Clime Capital Limited (ASX:CAM)

Quarterly Newsletter

March 2012

www.climecapital.com.au

Dear Fellow Shareholder,

Welcome to the first Clime Capital Limited (CAM) Quarterly Report.

The manager of Clime Capital Limited (ASX:CAM) is Clime Asset Management Pty. Limited (the manager) and it is a fully owned subsidiary of Clime Investment Management Limited (ASX code CIW).

The manager has a broad investment mandate but it undertakes its obligations in a disciplined manner. This manner can best be described as a "value based" investment approach where retention of capital and solid income generation is a focus.

The description "value based" does require further explanation as it is a much used and abused term in equity markets. Indeed in a simplistic sense most equity investors believe they are value investors. This is because in the main a purchaser of equities is generally buying securities which they believe are undervalued. That is logical, for why else would they buy a security? However, where "value based" becomes misused or abused is where an investor does not have a logical or consistent approach in assessing value. Beauty may be in the eye of a beholder, but the assessment of value of an investment asset is not!

This does not mean that market price at any point as derived by many buyers and sellers acting simultaneously will derive value. Indeed much market price activity is the result of many acting independently in guessing, or hoping, or charting, or attempting to front run, or following, or comparing, and/ or speculating on value. All of these activities create a market price but the true assessment of value occurs away from the market and is independent of price.

The manager derives its valuations of listed securities from the actual

In this issue

and forecast financial performance of companies. The manager uses a consistent and disciplined methodology to identify companies and securities of interest. This is best described as the investment universe. From this universe a portfolio is created of 20 to 25 securities and these are acquired when their market price is at a meaningful discount to the assessment of value. In other words the market place is regarded as a place where there may be an opportunity to acquire good securities and companies based on performance and/or outlook. The chaotic nature of the market does often present the manager with opportunity, however this is tempered by a constant assessment of macroeconomic influences. We are very keen for shareholders to consider that CAM does not need to be fully invested in listed securities. Cash is regarded as working capital that also generates returns. Sometimes the macro overlay may suggest that higher cash (working capital) is more appropriate than employed capital (investment).

Thus, CAM should be considered as high conviction focused investment company. Given the concentration of the investment approach the manager also constantly monitors exposures to ensure that individual positions do not exceed reasonable levels.

The approach outlined above is working well for shareholders with the company's portfolio returns consistently out performing equity market index returns over 1, 3 and 5 years. The added feature has been a growing stream of franked dividends to Clime shareholders.

Kind Regards,

John Abernethy
Chairman

What does the ownership of Clime Capital shares provide to shareholders?

Clime Capital provides investors the opportunity to invest in a value focused closed end investment company.

This provides a number of key advantages:

- Your managers will not be a forced seller of securities in difficult times;
- Nor will we be forced buyers at inappropriate times.

This allows us to focus on protecting and growing the company's capital over the longer term.

The company invests in a diversified portfolio of Australian businesses, trusts and interest bearing securities.

Clime Capital gives shareholders access to a disciplined approach focused on a clear distinction between price and value with a macroeconomic overlay assisting asset allocation. Your manager has the ability to hold significant cash levels when we consider market risks to be elevated. Your manager has the ability to look across asset classes to seek returns. This is a unique offering in an environment where many managers are often forced to be fully invested in one asset class with asset consultants dictating weightings.

Clime Capital benefits from a strong and experienced team of value focused investment professionals. You can take comfort that your managers are invested alongside shareholders with our interests strongly aligned.

Investment Objectives & Our Process

“Our first preference is to deploy our capital into growing businesses that can self-fund their growth and create value for owners by generating strong returns on equity”

The key objectives of the company are:

- Preserve the capital of the company;
- Generate long term growth of capital and dividends without taking excessive risk.

Your managers seek to achieve the company’s objectives by purchasing securities that we understand, that have honest and capable managers and are highly likely to increase the purchasing power of the company’s capital over time. We will only purchase securities when the price on offer is below our appraised value. From time to time this will require a focus more weighted to capital preservation via elevated cash holdings and income producing securities.

At other times in the economic cycle this will require a focus on attractive growth orientated opportunities.

Returns are generated by a disciplined and transparent investment approach. The features of this approach are:

1. Acquiring positions in attractive companies when the market price on offer is at a discount to our assessment of value;
2. Reducing or closing positions when the market price is well above our assessment of value;
3. Maintaining a realistic requirement for required return for our preferred equity investments;
4. Seeking out yield in the market from interest bearing investments;
5. Reverting to cash when prices are expensive and value is not readily available in the market.

As investors, we are firmly of the opinion that price and value are different concepts. Price is what we pay and value is what we receive. While the share price is freely observable, the valuation of a company requires calculation. Our investment process identifies companies that have attractive investment characteristics, applies a consistent valuation methodology, calculates a valuation for the company and identifies the companies whose share price is below our assessment of the company’s value and cashflow characteristics.

Our first preference is to deploy our capital into growing businesses that can self-fund their growth and create value for owners by generating strong returns on equity with appropriate leverage for their business models.

The profits generated by this group of businesses are best retained by the business where their managers can deploy their retained earnings at similar return on equity levels.This is challenging to do for many our investee companies. In cases where investee companies cannot redeploy retained earnings at attractive rates we look to their managers to rationally payout these profits to us as dividends along with attractive franking credits. This allows us to make the capital allocation decision.

Your manager continually assesses investee businesses with reference to the demonstrated returns on incremental capital and the outlook for future returns on existing and incremental capital. We dislike businesses with low returns on equity and capital as well as businesses that continually ask shareholders for additional capital.

Clime Capital does not have any borrowings or the intention to take on debt.

Performance

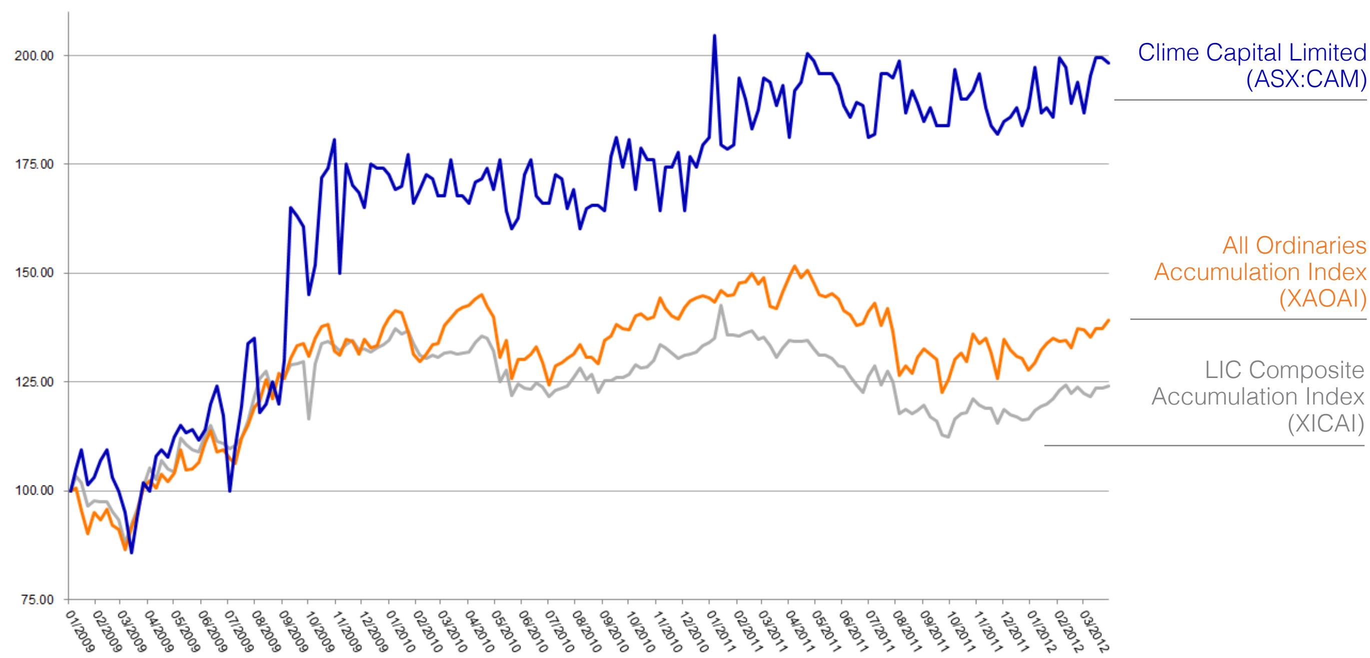
We are pleased with the medium term performance of the portfolio. We continue to focus on driving strong total returns to shareholders by concentrating on companies we understand that are available for purchase at a discount to our valuation.

Investments	31 Oct '11	30 Nov '11	31 Dec '11	31 Jan '12	29 Feb '12	31 Mar '12
Listed Securities	$53.6m	$51.2m	$52.5m	$53.5m	$52.8m	$53.8m
Cash	$9.2m	$10.5m	$9.6m	$10.0m	$11.4m	$11.5m
Net Assets	$62.8m	$61.7m	$61.2m	$63.4m	$63.9m	$65.3m

Over the past 3 years returns have been driven by a strong focus on capital preservation during uncertain market conditions. This has necessitated heavy cash weightings and a significant focus on income producing securities. Many companies have struggled to grow earnings and profitability with retained earnings due to poor business conditions and weak business & consumer sentiment.

As at 31 March 2012	1 Year	Since January 2009
Clime Capital Total Shareholder Returns	9.4%	23.5% p.a.
LIC Composite Accumulation Index	-7.8%	6.9% p.a.
All Ordinaries Accumulation Index	-6.7%	10.8% p.a.

Clime Capital Total Return vs Accumulation Indices



Data Sources: Thomson Reuters; IRESS

Dividends & Reinvestments

"each $1 invested in CAM shares has been turned into $1.93"

Considering the performance of Clime Capital Total Shareholders Return since January 2009, that is since current management took over, each $1 invested in CAM shares has been turned into $1.93 of total shareholder return as at the 31st of March 2012. This is a 23.5% compound annual rate.The total return includes dividends declared and bonus shares issued.

This is a meaningful increase of purchasing power and strong outperformance v's the LIC Composite Index and the All Ordinaries Accumulation Index which returned 6.9% compound and 10.8% compound respectively.

Clime Capital has increased franked dividend payments to shareholders by 10% over the past year.

In many businesses much of the period's profits are not free for distribution and are required for 'stay in business' expenditure. This is particularly relevant for businesses that have high levels of assets that wear out over time and require intermittent replacement along with businesses that have depleting assets. Manufacturers and miners are examples. These businesses have restricted profits, for if they do not reinvest in their production ability they will surely decline. Without further capital raisings their businesses are destined for trouble.

The much more attractive type of earnings is the unrestricted type of earnings. It is this type of earnings that we look for in our investee companies as they provide their managers the ability to consider the best use for the capital. Fortunately at Clime Capital the vast bulk of our earnings are unrestricted allowing a rational discussion to be entered as to their retention and distribution.

	FY2010	FY2011	FY2012 (estimate)
Fully Franked Dividends	$1.52M	$1.63M (+8%)	$1.80M (+10%)

Dividend policy is often reported to shareholders but rarely explained. Listed companies frequently will say something along the lines of 'Our goal is to pay out 60% of NPAT'. Often this is all the explanation shareholders receive without reasons why this policy is best for the owners of the business. The task of capital allocation is very important to the long term total returns shareholders receive. We believe managers and shareholders need to think long and hard about the conditions where earnings should be retained and the circumstances when earnings are best distributed.

It is the view of your manager that if a business has the ability to retain its earnings and produce a return on those earnings equal to or above those generally available to shareholders, it should retain its earnings. This prospective return should be backed by historical evidence over a reasonable period of time to provide a level of confidence in the decision.

"23.5% compound annual rate"

"When the investment can generate a return higher than is available elsewhere it makes sense to retain the earnings and compound them at the higher rate."

Another item for consideration for your board of directors is in Australia we benefit from the franking credits generated by your company each year when we pay tax. These franking credits are of immense tangible value to Australian shareholders, for if they are not used to offset a tax liability they are refunded by the tax office. Should these franking credits remain within a company they are eroded each year by inflation.

To illustrate let's consider an example of an investor that owns a bond earning 10% per year. The investor can elect to receive their 10% interest or to reinvest the capital in new bonds at the same 10% return. If similar investments are offering 5% returns the investor is wise to reinvest in the additional bonds and sell them immediately. This would realise more cash than they would via their interest payment even if they needed cash for living purposes.

If on the other hand the yield on similar bonds was higher at say 15%, no sensible investor would wish their capital to be reinvested at 10%. The most rational thing to do would be to request the cash and reinvest it in a similar bond earning 15%, even if an investor did not need the cash for living expenses.

When the investment can generate a return higher than is available elsewhere it makes sense to retain the earnings and compound them at the higher rate. This hurdle needs to consider the franking benefits available.

A similar thought process is adopted by your manager in the way we assess potential investment candidates and apply our asset allocation policy. The decision is not as clear cut with equity investments as the future rate of return is not guaranteed and is subject to fluctuation. This is where a sound track record offers a good platform to make rational decisions. Once a view is formed you should wish your earnings to be retained if they can be expected to generate strong returns and paid out if low returns are expected.

Since the beginning of 2009 your investment in Clime Capital Limited has shown a 23.5% compound annual rate of return. This has encouraged us to consider retaining capital and considering alternative ways to distribute the franking credits generated.

The dividend reinvestment plan continues to operate at 1% discount. If you would like to register for the Dividend Reinvestment Plan you can do so by contacting our share registry.

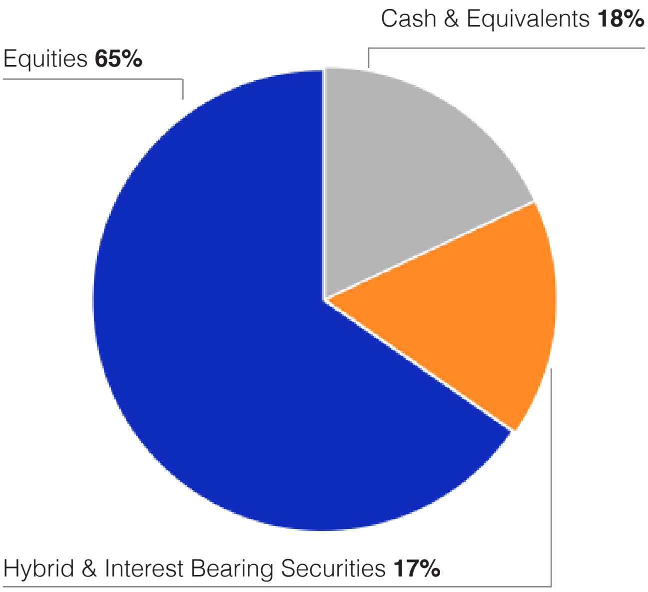
Boardroom Limited

GPO Box 3993
Sydney NSW 2001
Phone: 1300 737 760
Fax: 1300 653 459

We would like to hear shareholders view on dividend policy. Please forward your thoughts to *john@clime.com.au* and *george@clime.com.au*.

Portfolio - 31 March 2012

Since June the portfolio turnover has remained low with little need to make major portfolio changes. Most changes have been opportunistic additions to existing positions resulting from heightened volatility or trimming of existing positions to maintain target portfolio weights.



There have been modest reductions to our holding of Australand Convertible Notes, Commonwealth Bank, Ethane Pipeline and Mineral Resources.

Additions included Macquarie Bank Perpetual notes, IMF convertible notes, Multiplex Convertible Notes and Seven Group Holdings Convertible Notes, Brickworks, Mothercare Australia (ordinary shares and convertible notes), McMillan Shakespeare, OrotonGroup, Telstra, The Reject Shop, Westpac Banking Corporation and Woolworths.

We exited our position in Coca-Cola Amatil and RHG Limited as their prices ran ahead of our valuations during the period.

We started acquiring new positions in three operating businesses over the period. Each of these has been purchased at various discounts to our assessment of value and display very strong positions in their respective industries with demonstrated abilities to create value for shareholders. Once our acquisitions are complete we will comment further.

We have continued our interest in high yielding hybrid securities and shares. As noted we are still attracted to securities such as Australand notes, Multiplex Sites and Macquarie Bank debt. Our preferred high yielding equities such as Telstra and Ethane Pipeline Trust have jumped in price in recent months. Similarly we remain positive on three of the major banks and are active accumulating them when deep value and strong prospective franked yields appear. Our preferred banks at present are Westpac and ANZ while Commonwealth Bank remains our highest quality bank.

Our weighting in BHP Billiton has contracted recently along with its share price; the company represents value but its willingness to distribute its burgeoning profits to shareholders is not occurring. Whilst BHP is highly profitable its return on equity is likely to decline (along with our attraction) in coming years unless it increases the distribution of its profits.

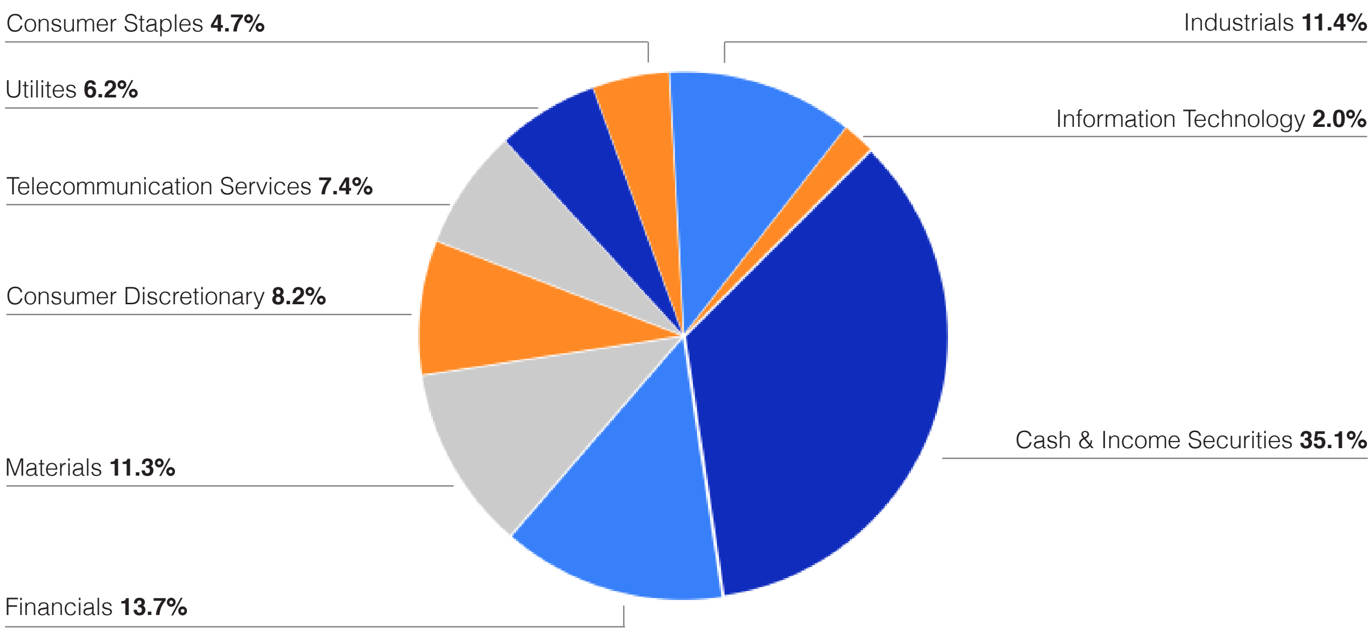
Management appears reticent to increase dividends which may be a reflection of management's incentive structure where long and short term components include shares and options, the value of which is increased by retaining profits and seeking growth instead of paying dividends.

Mining services and related businesses continue to be of interest as one of the few sectors likely to grow earnings strongly in the medium term. The elevated level of capital investment and mine development presents an attractive environment for many mining servicing companies. Our Mineral Resources investment has performed well and looking forward, we expect sound value growth.

Our interest in Brickworks through its holding in Washington H. Soul Pattinson and Co. and thus New Hope Corporation is a highly attractive asset play. This has attracted our attention by the contrarian nature of the opportunity while the building industry is around cyclical lows. These businesses are anchored by proven sound long term focused managers with clear incentives that are aligned with ours. We are confident that in due course value will be realised.

The troublesome retail sector is constantly monitored by your manager. This sector, in parts, has been significantly influenced by structural changes driven by technology and the recent strong currency. We continue to have the view those businesses in this sector that do not control their brands and are susceptible to economically viable delivery of their product will continue to struggle from overseas substitution. This is occurring through global price harmonisation and is continuing to put pressure on local reseller margins. The large department store chains look particularly weak should these industry trends continue. We continue to like OrotonGroup because of its high quality brand and skilled management. Woolworths attracts as a stable business that will benefit from its strong industry position, outstanding supply chain and population growth over time. The Reject Shop is now positioned to recommence its growth as it recovers from last year's Queensland floods. As for Mothercare we are optimistic of a successful rollout of its stores across Australia and New Zealand. The business has a strong brand and it sources product from its UK parent which enables stronger margins. Like OrotonGroup, Mothercare should be able to build a strong online and retail presence over time.

As at 31 March 2012, your manager has meaningful cash reserves, in anticipation of continued volatility, a conviction list of target companies and is poised to act as opportunities arise.

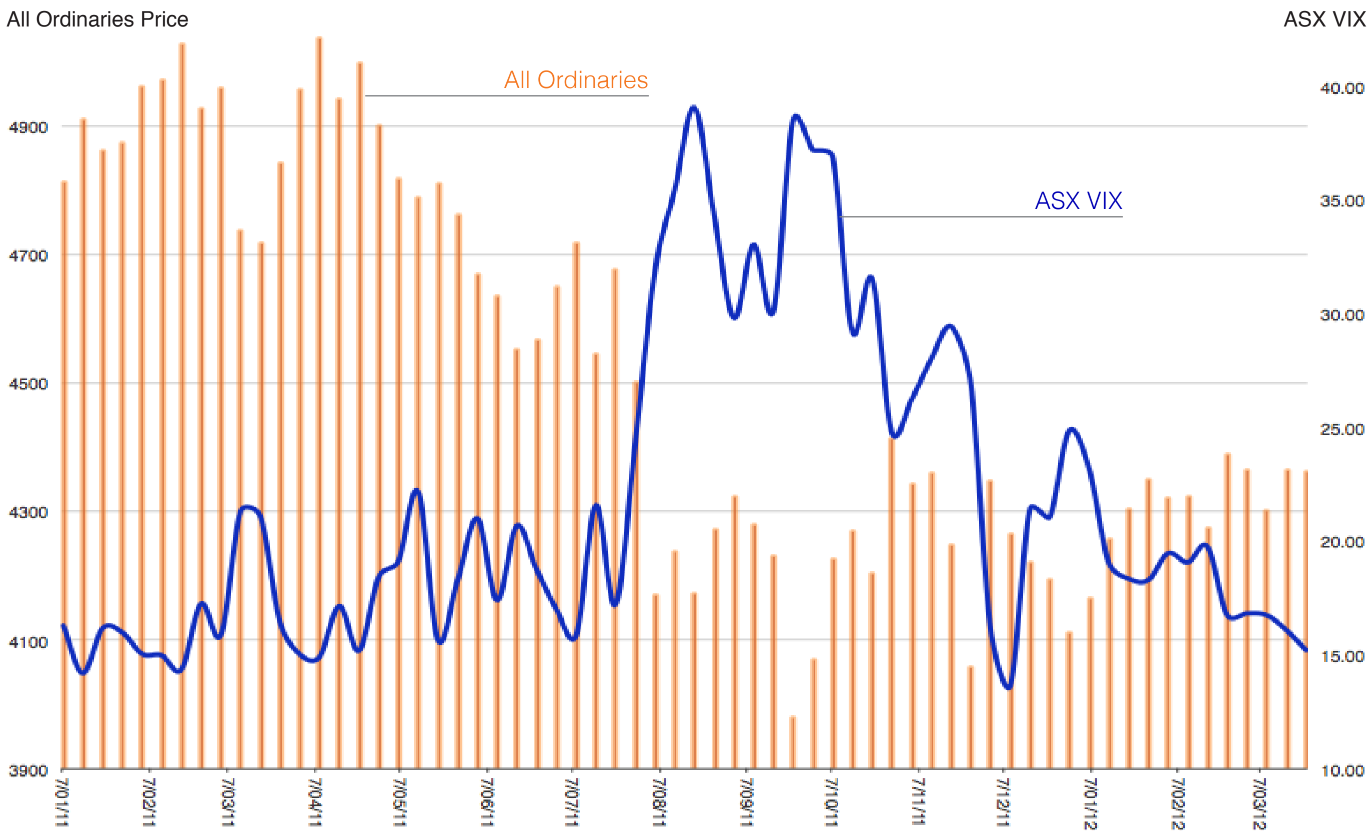


Outlook & Commentary

The year 2011 was certainly a poor one for the Australian equity market and it followed the poor market in 2010. These recent returns have sapped investor enthusiasm for equity investment which has resulted in a number of attractive opportunities for your manager. The market is likely to continue to be buffeted by global uncertainty for the immediate future as well as relatively tight local monetary conditions. The mining boom is driving the local currency to historically high levels. The strong currency is having a profound effect on the economy and the Australian share market. This has constrained many sectors such as manufacturing and inbound tourism and reducing repatriated profits for many others. Employment in non mining related sectors has been reduced which leads us to the view there is currently downward pressure on interest rates. Consumers remain highly leveraged and this is likely to be a catalyst for stronger retail spending, building approvals, employment and equity returns over the medium term.

Our monthly commentary has consistently suggested we have not been in a hurry to become fully invested in the equity market. This asset allocation view is a reflection of our macroeconomic overlay and has encouraged us to focus on income producing securities, as generally large parts of earnings retained by listed companies have not recently resulted in growing profits or profitability.

Volatility presents opportunities



Data Source: IRESS

The global economy has faced a very testing time over the last 5 years and Australia has not escaped the change in sentiment toward equities. Global growth expectations have moderated in the past few months from 5%, down to around 3.5% today. Recently investor sentiment has benefitted from continued positive macroeconomic data from the US together with the Federal Reserve confirming its current policy settings would remain in place. The US economy continues to grow at a pace that is not supportive of large gains in employment which is key for stronger corporate earnings. A protracted recovery remains our expectation.

Chinese inflation and economic growth have slowed; this was the intention of government policy tightening in mid 2011 to rein in inflation that was running some 50% higher than target. The Chinese government today has the option of loosening to stimulate growth. This is the fine line central banks walk. Whether the Chinese economy grows at 6%, 7% or 8% over the next few years the demand for commodities will increase, a positive for our resource sector. How quickly the supply side reacts will determine prices and profitability. An observation of how economies grow illustrates that as GDP per capita increases demand for base metals moderates and demand for energy accelerates. Today BHP Billiton is learning the ropes in the shale gas sector in the second largest shale gas basin globally, the US. The Chinese shale gas resource is estimated to be 50% larger than the US and 300% larger than the Australian resource. The challenge China has is it currently does not have the technology to make the best use of this resource. BHP seems to be setting the ground work to participate in this market in time.

Debt, unemployment and growth concerns continue to plague much of Europe with Germany the only bright spot due to its manufacturing sector benefiting from a lower Euro. We view the chance of a complete implosion in Europe to have reduced as a result of recent ECB actions. A €1 trillion liquidity injection was bound to have an effect however it influences liquidity but not solvency. This has resulted in the recent sentiment driven global equity rally, that may be moderating currently, as economic and earnings growth is becoming harder to see in the short term. We are positioned well to take advantage of increased volatility should Spain or Italy experience the same troubles as Greece, Portugal and Ireland.

Today, Australian businesses in aggregate are displaying sound financial health with aggregate corporate debt levels low by historical measures. The Australian equity market for the last few years has faced an earnings growth challenge rather than solvency concerns. Market wide earnings have increased by around 3.5% over the last year which is below the 20 year average of 6%. This has caused a de-rating of prices many market participants are willing to pay for equity investments and encouraged your manager to seek income producing assets during this period. We see value in the market but only small pockets of earnings growth that is the driver of profitability and value growth.

The heightened volatility of late has not been a significant concern for your manager as the pessimism it produces has presented a number of securities at attractive pricing. For focused long term holders of equity, heightened volatility presents us with the opportunity to purchase securities in which we have conviction at prices that are highly likely to provide us with healthy long term returns. Going forward should we experience similar volatility to the August – October period of last year you should rejoice as your manager will be acquiring shares in outstanding businesses at attractive prices.

In conclusion we thank you for your continued support of Clime Capital and the entrustment of your investment capital with us. Should you wish to discuss any of the above please do not hesitate to contact us.

Kind Regards,
John Abernethy, *Chairman*
George Whitehouse, *Portfolio Manager*

clime capital limited

www.climecapital.com.au

Level 5, 352 Kent Street, Sydney NSW 2000

T (02) 9252 8522 **F** (02) 8917 2155 **E** info@clime.com.au www.climecapital.com.au

Clime Capital Limited (ASX:CAM) was listed on the ASX in February 2004 to provide investors with the opportunity to participate in a long-term approach to portfolio investing using value investing principles.

The company's investment objective is to generate returns for shareholders by investing in businesses with understandable economics and excellent growth and income potential that are run by capable management.

The company was formed to provide access for all investors to a strategy intended to create long-term wealth by purchasing, at rational prices, a portfolio of businesses whose earnings are expected to increase over the years.

John Abernethy
Chairman
T (02) 8917 2107
john@clime.com.au

Adrian Ezquerro
Analyst
T (02) 8917 2136
adrian@clime.com.au

George Whitehouse
Portfolio Manager
T (02) 8917 2119
george@clime.com.au

Matthew Koroi
Analyst
T (02) 8917 2106
matthew@clime.com.au

Vincent Chin
Senior Analyst
T (02) 8917 2143
vincent@clime.com.au

Alex Hughes
Analyst
T (02) 8917 2165
alex@clime.com.au