Clime Capital Limited (ASX:CAM)

Quarterly Report

March 2013

www.climecapital.com.au

Dear Fellow Shareholder,

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

Thank you to all those shareholders who supported our recently conducted rights issue. It is pleasing to report that the issue was oversubscribed and the Directors were required to scale back applications.

The capital raising has increased the size of the company's portfolio to about $90 million and lifted the company's cash holding to about $27 million or 30% of gross assets. This cash puts the company in a sound position to invest when opportunity presents itself and indeed in the first week of April the investment manager has identified a few opportunities to employ capital.

However, the ability to aggressively deploy capital at present is certainly tempered by the market prices of our favoured securities. The general rise in market prices up until February was generally indiscriminate between poor, average and good companies. This was because market prices exhibited a general repricing of equities shown by an expansion of price earnings ratios. Company earnings did not grow much in the December half just reported and expectations are not suggesting much growth in the next 6 months. Thus share prices have generally increased independent of earnings.

Last quarter I outlined the perverse effects of quantitative easing (QE) to increase the prices of investment assets and most recently the Central Bank of Japan has substantially accelerated its QE programme. The nightmarish scenario being played out in Cyprus, the rolling recession of Europe and the precarious outlook for the UK suggest that equity markets are likely to track sideways with increased volatility. Our large cash holding will allow the company to increase its holdings of our preferred equities.

Given the world economic situation, there is clearly no hurry to invest and indeed this reality seems to have swamped the Australian market in recent weeks. Our elevated dollar with a lack of response from either the Government or the Central Bank suggest that many Australian industries will remain under pressure in coming months.

Like many of you, I lament the lack of leadership and vision present in our Parliament and our bureaucracy. However, despite this impediment, Australia will continue to grow in a lop-sided and sporadic fashion. That is the good news for long term value investors and this is where Clime Capital Limited is focussed.

Kind Regards,

John Abernethy, Chairman

In this issue

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 Australian Value Equity Manager - Clime Asset Management ("the Manager").

The Clime Listed 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; and
- 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 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 2013)	$1.11
Rolling 12 Month Dividend	$0.04
Historical Dividend Yield	3.6%
Percentage Franked	100%
Grossed Up Yield	5.2%
Dividend Reinvestment Plan	Yes

Preference Shares Overview (ASX:CAMPA)

Share Price (as at 31 March 2013)	$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 1.30967 Ordinary Shares for every Converting Preference Share.

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. Positions are reduced or closed 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 judgement and calculation.

The 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.

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

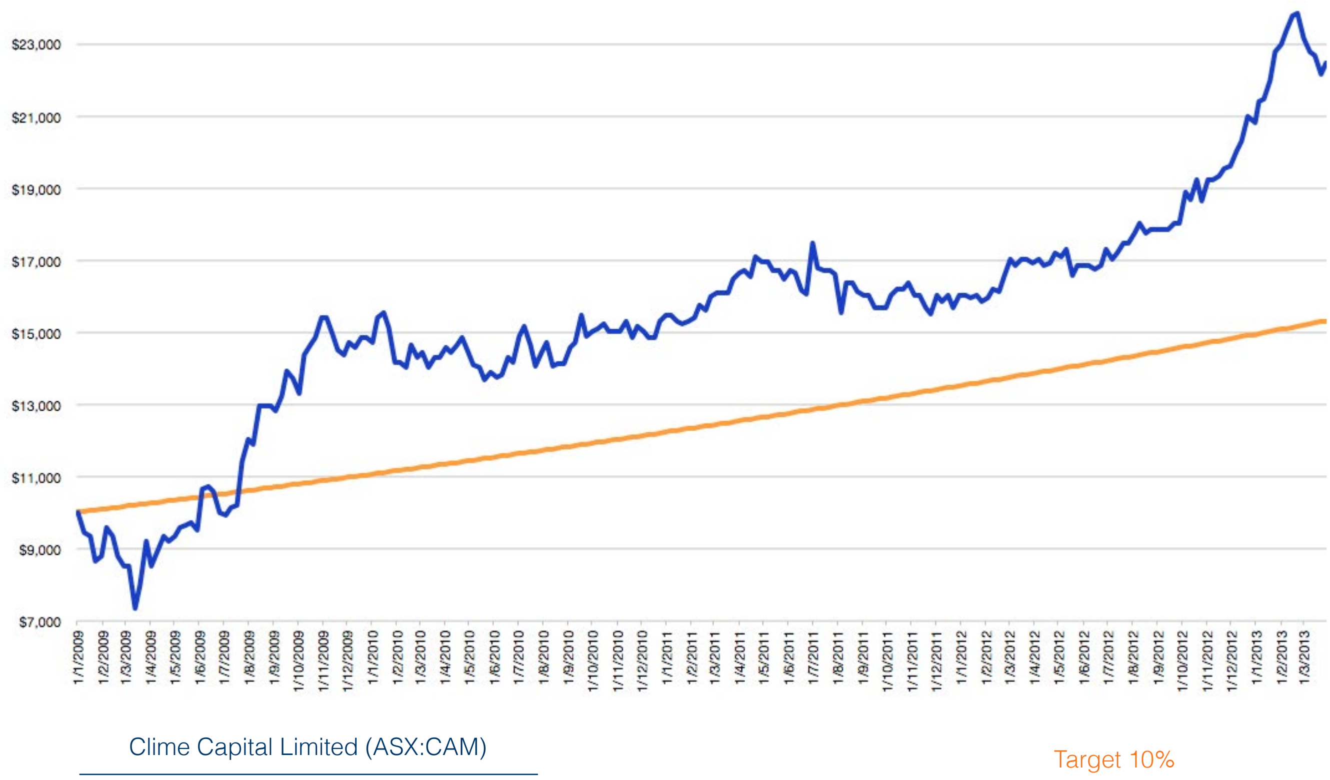
The returns of Clime, under current management, have generated strong outperformance over time.

As at 31 March 2013	1 Year	3 Years	5 Years
Clime Capital Total Shareholder Returns	32.7%	15.5% p.a.	11.6% p.a.
All Ordinaries Accumulation Index	17.8%	5.0% p.a.	2.8% p.a.

Clime's 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.

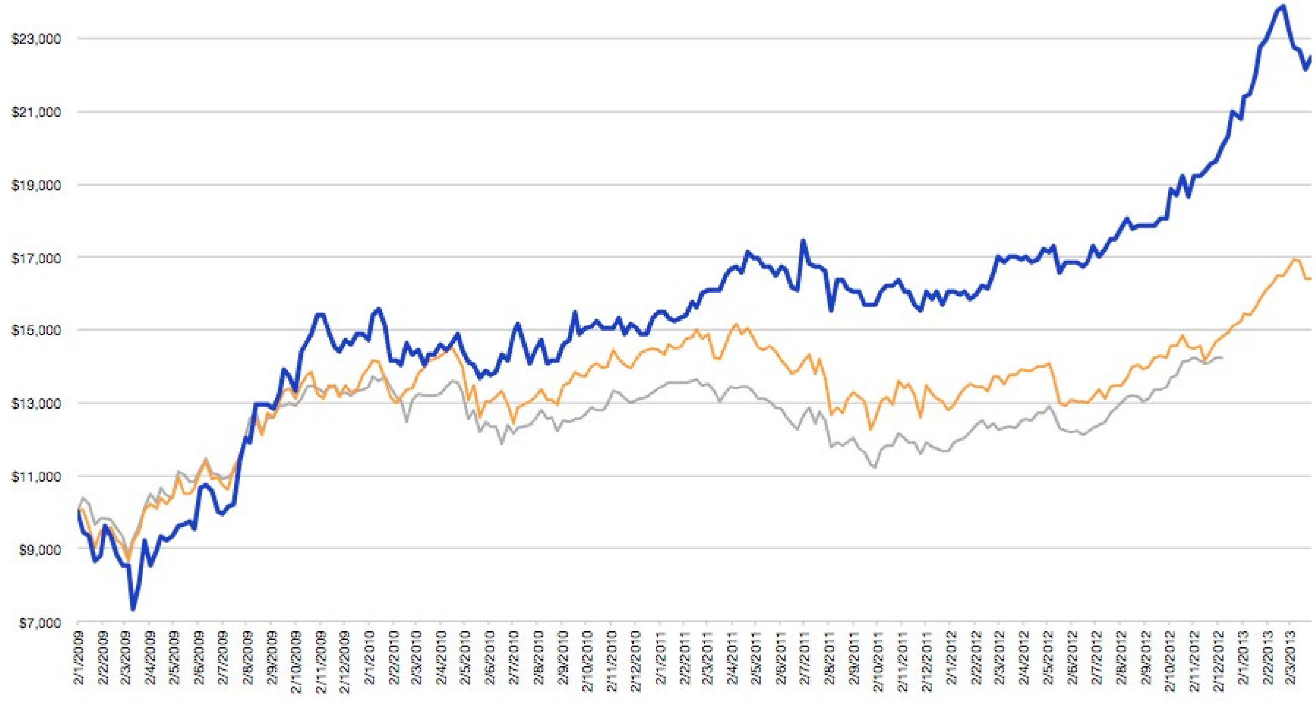
More recently and despite market volatility, the Manager has ensured that Clime's capital has been maintained along with the payment of regular quarterly dividends to both ordinary and preference shareholders.

Year Shareholder Returns: $10,000 (Jan 2009 to Mar 2013)



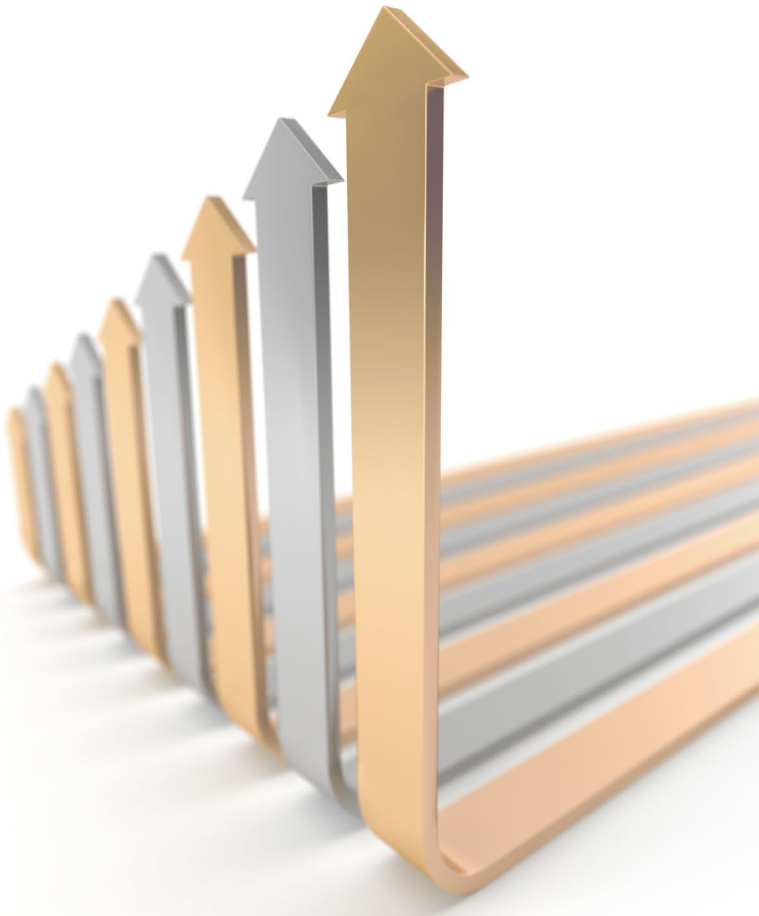
Data Source: Thomson Reuters

$10,000 invested in Clime Capital vs LIC and Accumulation Indices



Clime Capital Limited (ASX:CAM) All Ordinaries Accumulation Index (XAOAI) LIC Domestic Accumulation Index (XICAI)

Data Sources: Thomson Reuters; IRESS



Portfolio - 31 March 2013

Investments

Investments	Oct'12	Nov '12	Dec '12	Jan '13	Feb '13	Mar '13
Listed Securities	$56.6m	$56.7m	$57.7m	$61.5m	$60.3m	$61.0
Cash	$10.7m	$10.6m	$11.5m	$9.5m	$16.7m	$15.0
Net Assets	$67.3m	$67.3m	$69.2m	$71.0m	$77.0m	$76.0

Over the period the holding in IMF convertible notes was liquidated as the price appreciated reducing the expected return profile. This position was replaced with National Australia Bank floating rate notes which are trading at a significant discount to face value, displays sound credit characteristics, offer medium term capital upside and acceptable short term yield. Holdings in Australand, Multiplex & Seven Group Holding Convertible Notes were maintained over the period and have continued to perform as expected. When reviewing asset allocation the manager considers hybrid type securities as alternates to equity investments when risk adjusted opportunity to invest in equity does not exist. Current hybrid asset allocation is approximately 12%.

The holding in Harvey Norman Limited was liquidated in the quarter as the share price appreciated past our assessment of value and the target return was achieved. The holding in Shopping Centres Australia, accumulated over the previous quarter via the in specie distribution as well as on market was liquidated above NTA. While buying equities with demonstrated enduring earnings power is our primary focus the manager will from time to time purchase asset rich opportunities that display cyclical or catalyst characteristics.

The holding in BHP Billiton was marginally increased toward the end of the quarter as attractive pricing presented, BHP's portfolio weight decreased marginally due to price weakness and the incoming Placement share capital.

Early in the period holdings in the major banks were increased by approximately 1% each reflecting the manager's view of acceptable discounts to appraised valuations and improving leading indicators for the industry. As the period progressed many of the identified leading indicators became apparent and our meaningful investment in the major banks performed well. Today major banks prices trade at approximately our appraised valuations and yields have compressed somewhat. We expect much more muted total shareholder returns from this point. Clime's investment process identifies three key areas of return generation.

i. Rerating of price to value.

ii. Ongoing dividend yield and associated franking &

iii. Value growth over time as the businesses redeploy retained earnings.

With our holding in the major banks today we have enjoyed item one and continue to hold in anticipation of items two and three however keep a vigilant view on the industry as the level of leverage and sensitivity to broad economic conditions is high.

The holding in OrotonGroup was liquidated in the quarter as attractive pricing presented. Oroton remains a well-managed profitable business however the range of possible outcomes from the redeployment of capital following the cessation of Ralph Lauren licence remains large with meaningful positive or negative outcomes unpredictable. We are content to watch from the sidelines until a clearer picture appears as preservation of capital is paramount in the manager's investment approach.

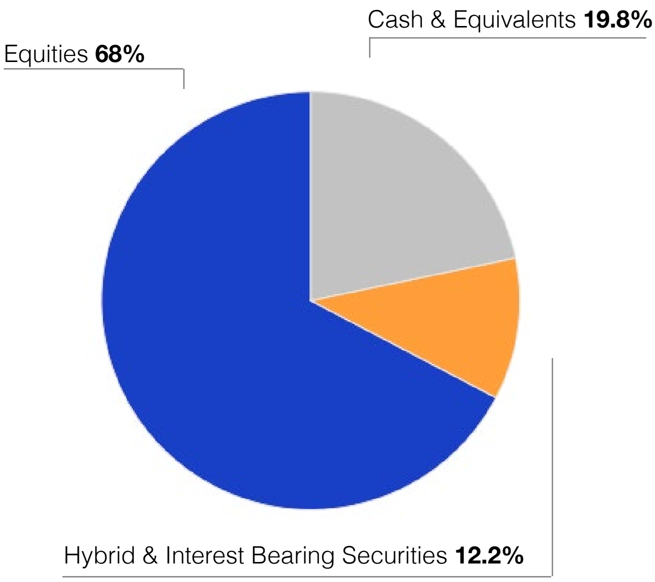
New holdings in Nick Scali & SMS Management & Technology were built during the period as these highly profitable, well managed cyclical businesses pricing became attractive. Nick Scali is a remarkably profitable furniture retailer operating toward the upper end of the market. We have a positive view on the residential building cycle where Nick Scali is a later cycle beneficiary. The business reported a stronger than expected first half result and management expressed optimism for the full year. SMS Management & Technology, an IT consulting company is a high quality however cyclical business operating in an industry with bright longer term prospects and weak short term leading indicators. This is currently providing an opportunity at attractive pricing with business confidence likely to improve post the upcoming federal election driving business investment.

The long term Reject Shop position was reduced during the period as pricing reflected an overly optimistic view of the likely forward looking profitability. The business reported strong performance reflecting successful strategy execution and a weak competitor. This resulted in recent strong share price appreciation. Share prices significantly above assessed valuations reflect an opportunity to capture tomorrow's investment returns today and serve to increase risk of subpar future returns.

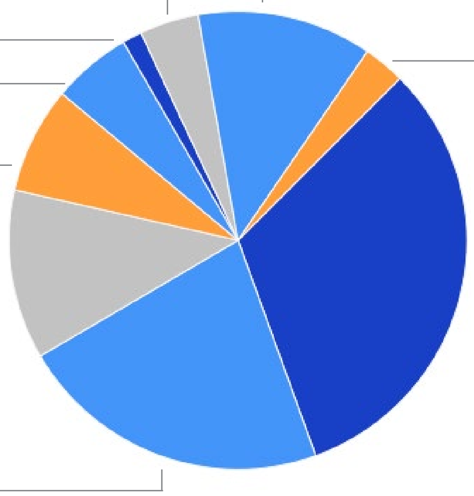
Holdings in Brickworks Limited, Reece Australia, Thorn Group, Treasury Group and Fleetwood Corporation were maintained and all have displayed sound performances stemming from diverse and sound underlying business fundamentals.

As at the 31st March Clime holds a meaningful cash reserve, in anticipation of continued opportunity however the lower RBA cash rate has reduced the relative attractiveness of holding cash and equivalents. As a result of the recent Placement & Rights Issue the cash holding is somewhat larger than our ideal asset allocation. With an absence of significant mispricing of equity today we feel patience is necessary with history illustrating opportunity can present swiftly.

Asset Allocation



Sector Allocation



Top 15 Holdings as at 31 March 2013	Weightings
BHP Billiton Limited	7.17%
ANZ Banking Group Limited	5.92%
Westpac Banking Corporation	5.92%
Telstra Corporation Limited	5.65%
Multiplex SITES Trust Convertible Notes	5.09%
McMillan Shakespeare Limited	4.97%
Brickworks Limited	4.79%
Commonwealth Bank of Australia	4.78%
National Australia Bank Limited	4.32%
Woolworths Limited	4.17%
Mineral Resources Limited	3.77%
The Reject Shop Limited	3.23%
Thorn Group Limited	2.23%
Australand Convertible Notes	2.20%
Seven Group Holding Convertible Notes	2.08%
Cash & Equivalents	**19.83%**
Total	**86.12%**

Market Outlook

Australian GDP growth is broadly in line with the longer term trend, inflation is within the RBA's target range and unemployment remains low in historic and absolute terms while the participation rate remains toward historic highs. The short term outlook for these key metrics remains relatively stable. This supports the RBA's view that interest rate settings are about right, albeit with current capacity utilisation and business confidence relatively low. The more interesting debate centres on how the economy will cope with a peak and then a declining level of mining investment that appears near. There is some evidence such as consumer confidence & increasing house prices to suggest the interest rate reductions of the last year or so are having the desired stimulatory effect. However indicators such as business conditions, job advertisements and manufacturing activity are still performing poorly, significantly influenced by the strong AUD. Our view remains that the transition is unlikely to be as smooth as the RBA may like which will result in a further loosening of monetary policy, particularly so should the local currency remain at elevated levels. The high AUD continues to be a significant constraint on the Australian economy, & share market, however identifying a catalyst for a correction remains elusive.

Positively the yield curve has recently turned positive suggesting bond markets are perhaps a little more optimistic about forward looking economic activity. The broader equity asset class is trading around our estimate of value for year end with broad mispricing absent. The rerating of equity over the last year or so in the face of very low earnings growth is typical of equity markets forward looking nature. There continues to be pockets of individual equities with varying degrees of mispricing relative to assessed valuations that we are continuing to focus upon.

In the broader global economy significant challenges persist in the face of very accommodative financial conditions, the hangover from the credit binge continues to reverberate particularly throughout Europe where the crisis is not over. Global growth is likely to be lower than longer term averages for some time however many of the downside risks appear to have reduced and broader sentiment has improved driving a rerating of equity prices over the last year or so.

The outlook for the Chinese economy remains a hot bed of debate with a number of bearish global commentators getting media attention of late. In our view the Chinese economy, like all economies, has weaknesses and capital misallocations however it also has significant strengths that differentiate it from many peers such as, no net sovereign debt, persistent trade surpluses, significant foreign assets, a competitive currency and a resulting strong fiscal position. While the double digit GDP growth rates of years gone by are highly unlikely to re-emerge, growth rates in the 5-7% range on greatly enlarged GDP base offer significant opportunity. An often cited bear argument is overbuilding of residential property. Whilst superficial analysis would suggest some substance to this view, particularly relative to western experience. In a centrally planned Chinese economy that is rapidly urbanising the characteristic is less alarming. Particularly due to government controls that only allow localised investment, a weak equity market, negative real interest rates from banks and a poorly developed bond market. It is of little surprise property investment is popular. According to the OECD some 300 million citizens will move to urban areas before 2030, at 3 per household 100 million new dwellings will be required along with significant infrastructure and consumer goods. The vacant properties are highly likely to be occupied in due course, a good case study being

Shanghai's Pudong which in the 1990's was a large construction site without residents, today a vibrant area with a 6 million population. Recent research suggests that housing inventory is currently below longer term averages and housing starts are improving. Housing affordability appears a little stretched on a global basis however the current average Chinese property price to income ratio is the lowest in a decade.

On the broader economic front recent Chinese data points to a mild recovery with positive data on exports, retail sales, vehicle sales, infrastructure investment and manufacturing activity. The chances of a sharp economic slowdown appear to be receding.

Significant challenges remain and one key to the Chinese story, of strong significance to the Australian economy, is continuing urbanisation, the time for concern would be if this slows sharply, possibly toward the end of the 2020's. In the meantime typical supply & demand cycles and volatility are the most likely outcome in a rapidly developing economy.

Japans recent policy action aiming to create inflation is likely to have meaningful second order effects on several of its trading partners as the BoJ aims to double the monetary base over the next two years. As with US quantitative easing much of the new capital is likely to seek higher returns in asset classes around the globe such as equities, real estate & bonds. As the policy actions act to weaken the Yen and stimulate the economy take hold, profound effects will result that are already being priced into Japanese equities. Consumers in the market for products from the likes of Toyota, Honda, Hitachi, Nissan, Mitsubishi, Fujitsu or Sony are likely to see prices in AUD fall meaningfully. Competitors manufacturing product in other parts of Asia including Australia are likely to face significant margin challenges as pricing pressures escalate, the local automotive & steel industries certainly will have their work cut out to remain viable. The much discussed currency wars are continuing and second order effects for local manufacturing employment appear a likely casualty.

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,
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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