbers are produced by Phoenix Fund Services, Nomad's administrator, and have been audited by Ernst and Young to 2011, and from then on by Grant Thornton, in their annual audits that follow 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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