Clime Capital Limited (ASX:CAM)

Quarterly Report

March 2014

www.climecapital.com.au

Dear Fellow Shareholder,

In early March the Board of CAM announced that the investment scope of the company would be expanded so that the investment manager could introduce international shares to the portfolio.

At this point the manager has proposed that about 30% of the company's assets should be allocated to quality international equities. The manager does not propose to hedge these positions but retains the right to hedge the currency exposure.

The timing of these investments will be left to the manager's discretion but it is likely that shareholders will see investments under taken over the next few months.

To mark this expansion of the portfolio the Board undertook a 15% placement of shares to sophisticated and wholesale investors. The Board also declared an increased quarterly dividend rate (now 1.15 cents franked) and a bonus issue of options at $1.04 strike price. These options allow shareholders generally and options holders in particular, to monitor the progress of the company and to subscribe for new shares over the next 18 months if the subscription is attractive.

The decision to expand the investment universe of the company and increase the capital base of the company has met with support from the market. We believe that both decisions will increase the depth of trading in the company's shares and attract financial advisors to the company. The move by advisors to suggest their clients consider listed investment companies in preference to unlisted managed funds is in its early stages. I believe this trend will continue and strengthen as time passes.

In conclusion I am pleased to advise that the manager will be presenting to shareholders in all major cities in late May and early June. So please watch out for the invitations to these events.

Kind Regards,

John Abernethy
Chairman

In this issue

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 and 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 (as at 31 March 2014)	$1.025
Rolling 12 Month Dividend	$0.04
Historical Dividend Yield	3.9%
Percentage Franked	100%
Grossed Up Yield	5.6%
Dividend Reinvestment Plan	Yes

Preference Shares Overview (ASX:CAMPA)

Share Price (as at 31 March 2014)	$2.14
Rolling 12 Month Dividend	$0.19
Historical Dividend Yield	8.9%
Percentage Franked	100%
Grossed Up Yield	12.7%
Dividend Reinvestment Plan	No

Converting Preference shareholders will accrue the bonus issue and upon conversion will receive 1.362 Ordinary Shares for every Converting Preference Share as at last bonus – however this is being reviewed to reflect the recent option announcement.

Investment Objectives & Our Process

“Clime’s first preference is to deploy its capital into businesses that can self-fund their growth....”

The key objectives of Clime are:

- To preserve the capital of the company;
- To generate long term growth of capital and dividends without taking excessive risk.

The Manager seeks to achieve these objectives by purchasing the securities of companies that are understandable, that have honest and capable managers and are highly likely to generate superior returns over time. Securities will only be purchased when the price on offer is below the appraised value.

The investment approach is disciplined and transparent. The features of this approach are:

1. Securities are acquired in attractive companies when the market price on offer is at a discount to our assessment of value;
2. Holdings are reduced or liquidated when the market price is well above the assessment of value;
3. A realistic requirement for required return is maintained so that the risk of the portfolio is properly balanced to achieve returns without risking capital;
4. Yield is sought to enhance portfolio returns through compounding; and
5. Cash will become an important asset of the portfolio when prices are expensive and value is not readily available in the market

*“**Price** is what we pay **&** **Value** is what we receive.”*

The Manager is firmly of the view 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 judgment and calculation.

The investment process applies a consistent valuation methodology to identify companies that have attractive investment characteristics. The process calculates a valuation for the company and identifies those companies whose share price is below the assessment of the company’s value.

Clime’s first preference is to deploy its capital into businesses that can self-fund their growth. These companies 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 so long as their managers can deploy retained earnings at similar “return on equity” levels. 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 franked dividends. This allows us to make the capital allocation decision.

The Manager continually assesses investee businesses with reference to the demonstrated returns on incremental capital and the outlook for future returns on capital. Low returns on equity are not attractive nor are businesses that continually ask shareholders for additional capital.

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

Performance

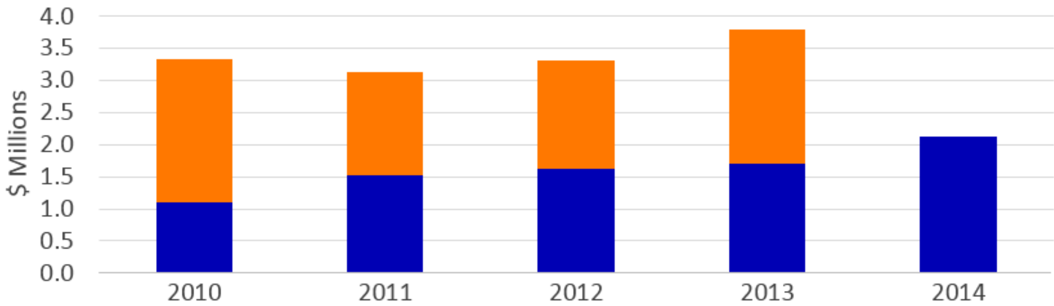
The returns of Clime, under current management, have generated strong performance over time.

As at 31 March 2014	1 Year	3 Years	5 Years
Clime Capital Total Shareholder Returns	0.2%	10.6% p.a.	21.4% p.a.
		35.4%.	163.9%

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.

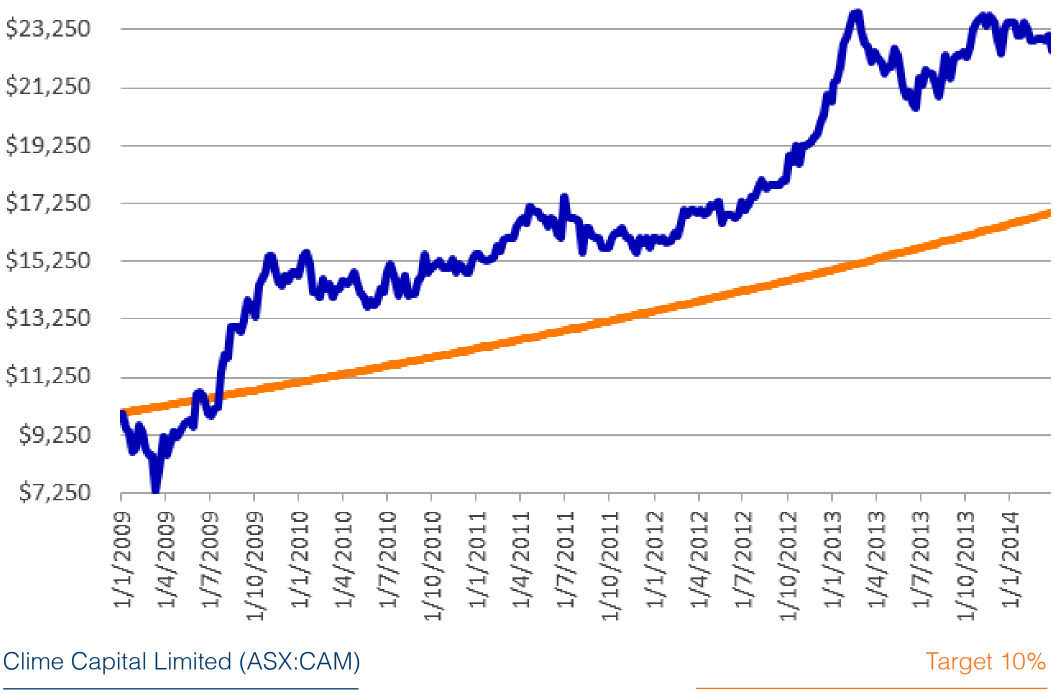
More recently and despite market volatility, the Manager has ensured that Clime's capital has been maintained along with the payment of regular quarterly franked dividends to both ordinary and preference shareholders.

Dividend Growth Over Time (July 2009 to March 2014)



	2010	2011	2012	2013	2014
2H	2.22	1.60	1.68	2.07	
1H	1.10	1.53	1.63	1.71	2.13

Year Shareholder Returns: $10,000 (January 2009 to March 2014)



Data Source: Thomson Reuters

Portfolio Summary at 31 March 2014

Investments

Investments	Oct'13	Nov '13	Dec '13	Jan '14	Feb '14	Mar '14
Listed Securities	$56.6m	$57.9m	$58.5m	$53.5m	$56.6m	$55.4m
Cash	$35.4m	$31.4m	$30.0m	$32.4m	$30.5m	$42.1m
Net Assets	$92.0m	$89.3m	$88.5m	$85.9m	$87.1m	$97.5m

Toward the end of the period the investment in Australand Convertible Notes was reduced by half as pricing close to par presented. This brings toward a close of a successful investment your company has held for the last 5 years with a cost base of $58, continuous quarterly income received & a realised sale price above $99. The investment in Multiplex Convertible Notes has displayed similar characteristics and is well on the way to a similar outcome, this investment was maintained during the period. Investments in Macquarie & National Australia Bank Perpetual Notes have been increased over the last couple of periods and are displaying sound unrealised capital gains and low risk income profiles, medium term potential for capital gains is strong and risk of default quite low.

The holding in BHP Billiton (BHP) was marginally reduced over the period as price traded above value. Call options were sold over a quarter of the BHP investment as we are content with both possible outcomes, to either sell our shares at prices above our estimate of value or to receive elevated income in the meantime. We continue to have a distinct preference for BHP over RIO due to BHP's wider diversification and long life expandable assets that are producing at low points of the respective cost curves. BHP's first half result was sound on the metrics that matter, earnings, dividends, cash flow and gearing. Strong outcomes on productivity as debottlenecking initiatives started over the last year or two completed and increased production, particularly in the iron ore business. Reductions in exploration spend and capital expenditure contributed allowing meaningful free cashflow generation and the resulting capital management speculation.

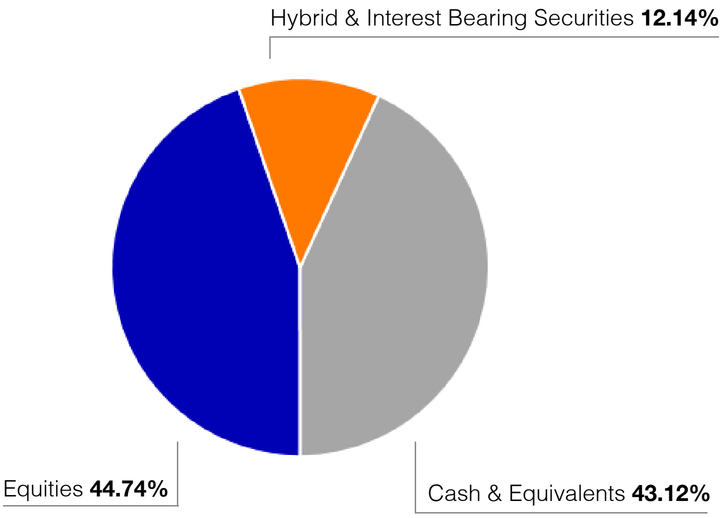
As discussed at the AGM in November the investment in The Reject Shop was reduced meaningfully in 2013 as excessive pricing presented opportunity and the assumption that execution on the store roll out opportunity would occur without incident became the consensus view. Equity investments always entail risk & reward, at elevated prices relative to fair valuations risks of not obtaining a satisfactory investment outcome increase. It is at these points your manager reassesses the equity holdings.

It became evident in January that The Reject Shop encountered a bump in the execution of its roll out strategy and a lower gross margin was the result along with the expected elevated store roll out costs. This bump has created a buying opportunity as the market overreacted. The business model is tried and sound, the infrastructure is in place, the store network

expanded and the balance sheet is in good shape. The board is searching for a CEO replacement and appears well down the path to finding a seasoned retailer.

During the period we maintained the holdings in Westpac Bank (WBC) & Australia & New Zealand Bank (ANZ). Market pricing for local banks continues to be buoyant and WBC is approaching levels we would consider reducing the investment as the forward looking return is moderate. Credit conditions remain benign and credit growth moderate, as a result capital generation is sound allowing healthy dividends to be paid. We expect sound results from the three major banks reporting in early May however market prices are reflecting this view. Our caution on local banks is elevated.

Asset Allocation



The investment in Ethane Pipeline was sold late in 2013 and early in the period. This closed a long term successful investment. The asset remains sound however there is increased uncertainty and lack of transparency around the contract for ethane and the intentions of the single consumer of the ethane. The decision to sell the investment was taken following the switch from a take or pay arrangement to a fixed change & volume based payments, this change occurred late in 2013. We continue to monitor this security for opportunity.

The investment in NWH Holdings was liquidated early in the period as the price ran through our forward estimate of value. Management & the fundamentals continue to screen attractive however we have become a little more cautious around the outlook for new contracts & margins in the sector.

A reduction in the Telstra investment occurred during the period as the share price touched five year highs and the price continues to trade above our NBN adjusted valuation. Telstra has produced strong unrealised capital gains and elevated income returns for your portfolio. Telstra remains in a strong position to increase its participation in the revised NBN plans the new federal government are implementing.

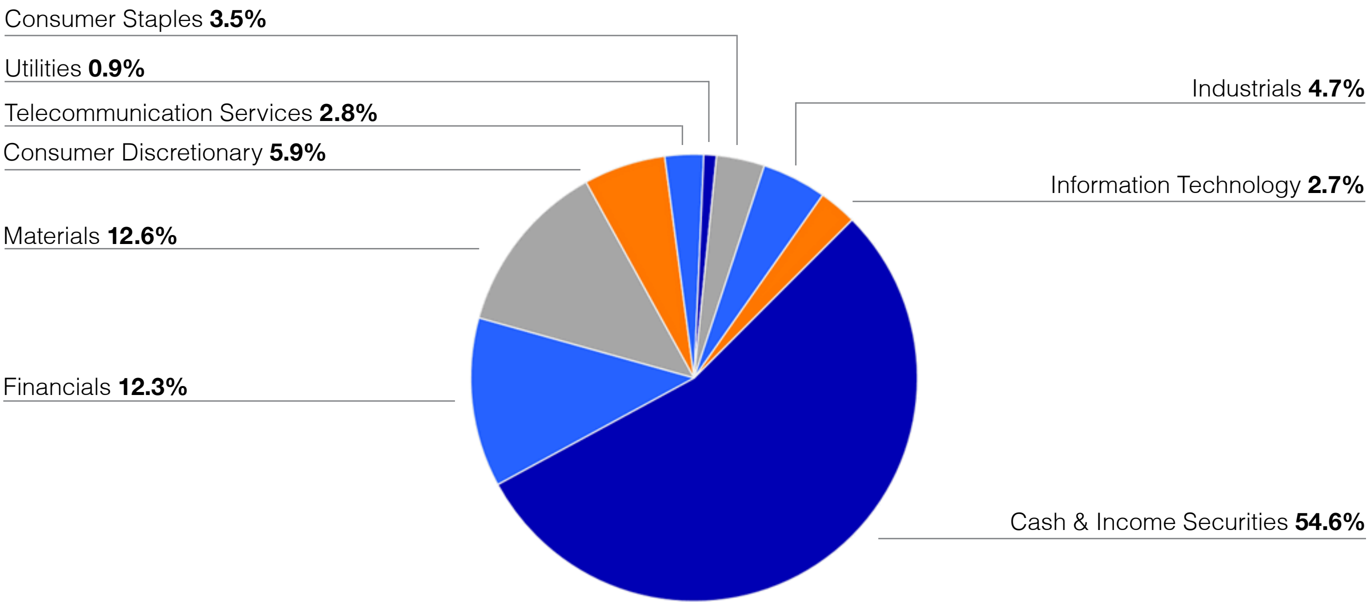
New investments in Austal Limited, Bentham IMF Limited & Sunland Group occurred during the period as sound business strategies & performance and sound forward looking return profiles attract.

Reflecting a thematic we have embraced over the past several years, an improving building cycle, the holdings in Brickworks Limited (BKW) was maintained and tangible impacts of increasing activity are starting the become clear in the P&L, particularly via the operating leverage the business is starting to enjoy. BKW continues to trade marginally above our valuation however not high enough to encourage action. BKW continues to have outstanding management on the operating business and strong leadership from the board around capital management, a rare combination that provides investors a level of certainty few building product companies enjoy. We remain cautious that at price levels above valuations, strong business performance outcomes are necessary for the investment to own its position in the portfolio.

As at the 31st March Clime holds a meaningful cash reserve, in anticipation of continued opportunity both locally & internationally.

Top 10 Holdings as at 31 March 2014	Weightings
BHP Billiton Limited	7.47%
Australia & New Zealand Banking Group Limited	5.01%
Brickworks Limited	4.04%
Multiplex Convertible Note	3.84%
Westpac Banking Corporation Limited	3.61%
Woolworths Limited	3.44%
The Reject Shop Limited	3.26%
National Australia Bank Notes	2.86%
Telstra Corporation Limited	2.76%
SMS Management & Technology Limited	2.70%
Cash & Equivalents	***43.12%***
Total	***82.11%***

Sector Allocation



Outlook and Market Commentary

Over the recent past the Australian equity market has traded sideways with minimal volatility and marginally above our assessment of value. While sporadic opportunities have presented and have been taken, broad equity opportunities have been minimal lately. Our focus is twofold, protect shareholders capital & generate healthy real returns over the medium to long term. To achieve these outcomes we focus on estimating value of operating businesses, buying shares when the risk/reward probability is tilted firmly in our favour and considering selling shares when the probability of sound forward returns is not evident.

It has been quite some time since the local market experienced a meaningful correction and the volatility index (VIX) has been quite subdued since mid 2012, rarely trading above 20. From our anchor point of fundamental value typically broad buying opportunity appears as volatility & uncertainty increase and selling opportunity presents during periods of optimism, typically reflected in low VIX readings.

Indeed in early April we saw one of the four lowest VIX reading since the data series has been produced, two of the other four low points have been recorded since January 2013. As a result over the recent periods we have seen more opportunities on the sell side and lower opportunities on the buy side. This lack of fear in equities pricing is a result of negative real interest rates in Australia and across many parts of the developed world driving investors up the risk curve in search of adequate returns, this has distorted the pricing of risk.

Central banks via monetary policy are clearly influencing asset prices and attempting to drive confidence & consumption via the wealth effect. So far confidence has lifted however economic activity & consumption, particularly in developed markets, remains subdued in the face of unprecedented monetary policy & debt levels. It is this mix of rising and somewhat elevated asset prices, subdued earnings growth and ultra-loose monetary policy that continue to give us reason for caution.

Following the board's decision to engage your manager to invest up to 30% of the portfolio in internationally listed securities we have been busy building the requisite additional dataset and progressively adding new names to our investment universe. Our database is large, some 80,000 listed securities globally, our valuations today cover the MSCI World index of approximately 1,600 securities and our investment universe has expanded by approximately 100 names so far. Our enthusiasm for embracing new businesses in various industries unavailable locally is tempered by the observation that equity prices on a local & global scale are not attractively priced at broad market levels.

On broad metrics we view the MSCI USA & MSCI World indices as trading 17% & 10% above our estimates of value. There are pockets of opportunity and this is where our primary research is focused. We have looked in detail at quite a number of outstanding businesses listed in different parts of the world. Many have remarkable fundamentals & business models however today find ourselves wanting a little more 'margin of safety'.

In conclusion we thank you for your continued support of Clime Capital and the entrustment of your investment capital with us and we would like to welcome our new shareholders as part of the company's recent placement. Should you wish to discuss any of the above please do not hesitate to contact us.

Kind regards

George Whitehouse
Portfolio Manager

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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