Clime Capital Limited

14 January 2021

Company Announcements
Australian Securities Exchange

Net Tangible Asset Backing

Please find attached Net Tangible Assets report of Clime Capital Limited (ASX: CAM) as at the close of business on 31 December 2020.

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Clime Capital Limited (ASX: CAM)

NTA Report December 2020

NTA before tax	NTA after tax	Total Portfolio Including Cash	Rolling 12 Month Dividend	Historical 12 Month Dividend Yield	Historical 12 Month Dividend Yield Including Franking
$0.88	$0.87	$131.8m	4.65cps	5.2%	7.4%

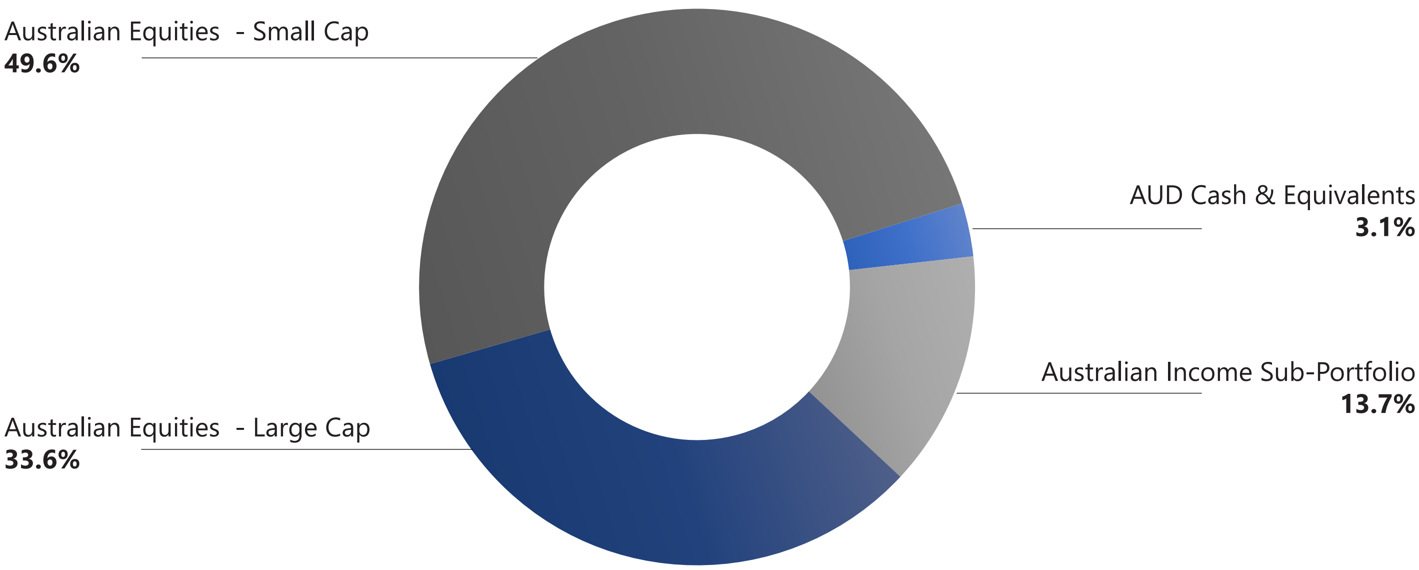
Net Tangible Assets (NTA)

	December[1]	November[1]	October[2]
NTA before tax	$0.88	$0.87	$0.79
NTA after tax	$0.87	$0.86	$0.80
CAM Share Price	$0.90	$0.83	$0.78
Historical 12 Month Yield Excl. Franking	5.2%	5.6%	6.0%
Historical 12 Month Yield Incl. Franking	7.4%	8.0%	8.6%

1 On 9 November 2020, the Board declared a fully franked dividend of 1.175 cents per share in respect of the Company's ordinary shares for the period 1 October to 31 December 2020, payable on 29 January 2021. NTA before and after tax disclosed above for November and December is before the effect of this dividend payment.

2 On 25 August 2020, the Board declared a fully franked dividend of 1.125 cents per share in respect of the Company's ordinary shares for the period 1 July to 30 September 2020, paid on 30 October 2020. NTA before and after tax disclosed above for October is after, and for September is before the effect of this dividend payment.

Gross Asset Allocation



Company Overview ($m) - Cum Dividend

Assets	$M
Australian Equities	$109.6
Australian Income Sub-Portfolio	$18.0
AUD Cash & Equivalents	$4.1
Total Portfolio including cash	$131.8
Convertible Notes (CAMG)	($28.5)
Net Tangible Assets Before Tax	$103.3

Top 20 Holdings (in alphabetical order)

Amcor	AMC	**Mach7 Technologies**	M7T
APN Property Group	APD	**Macquarie Group**	MQG
Austal	ASB	**Macquarie Telecom**	MAQ
BHP Group	BHP	**National Australia Bank**	NAB
City Chic Collective	CCX	**Navigator Global Investments**	NGI
Electro Optic Systems	EOS	**Nick Scali**	NCK
Fortescue Metals Group	FMG	**Omni Bridgeway**	OBL
Hansen Technologies	HSN	**RPM Global Holdings**	RUL
InvoCare	IVC	**Sonic Healthcare**	SHL
Jumbo Interactive	JIN	**Westpac Banking Corporation**	WBC

Portfolio Commentary

The portfolio returned 1.2% in the month of December (pre-tax net of fees), compared to a 1.2% return for the S&P/ASX200 Accumulation Index. For the 1HFY21, the portfolio delivered a return of 13.5%, compared to a 15.7% return for the S&P/ASX200 Accumulation Index.

Materials led the way in December, with the sector delivering a return of 8.8% for the month. Supported by strengthening commodity prices, Australia's large cap resource stocks are well placed to benefit from global reflation, as higher commodity prices drive earnings upgrades, in turn increasing the prospect of bumper fully franked dividend payments. The more defensive Health Care (-4.7%) and Utilities (-5.4%) sectors underperformed during the month, ostensibly impacted by the broader market's rotation to more cyclical exposures.

Key contributors and detractors to the portfolio return for the December quarter were:

- **Australian Equity Large Cap Sub-Portfolio:** Key contributors included BHP Group (BHP), Westpac (WBC), Fortescue Metals Group (FMG), Macquarie Group (MQG), National Australia Bank (NAB) and GPT Group (GPT), key detractors Appen (APX) and A2 Milk (A2M).
- **Australian Equity Small Cap Sub-Portfolio:** Key contributors included City Chic Collective (CCX), Audinate (AD8), Jumbo Interactive (JIN), Mach7 Technologies (M7T), RPM Global (RUL), Invocare (IVC) and Macquarie Telecom (MAQ), key detractor Austal (ASB).

We explore a number of these positions, while also introducing a new position, in the commentary to follow.

BHP Group (BHP) returned +19.2% for the quarter, which reflected strong price appreciation for the company's key commodities. The iron ore price increased by 32.1% in US dollar terms over this period, to US$158 per metric tonne. Iron ore accounted for 64% of group EBITDA in the 2020 financial year. The copper price increased by 16.2% for the quarter, also in US dollars, and accounts for 19% of group EBITDA. Finally, the oil price increased by 23.2% and accounts for 10% of EBITDA. These movements were only slightly offset by a 6.9% depreciation of the US dollar against the Australian dollar over the quarter.

Westpac Banking Corporation (WBC) returned +16.9% for the quarter given an improving outlook for bad debts, capital, and dividends. As the economic outlook has improved, with declining COVID cases and a highly stimulatory budget, expectations for loan losses have reduced. WBC reported its full year result in November, which included a lower impairment expense in the second half compared to the first half. The group has also made strong progress in getting loans off deferral arrangements, which is another positive indicator for bad debts.

Further, the bank is now comfortably above the unquestionably strong capital benchmark. The improvement on the bad debts front also means there will be less of a procyclicality impact on capital – whereby downgrades to loan performance result in higher risk weightings. A strong capital position is critical for the payment of dividends and APRA has also now removed their guidance to retain 50% of earnings from the start of 2021. Net interest margins remain the headwind for earnings in the current financial year. However, the RBA cash rate cannot go much lower and if there is any pick-up in credit growth or reduction in household savings, that would assist with the competitive pressure from excess deposits.

Fortescue Metals Group (FMG) returned 43.7% in the quarter. Similar to BHP, the driver has been the strength of the iron ore price, which increased by 32.1% in US dollar terms in the quarter. FMG's relatively greater price performance reflects the company's pure play exposure to this commodity. The stimulus efforts in China have centred on steel intensive activity, which is driving demand for Australia's iron ore at the same time as supply from Brazil has been impacted by infrastructure failures and COVID related disruption.

A2 Milk Company (A2M) returned -18.5% after the company downgraded sales and margin guidance in late September and again in mid-December due to COVID related impacts. Daigou resellers in Australia, who export goods to China, are an important component of A2M's infant formula sales. Disruption to the operation of the corporate daigou channel following the lockdowns in Victoria, combined with the fall in Chinese tourist and international student numbers, have impacted the distribution of A2M's products.

The company is now guiding to first half 2021 financial year sales of approximately $670 million, down 17% on the prior corresponding period. Sales are expected to gradually pick up through the progressive quarters of this financial year. There is reason to think that this disruption will be largely temporary given indications that demand for the brand in China remains strong. For example, A2M has continued to see increasing market share in Chinese Mother and Baby Stores, with revenue growth in this channel expected to exceed 40% in the December 2020 half year.

Adairs (ADH) was an addition to the portfolio during the quarter, providing attractively priced exposure to the booming eCommerce sector. ADH is a leading homewares and home furnishings retailer in Australia and New Zealand. It is a genuine omni-channel operator, with around 40% of sales from the online channel in 1H21.

Per ADH's 8 December trading update, total sales rose 23% in the first 23 weeks of FY21, with Like-for-Like sales across its 167 stores up 17% (5.2% including a 12 week closure of 43 stores in Victoria), and Adairs online sales up 99%. Mocka, the pure online nursery furniture business ADH acquired in December 2019, saw sales increase by 45%.

Online retailers were clear COVID beneficiaries as a result of rapid (and potentially permanent) shifts in consumer behaviour. Social distancing pulled-forward new online shoppers by several years, stimulus has supported discretionary spending, and travel restrictions diverted spend to fashion and home categories.

Occasionally, themes can herd the market towards the purest fundamental beneficiaries, leading to wide valuation disparities within certain sectors. We found that, in the COVID environment, omni-channel retailers were left behind in preference for the online pure plays, creating some interesting opportunities.

Take, for example, pure online home furniture retailer **Temple and Webster (TPW)**. TPW is a leader in its niche and has enjoyed a jump in demand with expectations of 80%+ sales growth for FY21.

After appreciating 5-fold off March lows, TPW is capitalised at $1.4 billion. By comparison, ADH is capitalised at $575 million. One would think TPW is 2-3x larger than ADH, but the opposite is the case. In FY21 ADH will generate more gross profit from its online operation than the whole of TPW.
In terms of valuation, ADH was attractive because it was trading on a 10% FY21 free cash flow yield for much of the quarter, despite a robust growth outlook and healthy balance sheet. We see further online growth, but as an omni-channel operator, ADH will also capture demand returning to physical stores as conditions normalise.

City Chic Collective (CCX) is another omni-channel beneficiary, and returned 40% for the quarter. CCX is a specialist in extended-size ladies fashion and has a strategy to acquire plus size customers online globally. CCX is generating 70% of sales online, up from 44% in FY19, with online exposure to much larger offshore markets including North America and the UK. The remaining 30% of sales comes from CCX's Australia and New Zealand (ANZ) network of 92 stores.

To date, CCX has acquired customers both organically and via opportunistic acquisitions. The COVID environment has benefited players with well-developed digital businesses, largely at the expense of those dependent on bricks and mortar networks. In the virus-stricken US and UK especially, CCX is targeting acquisitions of high quality digital assets of competitors that have been bankrupted under the weight of their under-performing physical store networks.

After its unsuccessful September bid for the eCommerce assets of Catherines (US), on 21 December CCX announced it had acquired the eCommerce assets of leading UK plus-size brand Evans, marking CCX's entry into the $9 billion UK market. Consideration for Evans was $41 million, funded from existing cash, and representing approximately 1x Evans's $46m FY20 online revenue, or about 5x EBIT on our estimates.

The acquisition follows a positive AGM update in November. For the first 20 weeks of FY21, CCX reported comparable sales growth of 18.7% excluding temporary Victorian store closures (7.9% including store closures), and a significant improvement in gross margins since the peak of COVID disruption in April and June. Gross margins are now above 50%. Like ADH, CCX commands superior margins due to its vertically integrated structure.
With a proforma cash balance of $73 million and no debt, CCX is well positioned to execute on its strategy. Despite the recent share price rally, we still see opportunity in the stock.

Electro Optic Systems (EOS) returned 8% on mixed news. More details about EOS SpaceLink, a potentially enormously valuable business line, were provided via webinar in November, which was followed by a $34 million contract awarded by the Australian Government for the "C4 Edge" program as Prime Contractor. However, in late December, EOS withdrew previous guidance of $20-$30 million EBIT, citing shipment delays (12 days) of its Remote Defence Systems to offshore customers.

Mach7 Technologies (M7T) returned 13% for the quarter on the back of a 7-year contract with Trinity Health, a top 5 health system participant in the US encompassing 92 hospitals. The contract, valued at $5.3 million, was for M7T's Enterprise Viewer called 'eUnity', with potential contracts in 2021 for M7T's other software including archiving, diagnostic viewer, and worklist products. Winning the remaining contracts represents a potential step change for the business.

Adrian Ezquerro	**Ronni Chalmers**	**Jonathan Wilson**	**Vincent Cook**
Head of Investments	Portfolio Manager - Australian Equity	Portfolio Manager - Ex ASX 100	Portfolio Manager - ASX 100

Market Commentary

Calendar 2020 was the year everyone wanted to see end. The pandemic has been the defining event that we will remember our entire lives – not just because it supposedly "came out of nowhere", but because it shook our confidence and proved to us that life is full of surprises and that nothing, least of all our prosperity and comfort, should be taken for granted.

The pandemic closed down large segments of the global economy, confined many of us to our homes for weeks or even months on end, saw the disappearance of immigrants, tourists, and overseas students from Australian shores, and caused unemployment to rocket and economic activity and financial markets to collapse.

The pandemic is likely to leave longer term scars with a setback to globalisation, more social tensions, bigger government and public debt, massive money printing (risking higher inflation), faster embrace of technology, and more consumer caution. In Australia, we will see lower population growth (at least for the next year or two), and have already experienced growing tensions with our largest trade partner, China.

While share markets plunged in March in the early stages of the pandemic, they then progressively rebounded over the next three quarters thanks to massive fiscal stimulus and limited economic re-openings, low interest rates and bond yields that made shares look comparatively cheap. In the last two months, good news on vaccines has enabled investors to look forward to recovery in 2021.

For those investors who stayed the course from the beginning of the year, there were double-digit gains from US and global equities and solid returns from bond markets. The US benchmark S&P 500 index gained 16% while the MSCI World index was up 14%. The Australian ASX 200 Index had a flat annual return, held back by greater exposure to cyclical sectors. Japanese and European markets also generally underperformed.

Government bonds had reasonable returns as yields fell in response to central bank rate cuts and bond buying along with safe haven demand. The Bloomberg Barclays Global Bond index showed total returns for the year of 9%. Government bond purchases have anchored long term interest rates at extremely low levels and this will probably continue during 2021, albeit at a reduced pace.

Real estate investment trusts had negative returns as a result of the hit to property space demand and rents. It was a similar story for unlisted commercial property and infrastructure, although industrial property generally did well.

Australian house prices rose 3% over the year, defying forecasts that housing could lose 10-15% of its value because of the pandemic. As the virus spread across Australia in March and April, residential property sales as measured by volumes fell 40%, causing prices to dip. A surge in buying activity in the fourth quarter bolstered by record low mortgage rates caused a rebound in prices, particularly outside the capital cities, with regional home values rising 6.9% in the 12 months to end December.

The strength of Australia's property prices has been mirrored across other developed economies, with UK house prices rising 7% in 2020 and New Zealand enjoying even faster growth. The trajectory of prices is important for Australia's economy, both for the health of the big banks and for sustaining consumer confidence during recovery. It is also of great importance during a time when the rate of household debt to income is above 200%.

Cash and bank term deposit returns were poor as the RBA cut the cash rate to just 0.1%.

After a pandemic-driven plunge to $US0.55 in March, the $A rose reflecting higher commodity prices and a falling $US.

2021 – Time for Recovery

Just as 2020 was dominated by the pandemic and this determined the relative performance of investment markets, 2021 will be dominated by the recovery. There are reasons for optimism. First, massive fiscal and monetary stimulus is feeding through economies with high savings rates indicating pent up demand that can be spent once confidence improves, and which will help offset the winding down of support measures (like JobKeeper in Australia).

Second, the news on vaccines is positive. While uncertainties remain, by end 2021 or early 2022 there is a good chance the developed world will be approaching a degree of herd immunity.

Third, new US president Joe Biden should usher in a period of more stable and expert-based policy making in the world's biggest economy. In particular, it will likely head off a return to trade wars that could have wreaked havoc in 2021. A more diplomatic US approach to resolving differences with China could also help Australia move down a path to resolving its own differences with China.

Fourth, Australia navigated 2020 remarkably well, controlling coronavirus far better than most comparable countries and seeing its politicians and institutions working well together. It also led to limited structural reforms that may help future growth (for example, property tax reform in NSW).
The combination of vaccines, policy stimulus and pent up demand is expected to see a strong cyclical rebound in global GDP of around 5% (and 4.5% in Australia) in 2021. This is likely to see strong double-digit rebounds in corporate profit growth.

Inflation is likely to remain weak, reflecting still high levels of spare capacity which in turn means interest rates will remain low. While this is not good for those relying on bank interest, it benefits the household sector as a whole (with debt exceeding bank deposits), eases the servicing of high public debt levels and makes shares look relatively inexpensive. Thus we remain in the sweet spot of the investment cycle with improving growth but very low interest rates. In Australia, the cash rate is expected to end 2021 at 0.1% but there is still a chance of further quantitative easing.

Implications for investors

Shares are at risk of short term correction after having rallied sharply from their March lows and 2021 is likely to see a few rough patches along the way. Looking through the noise, the combination of improving global growth and low interest rates augurs well for growth assets. We are likely to see a continuing shift in performance away from investments that benefited from the pandemic and lockdowns - like US shares, technology and health care stocks and bonds - to investments that will benefit from recovery, such as resources, industrials, financials, and tourism.

In a global context, Australian shares are likely to be relative outperformers because we have: 1) less Covid scarring; 2) more fiscal and monetary "dry powder" than most; 3) faster future population growth (when migrants return in 2022); 4) corporate Australia is in generally good health; 5) commodity prices are rising sharply ; 6) the financial sector is strongly capitalised and well regulated; 7) cyclical global recovery favours our materials and financials-heavy index; 8) a strengthening AUD is usually positive for foreign investor flow; 9) Australia has a well-regarded, stable government with a AAA credit rating; and 10) we are well served by a responsible and supportive RBA.

Investors will likely continue to search for income yield, benefiting the share market as dividends are increased resulting in better-than 4% grossed up dividend yield.

Cash and bank deposits are likely to provide very poor returns, given the ultra-low cash rate of just 0.1%.

Although the $A is vulnerable to bouts of uncertainty about coronavirus and China tensions, a rising trend is helped by rising commodity prices and a cyclical decline in the US dollar.

All prognoses about the future are inherently somewhat speculative and based on assumptions. For example, we expect the various vaccines to be effective in combating the pandemic and a return to relative normality by late 2021. We also expect that some incipient signs of re-emerging inflation will remain sporadic and frail, allowing central banks to maintain monetary support for global reflation. If inflation materialises in a more sustained way than expected, markets will react negatively.

Another factor to consider is whether share prices have already priced-in the recovery. In other words, have markets borrowed heavily from 2021 returns? Global and US share markets have already recorded two consecutive years of double digit gains and history suggests that a string of three straight years of double digit gains is unusual.

The answer probably rests with the scale of an anticipated corporate earnings recovery. Looking at the US market, which remains the global bellwether, the current consensus estimate for bottom-up earnings per share for the S&P 500 for the 2021 calendar year is $169.20, which is an increase of 21.7% from 2020. That would mean a record high EPS for the benchmark and would come after an earnings decline of 13.8% in 2020. Fundamental measures for the Australian market suggest our market is similarly pricey when considered against historical patterns.

China

With the US and Europe facing difficult winters as vaccines roll out, China will continue to lead the global economic recovery in the interim. As the first economy both to succumb to the virus and to bring it under control, China has already completed its recovery phase and entered into a new period of growth.

It has been unfortunate to see the deterioration of China - Australia political relations, with the consequent trade and sanction outcomes. China remains our largest trading partner by a wide margin, notwithstanding recent ructions in the relationship: it represents an extraordinary 48% of Australia's two-way trade with the world and so this relationship is vitally important. Fortunately, China's appetite for Australian iron ore is not capable of being easily replaced, and high prices for that commodity are delivering a vital windfall to our economy at a time we really need it. China has few alternatives as it seeks to stimulate its economy through infrastructure investment, with Australia accounting for more than half of iron ore shipments globally. If Beijing were to try to purchase solely from non-Australian producers, at best it could get around 55% of the volumes it typically imports.

Concluding comments

It looks increasingly promising for vaccines and herd immunity to suppress the virus. The Federal Reserve, the RBA and other central banks are likely to remain accommodative on monetary policy, keeping short-term interest rates low throughout 2021. With gradual economic re-opening and slow return to normality, we anticipate a favourable backdrop for economic recovery. This will prove supportive for the reflation of growth and risk assets in 2021.

A strong recovery in global growth will provide a boost to cyclical assets, including commodities and cyclical goods sectors (examples are discretionary consumer markets, housing, tourism, travel, leisure, etc). However, the path may be volatile as the market balances occasional growth hiccups with a forward outlook that is more supportive. The most concerning issue is probably that starting valuations are already somewhat full. That said, the market is large enough that there remain many excellent companies that offer an attractive mix of high quality, growth optionality and solid fundamental value that we can purchase at favourable prices.

Adrian Ezquerro
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