climecapital

Clime Capital Limited (ASX:CAM)

Quarterly Report

June 2015

www.climecapital.com.au

Chairman's Letter

In this issue

Dear Fellow Shareholder,

The ASX200 price index receded by 5.5% in June and by 7.3% for the June quarter, highlighting the challenges domestic investors have faced of late. Importantly, the Australian share market's volatility over recent months is symptomatic of a long term trend that has seen limited capital appreciation.

Today the Australian equity market index sits at much the same level that it did twenty months ago (October 2013). It is also at the same level of some nine years ago in late 2006 (admittedly, the price index and not the accumulation index). Over the last financial year, the market index has gyrated around 5500 points, covering 800 points of amplitude. This ~16% movement in the index is not abnormal on a historic basis, but it has given false indications of optimism and despair at different points of the year.

There are a number of macro factors that are driving market volatility. Greece and the Eurozone have dominated the headlines recently as negotiations relating to debt restructuring and austerity programs drag on. Bearish pundits have been swift to question the stability of the less developed Chinese equity market as it continues to swing heavily. While the US continues on its slow recovery path, the rising US dollar poses an earnings threat to US domiciled multinationals.

As is often the case, there are plenty of issues for investors to reflect on and perhaps worry about. However, we should keep these issues in perspective and therefore we make the following observations:

1. The ECB's Quantitative Easing (QE) program, which commenced in March, will certainly be turned to buying Greek debt or bonds held by European and offshore banks. There will be minimal financial contagion and the ECB will follow the precedent set by the US Federal Reserve (the Fed) in 2008/09. The ECB will buy debt at face value and bury it inside their balance sheet just like the Fed did with sub-prime mortgages. Also noteworthy is the fact that the European financial system had been reducing its exposure to Greece over the last few years in its effort to ring-fence possible contagion.

2. Foreign bank exposures to Greek government debt are low and would easily be contained by the European QE program. It is worth remembering that in QE 1 in the US, the Fed acquired about $1.5 trillion of subprime mortgage debt. The Greek debt held by private institutions is minuscule compared to those US subprime loans. It is also miniscule when compared to the ECB's stated intention to buy €1.1 trillion of assets from March 2015 to September 2016.

3. Volatility in the mainland Chinese share market is symptomatic of its emergence into the world financial system. The market lifted by a massive 150% from mid-2014 to April 2015. Since then, it has corrected 20% in a few

weeks and it continues to gyrate by 5 to 10% per day. While the Chinese market enjoyed an extreme run up, note that it had failed over a sustained period to reflect the extraordinary underlying economic growth of its economy. The Chinese share market is relatively thinly traded and actually quite small relative to Chinese GDP (around 40%) or as a percentage of household assets (less than 20%). Therefore it would be a stretch to suggest that the share market swings will become a serious financial contagion issue for the underlying economy.

4. Meanwhile, developed equity markets (ex-Australia) have staged a remarkable recovery since the GFC. World equity markets have in aggregate grown at a substantially faster rate than their underlying economies. Developed world economic growth has barely averaged 1% (real) per annum, but stock markets have roared upwards as bond yields collapsed and PERs (price-earnings ratios) expanded. World equity market capitalisation is now 22% higher than the pre-GFC peak, having tripled since 2002. Hence, it is possible to argue that the Chinese equity market is playing catch-up from a period of significant underperformance.

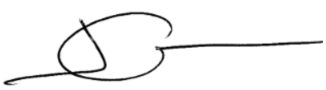
In terms of thematics, we believe that China (and Asia more broadly) will remain the key engine of global growth over the coming decade. Current indications are that the Chinese middle class will total around 500 million people by 2025, while GDP growth rates suggest China will be the world's largest economy by about the same time. Such thematics provide longer term opportunities for Australia beyond commodities in sectors such as tourism, education, agriculture, healthcare and financial services.

Domestically, we view economic conditions as subdued, with non-mining capital investment stalling and unemployment grinding higher. The outlook for the Australian economy is challenged by poor economic growth in the developed world and a sharp deterioration in our terms of trade. The $A must continue to devalue to offset the fall in our export income. However, with historically low cash rates and bond yields still apparent, it is our view that the Australian equity market now has some degree of both value and yield support following the recent pullback.

The higher level conclusion is that more of our capital needs to be allocated to foreign currency investments, with Australian investments focused on companies with solid offshore growth profiles (strong businesses as well as currency beneficiaries) and sustainable yield.

Australian-based investing is moving through a difficult period. Short term returns will remain volatile and it is a focus on the longer term that will properly determine wealth creation.

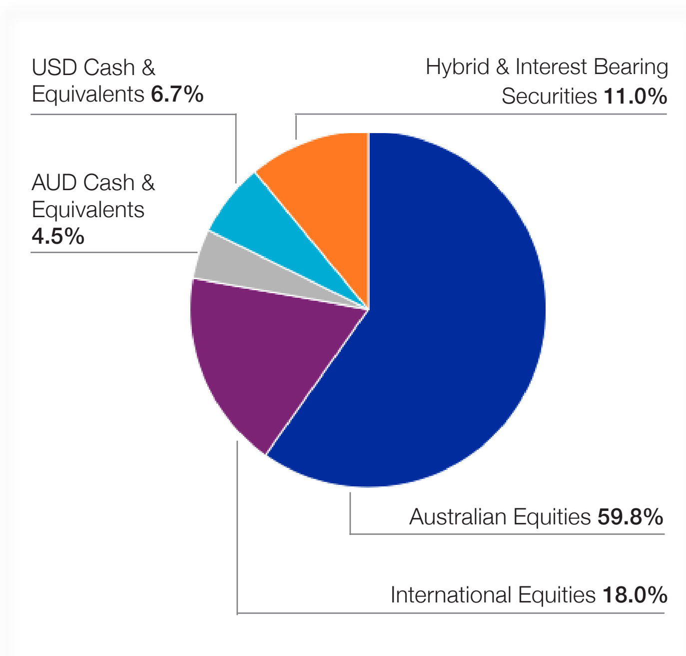
Kind Regards,



John Abernethy
Chairman

Portfolio Summary at 30 June 2015

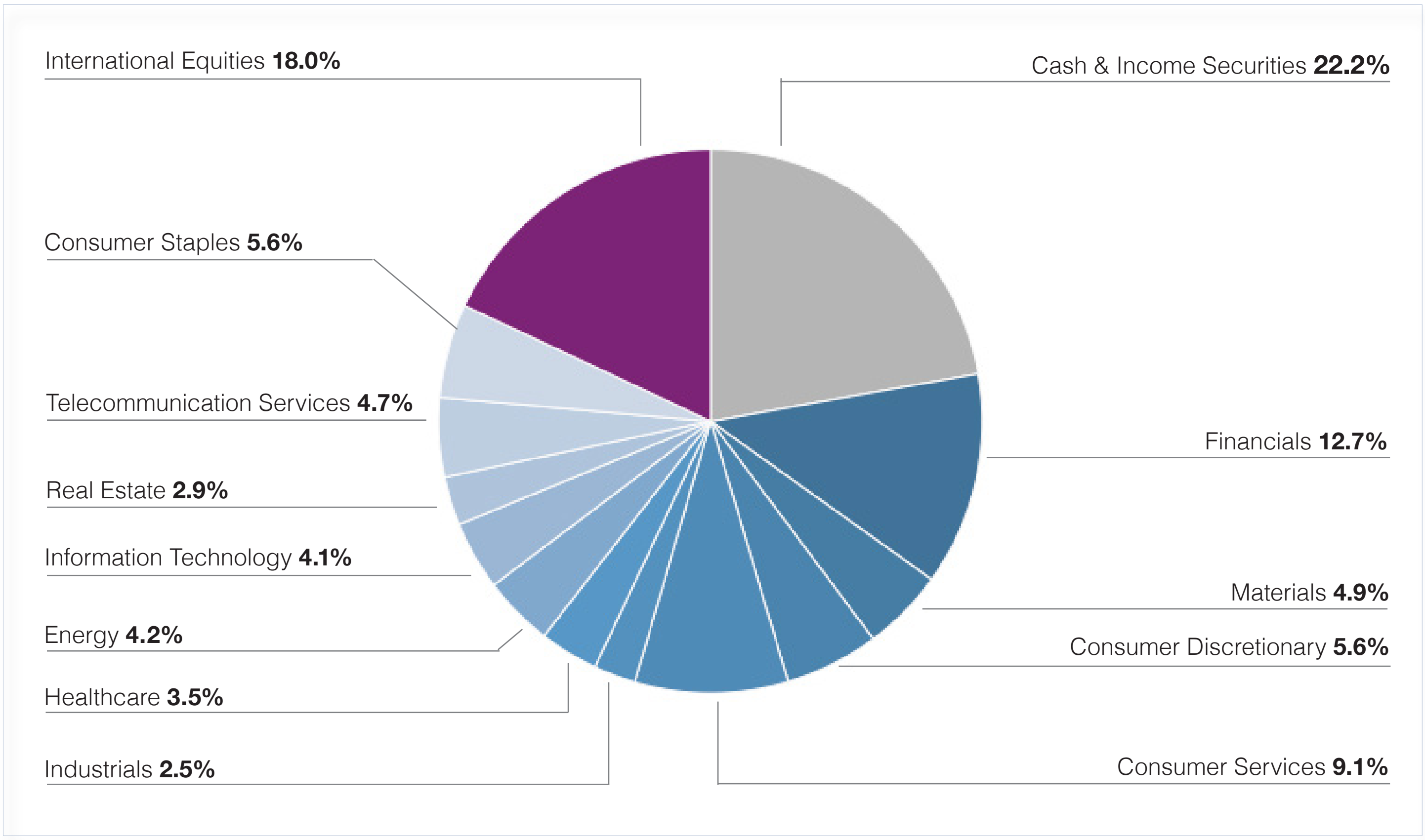
Asset Allocation



Top 10 Holdings (Weightings %)

Australian Equities	
Woolworths Limited	5.67
Telstra Corporation Limited	4.80
Australia & New Zealand Banking Group	4.42
National Australia Bank	4.38
The Reject Shop Limited	3.08
Ardent Leisure Group	2.86
National Australia Bank Notes	2.81
Macquarie Perpetual Notes	2.77
Origin Energy Limited	2.61
Dick Smith Holdings Limited	2.56
International Equities	
American Insurance Group	1.66
McDonald's Corporation	1.41
American Express Company	1.39
AUD Cash	*4.49*
USD Cash	*6.73*
Total	51.64

Sector Allocation



Australian Securities Summary

As discussed in the Chairman's Letter, the June quarter was both a difficult and volatile period for Australian equities. In line with our value based process, your manager utilised market volatility to build positions in high quality companies as value became apparent. This was increasingly the case late in the June quarter and underlines the importance of retaining cash reserves when markets are expensive. Such a strategy allows cash to be deployed when the market is sold off indiscriminately.

As introduced in the March quarterly report, we have initiated positions in a growing range of high quality companies with attractive offshore growth profiles. Volatility within the June quarter provided opportunity to add to positions in Ardent Leisure Group (AAD), Crown Resorts (CWN), CSL Limited (CSL) and Flight Centre Travel Group (FLT). These companies enjoy market leadership in their respective sectors, backed by enduring competitive advantages, whilst offering above average rates of growth in markets much larger than those apparent domestically.

The position in AAD was increased during the quarter. We believe that AAD's US focused Main Event business unit, which has delivered 21 consecutive quarters of like for like sales growth, represents a substantial long term growth opportunity for the group.

CWN has drifted back significantly over the past 18 months into a range that represents sound long term value for patient investors. CWN is a leading operator and developer of integrated resorts, with operations in Australia, South East Asia, the UK and the United States. The business has a number of greenfield and brownfield growth options both domestically and in offshore markets, in turn providing a tangible pipeline to drive earnings growth over the coming 5 to 10 years. When coupled with favourable structural changes relating to the emerging Asian traveller and a depreciating AUD, CWN is well placed to deliver growth over the long term.

CSL is a market leader in the global plasma product industry, with approximately 25% global market share. It is a high quality, high margin business that benefits from a strong focus on research and development (R&D) and above market volume increases. CSL has consistently delivered efficiency gains over the past decade, largely a factor of improving scale. This has seen EBIT margins double over the same time frame. As CSL reports in USD, investors will likely enjoy translational benefits as the AUD depreciates.

FLT is a high quality travel business with a dominant market position domestically. When coupled with a growing offshore business, now approximately 20% of FLT earnings before interest and tax (EBIT), FLT is priced quite modestly given the opportunity for long term growth. FLT has a strong net cash balance sheet while cash flow has historically been excellent. In our view, FLT offers a sound mix of growth and fully franked income.

It is often the case that attractive long term investment opportunities arise at times when great companies are faced with issues more transitory in nature. Such circumstances tend to provide more attractive near term pricing, which in our world often equates to discounts to assessed intrinsic value. To varying extents, this is reflective not only of the above set of companies, but also a number of new positions initiated during the June quarter.

In our view, Seek Limited (SEK) is one such long term opportunity. SEK suffered a near term setback during the June quarter, a factor that provided the opportunity to build a position in an excellent company. As shareholders are likely aware, SEK is a global leader in the employment classified industry with a significant global growth pipeline encompassing market leading positions in South East Asia, Mexico, Brazil and several other emerging markets. When coupled with a dominant domestic business and an embryonic learning division, SEK is well positioned to drive long term earnings growth.

If one were to look exclusively through the rear view mirror with regards to Origin Energy (ORG), a position recently initiated following considerable share price weakness, you could be forgiven for thinking that this is a company that has lost its way. The reality is ORG has invested vast sums of capital over the past 6 years for little incremental return. However, while not without risk, our view on ORG's future is decidedly more optimistic given the impending commissioning of the Australia Pacific LNG project (APLNG).

ORG is an integrated energy company involved in energy exploration and production, power generation and energy retailing. It is well placed as a domestic leader in energy retailing, with 4.3 million customer accounts across Australia. This forms the backbone of ORG's more utility like business, which in turn provides a sound baseline of operating cash flow. We believe the near term ramp up of the APLNG project, 37.5% owned by ORG, provides significant potential for earnings growth over the next 3 years.

The most recent addition to the portfolio is that of Computershare (CPU), a market leading share registry and communications business. CPU enjoys a diverse, largely offshore revenue base and its financial metrics continue to impress. Much of CPU's revenue is recurring in nature, adding resilience to the business and its earnings. Furthermore, CPU is a capital-light, high margin business that exhibits a strong cash flow profile. Longer term, we expect marginal increases in yields to drive an incremental increase in earnings derived from the substantial cash float.

While the second half of FY2015 has delivered a solid outcome in the face of a difficult market, we acknowledge that the position in the Reject Shop (TRS) has not met expectations to date and remains a 'work-out'. TRS has a new, high quality CEO in place and in our view remains inexpensive on a quantitative basis.

Further reflection on the TRS investment suggests that a rejuvenated management team has the opportunity to strip out costs whilst refocusing the business on executing well throughout its existing store network. As at June 30, TRS is on a forward P/E in the single digit range, management continues to refocus the business and its cost base, the balance sheet and cash flow profile remain solid while like-for-like sales appear to be stabilising. All factors auger well for improved operational and investment performance over the medium term.

As we have noted in the past, sustainable income represents a solid portion of the Clime Capital portfolio. In aggregate, this includes positions in various income securities such as Macquarie Income (MBLHB), National Income (NABHA), Multiplex Notes (MXUPA) and Seven Group Preference Shares (SVWPA). When coupled with a small holding in the higher yielding A-REIT Australian Industrial REIT (ANI), we expect this portion of the portfolio to continue to deliver a blended yield of approximately 6%. This strong baseline of recurring income can be used to reinvest into high quality value opportunities over time.

Finally, we added to the portfolio position in National Australia Bank (NAB) during the quarter. On market accumulation was augmented by the full take up of the rights issue. While the operating environment for banks continues to tighten, reflected by increasing equity requirements and softening net interest margin trends, we remain of the view that such factors are well accounted for in a share price that corrected heavily during the quarter. As such, we believe NAB is now well placed to deliver a solid return over the medium term, comprised largely of fully franked income coupled with incremental growth.

If you would like to discuss any or all aspects of this quarterly report, please feel free to get in touch with the team here at Clime. We assure you that despite difficult market conditions, your manager remains focused on the key goals of capital preservation and sensibly growing shareholder value over the long term.

International Securities Summary

We continued to build positions in quality international names during the fourth quarter of 2015 whilst maintaining a sizeable weighting in USD cash. Current USD exposure represents 24.6% of the total CAM portfolio.

The S&P 500 returned -0.23% during the quarter, experiencing a sharp 3% drop in the last three days of trading. The AUD/USD pair went through a number of gyrations, moving up 1.02% from 0.7615 to 0.7692 during the period. Volatility across all asset classes continues to rise.

As we detailed in our last report, our view was that the market is historically expensive and saw a higher probability of AUD weakness than U.S. market strength. Despite this, individual opportunities across the equity market exist. We maintained our cash weighting above 40% and have begun a slow accumulation of equities on market weakness.

During the period we added a number of new holdings to the portfolio. These include;

- Precision Castparts
- Procter & Gamble Company
- General Electric Company
- Google Inc.
- Diageo PLC
- Amgen Inc.

A number of positions were topped up, taking advantage of the volatility in the market. These included American Express, Baidu, Citigroup and Emerson.

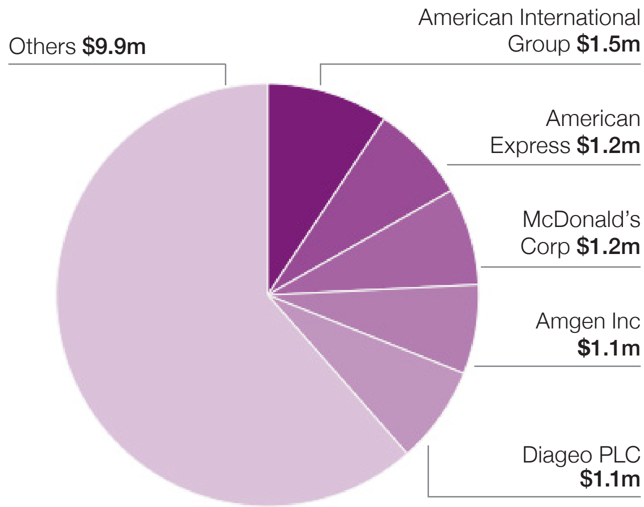
On the sell side, we sold our stakes in Estee Lauder and Yum! Brands for solid profits as well as selling out of Gazprom on a recovery from its lows. These names remain attractive investment opportunities at a more appropriate price. We also began de-weighting from U.S. automotive manufacturers General Motors and Harley Davidson as the appreciating dollar eats away at their competitive advantages. Our weighting in McDonald's was also slightly reduced to bring it in line with targeted portfolio weightings.

Our view remains that the U.S. equity market continues to present at elevated P/E ratios. This environment is supported by low bond yields but challenged by slow earnings growth.

We maintain our positive view on the USD and will continue to have significant USD exposure. If appropriate and subject to portfolio balance the portfolio manager may add an additional 10% of net assets to USD investments.

Top 5 International Securities

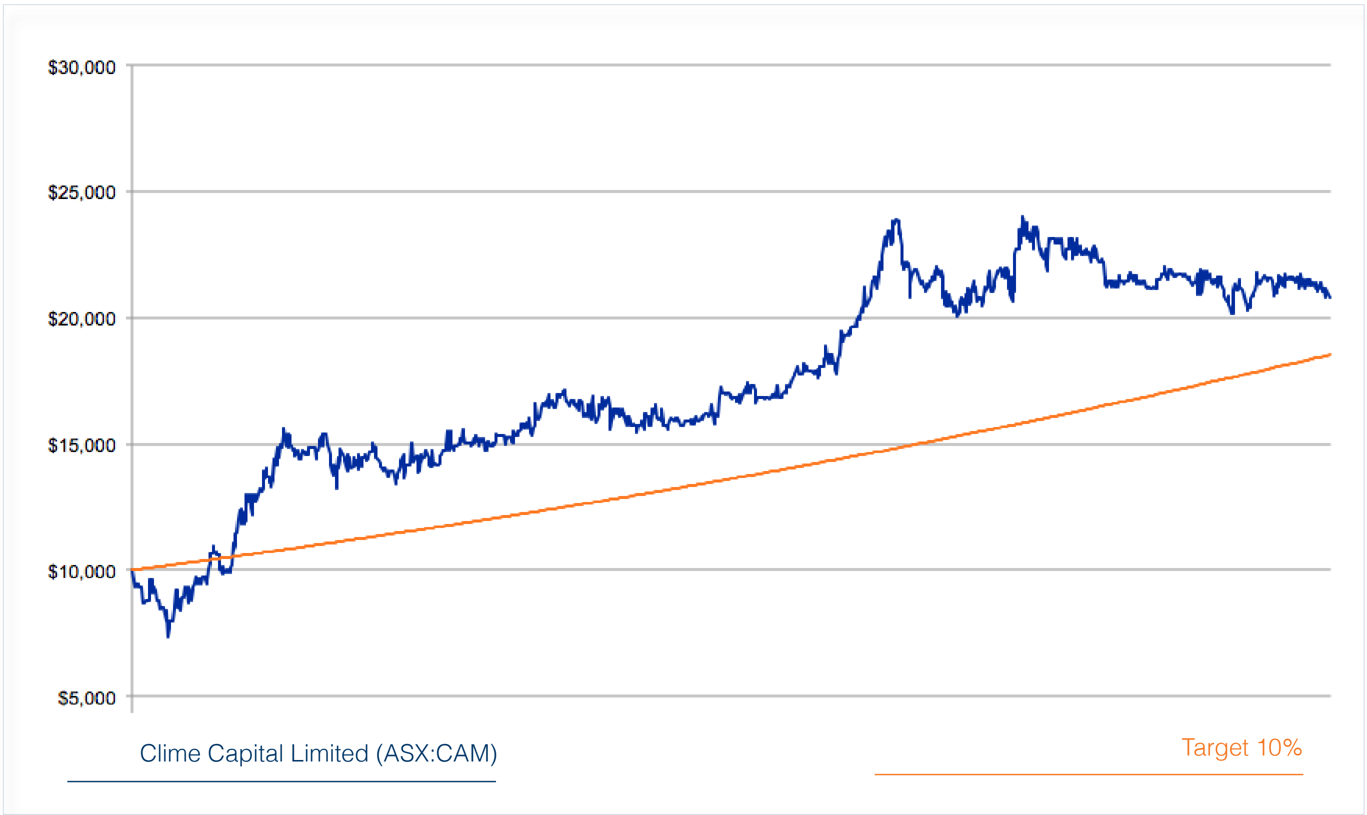
Total Equity Value: A$16.0m



Investments ($m)

	Jun '15	May ' 15	Apr '15	Mar '15	Feb ' 15	Jan '15
Listed Securities	$78.77	$77.94	$77.59	$70.7	$73.5	$71.0
Cash	$9.95	$15.27	$14.48	$24.0	$21.5	$19.3
Net Assets	$88.72	$93.21	$92.07	$94.7	$95.0	$90.3

Shareholder Returns: $10,000 (January 2009 to June 2015)



Data Source: Thomson Reuters

A focus on long-term performance

	3 years	4 years	5 years	6 years
Clime Capital Total Shareholder Returns (p.a)	6.29%	5.33%	7.96%	12.73%
Actual Total Returns	20.10%	23.09%	46.69%	105.24%

Clime returns do not include the added benefit of franking credits which are attached to dividend distributions. Further, the returns reported for Clime are after all management and transaction costs and payment of preference dividends.

The Clime Capital offer to shareholders

Clime Capital Limited ("Clime") offers investors the opportunity to invest in a value focused "closed end" Listed Investment Company managed by a recognized top performing Value Equity Manager - Clime Asset Management ("the Manager").

The Clime investment company structure offers a number of key advantages to investors.

These are:

- Clime (through its Manager's decisions) will not be a forced seller of securities in difficult times;
- Clime will not be forced buyers at inappropriate times;
- Clime pays quarterly dividends to ordinary & preference shareholders;
- High levels of transparency by being listed on the ASX.

This allows Clime to focus on protecting and growing its capital over the longer term.

Clime invests in a diversified portfolio of Australian & International businesses, trusts and interest bearing securities.

Clime has a disciplined investment approach focused on the distinction between value and price. The allocation of investment capital into the market generally and stocks specifically is tempered by the Manager's continual macro-economic overlay. The company has the ability to hold elevated cash levels when market risks are considered to be excessive or value is not apparent. The Manager has the ability to look across listed asset classes to seek absolute 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 benefits from a strong and experienced team of value focused investment professionals. The Manager is the largest shareholder in Clime and thus its interests are strongly aligned with shareholders.

Ordinary Shares Overview (ASX:CAM)	
Share Price (at month end)	$0.905
Rolling 12 Month Dividend	4.65cps
Historical Dividend Yield	5.1%
Percentage Franked	100%
Grossed Up Yield	7.3%
Dividend Reinvestment Plan	Yes

Preference Shares Overview (ASX:CAMPA)	
Share Price (at month end)	$1.40
Rolling 12 Month Dividend	18.75cps*
Historical Dividend Yield	13.4%
Percentage Franked	100%
Grossed Up Yield	19.1%
Dividend Reinvestment Plan	No

Converting Preference shareholders will accrue the bonus issue and upon conversion will receive 1.387 Ordinary Shares for every Converting Preference Share.

** With effect from June 2015 quarter, CAMPA dividends for future quarters has been revised to 4.5 cents (18 cents per annum) fully franked per share.*

About Clime Capital Limited

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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.

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