27 March 2020

Company Announcements
Australian Securities Exchange

CLIME CAPITAL LIMITED (“CAM”) UPDATE

Dear Fellow Shareholder,

The directors of CAM have refrained from writing to shareholders until we noted a semblance of stability in equity markets, Government health directives were understood and the resultant economic outlook became slightly clearer.

To some extent most of the above has transpired and in this letter, we will update shareholders on a range of important matters.

Gross Portfolio Value

The gross portfolio value is currently oscillating at around $105 million in value with cash holdings approximating $25 million (including market hedges) and unlisted securities valued at $10 million.

Over the last month, as the coronavirus began to affect markets, the Investment Manager has undertaken some prudent adjustment of portfolios as it became increasingly obvious that Government directives would seriously undermine either the business operations or the trading environment of many companies in our portfolio.

Whilst many of the Government directives are absolutely necessary, the consequence for important parts of the Australian economy are very negative. For example Tourism, education, some aspects of healthcare, consumer related stocks, property funds and any company reliant on the movement of people (like shopping centre tenants and landlords) are badly affected. Many other companies have serious second order affects.

International facing companies have their own issues and affected by similar overseas government directives to those seen in Australia.

Consequently we are witnessing business closures (many before imminent collapse) and a sharp rising trend in the level of unemployment. The economic consequences of the coronavirus will continue well into 2021 and require a significant Australian Government response that will massively grow its debt levels. The introduction of QE by the RBA was somewhat belated and it will now endure for the foreseeable future. We will return to these issues later.

Portfolio Management

The obvious portfolio response was to exit companies that were identified as being severely challenged by Government directions and the resultant or subsequent economic downturn. The decline in the value of the portfolio occurred as market prices retreated rapidly for a specific company and/or due to a broader market decline.

Today's portfolio contains companies that are expected to rebound operationally better than the broader economy and which have been presented in the market at attractive prices. However, the journey back to economic and market stability is far from clear at present.

Importantly, CAM also has significant cash available to deploy when or if markets decline further.

The current environment

Having made the above comments it is important for shareholders to understand that the Investment Management team absolutely believes that this health crisis will subside and sooner than the "six months" flagged by Government.

The problem is that the "six month" underlying forecast has been made by our Government due to the poor health safety net that was in place. For instance, the Australian Health System was short of intensive care beds given the risk of a pandemic occurring at any time. Further, the social security system is totally unprepared for the significant lift in the level of unemployed citizens.

The Government directions for the extensive "lockups" is partly caused by our country being ill prepared for a pandemic. Whilst both unfortunate and disturbing, this is the situation that we find ourselves in. The Australian Government, our bureaucracy and people will learn much from this. Australia will be better prepared in the future but it is too late for the present crisis.

Key portfolio decisions

In coming weeks, CAM will update shareholders on its major holdings and the introduction of new companies to its portfolio. Outside cash our biggest holding is BHP at about 6% of the portfolio. With other major iron producers the portfolio has 10% of its funds directed to tangible export markets. The largest non direct equity position is a bear ETF over the market that provides some portfolio insurance and dampens down portfolio volatility.

As noted above, the large cash portion of the portfolio will be accessed as opportunity presents and as the recovery in the Australian economy becomes more likely and less subject to speculation.

The economic and market outlook

Whilst in the shorter term (say one to two months) the road to recovery is unclear, in the longer term there is no doubt that recovery will occur. Importantly, for investors and particularly for our shareholders, the recovery of capital can only occur through a limited number of assets (mainly equities and property) because the so-called low risk yield or bond securities have been completely debased by central banks around the world. In Australia cash rates are now 0.25% and ten year bonds have "weakened" to a 1% yield.

That is not to suggest that all equities (for instance) will recover strongly as the Australian and world economy recovers. Clearly some companies have or will succumb and thus fail due to this particular economic downturn that is driven by unique Government direction.

However, high quality companies that can endure and self fund growth by generating free cashflow will become highly valuable in a world of enduring low yield.

Investing requires a positive outlook tempered by reality. It is our view that there is indisputable evidence that a significant lockdown will slow the progression of coronavirus. Further the worldwide investigation and development anti-viral drugs is showing preliminary positive results. That means that a possible return to a semblance of normal life is likely sooner than the Government's suggested six month period. However, the destabilisation of the economic framework will have an enduring negative impact on many industries. A return to normality will require significant ingenuity, financial assistance and market intervention by our Government, which at present is not on display.

It may be considered trite for a small LIC to offer advice but everyone has a role to play in the recovery of the Australian way of life and our economy. In our view there is clearly a need for the Government to seek assistance from the broad range of capital available through the Future Fund, Industry Super Funds and major Retail Super Funds. Collectively these funds control towards $2 trillion in long term capital of which over 40% resides in offshore markets or economies. Is it not time for a portion of these funds to be mobilised for Australia's immediate needs?

Meanwhile in overseas we are witnessing the extreme mobilisation of seemingly fictitious capital through what the US Federal Reserve recently described as an "unlimited QE program". This is a rerun of programs adopted across Europe and Japan that ultimately result in a ballooning of government debt that cannot be serviced without more QE designed to keep bond yields perpetually low.

Once the world endures the coronavirus crisis it will enter a debt crisis that can only be resolved by a massive restructuring or forgiveness of government debt by central banks. The RBA is correct to commence a QE for it will also be restructuring or forgiving Australian Government debt at some point in the future. The question is whether these debt renegotiations will ultimately be good or bad for equity and risk markets.

The world will recover and growth will recommence at a solid rate in the major developing economies of China, India and across most of Asia. As for the developed western world, we perceive a sustained period of sub optimal growth checked by both excessive leverage and an ageing population.

In Australia, we perceive the possibility for a significant restructure of our economy that has been drifting since the GFC. The economic downturn is destructive but it gives both our Government and Bureaucracy a chance to reconfigure an economy that has achieved well below its potential. Such an outcome would make Australia an exciting investment market once again.

Key issues for CAM shareholders

The board of CAM is pleased to advise that the March Quarter declared dividend of 1.3 cents fully franked will be paid in April. Future quarterly dividends will be determined by market and portfolio returns. The Board intends to continue to pay quarterly dividends if possible. At present the rate of such dividends and the level of franking cannot be forecast due to the extreme market conditions.

Clime convertible notes will continue to pay quarterly interest at the rate of 6.25% per annum as this is an obligation embedded in the terms of issue described in the note trust deed.

Whilst this is a long update the Board believes that it is important to explain both its and the investment Manager's views on the current crisis and outlook.

These are unsettling times for all of us and we wish all our shareholders good health.

We thank you for your continued support.

This announcement has been authorised for release by the Board of Clime Capital Limited.

For further information, please contact me on (02) 8917 2107.

John Abernethy
Chairman on behalf of the Board and Investment Manager