

March 2008 NTA Update:
\$1.10 before tax and \$1.10 after tax

	31st December 2007		31st January 2008		29th February 2008		31st March 2008	
Investments	\$m		\$m		\$m		\$m	
Listed Equities	46.8	74.88%	45.2	78.88%	37.2	73.23%	24.2	48.89%
Cash and Equivalents	15.7	25.12%	12.1	21.12%	13.6	26.77%	25.3	51.11%
Total Investment Assets	<u>62.5</u>		<u>57.3</u>		<u>50.8</u>		<u>49.5</u>	
Investment Asset Performance	-3.7%		-7.8%	¹	-11.3%		-2.6%	
Cash Adjusted Performance	-4.9%		-9.9%		-15.5%		-5.2%	
S&P/ASX 300 Indust. Accum	-2.4%		-11.9%		-5.3%		-1.2%	

Fully Diluted NTA Per Share Information as at 31st March 2008 *

NTA before tax - cents	110
NTA after tax - cents	110

* - Fully Diluted NTA per share incorporates both the fully paid ordinary shares and converting preference shares on issue.

¹ - Adjusted for preference share dividends paid during January 08

Dear Shareholder,

Clime Capital Limited seeks to invest in a concentrated portfolio of businesses that can generate high rates of return on equity, are run by honest and capable management and can be purchased at a fair price. We are not interested in the short-term gyrations that are evident in a share's price; instead we concern ourselves with the changes in intrinsic value that change much more slowly. Our strategy clearly outlined in the Prospectus and the basis on which the company was set up to follow is unchanged. We will continue to maintain large cash holdings unless sound investments can be made using our proprietary definitions for excellent businesses and wonderful value.

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COMMENTARY

“Peking Inflation”

As you read this month’s report, don’t forget the context; our systematic approach to investing in businesses. We must find businesses trading at a discount to intrinsic value. To obtain a conservative estimate of that value, we need to have confidence that the return on equity we adopt as the future businesses performance can be sustained. To determine if it can be sustained, one of the things we need to know is whether the business faces headwinds or is enjoying tailwinds. Forming a view on which companies have bright prospects is dependent on forming a view on whether their customers will prosper. And prosperity to some degree is dependent on your geographic location.

As you will find out if you are selling your products to a US retailer, you may find it tougher than if you are selling cotton, wheat, coal or uranium to China. That latter business won’t even know there is a recession in the United States.

In December I travelled to New York and Miami – the former to attend John Schwartz’s Value Investors’ Conference and the latter, ground zero for the sub-prime crisis, mortgage stress and house price declines.

In Florida, we talked to locals, retirees literally sunning themselves on South Miami Beach, a couple of billionaires and every business owner who wanted to have a chat to an Aussie with a desire to find out what is really going on.

It was from that visit that we could see the US was already in a recession. Housing, auto manufacturing and financial institutions were reporting numbers quite different to the US government’s aggregate statistics. We also formed the view that the depth of the credit crisis was being underestimated. The visit confirmed our view that the problems facing the United States cannot be reversed in a couple of months.

When Americans travel, they often comment about being harangued by beggars. I felt exactly the same way at Miami Airport, only the beggars had uniforms, worked a full day ferrying your luggage and hoped for tips. The appearance of full employment had been created but we saw literally hundreds of ‘working’ unemployed. These individuals had low purchasing power already and any increase in prices of food, petrol or services would serve to only reduce their purchasing power further.

We marveled however at the low prices for virtually every consumer item and were stunned by the ubiquity of the ‘Made in China’ label. When you are being paid 6 pesos an hour (sorry, I meant to say US dollars) you absolutely must have low prices. Even Australian wine was significantly cheaper than the same product here. Think about that; Australian dirt, Australian water, Australian grapes, Australian packaging, shipping half way around the world and yet cheaper than the same product locally.

To ensure low prices, the US has been trading off the goodwill it has built over the last 50 years. But I couldn't help feeling the accountants should think about an impairment charge against that goodwill. For as long as I can remember, winning a customer in the US was branded 'lucrative' and your business was described as having hit the 'big time'. Succeeding in New York, Manhattan and Los Angeles still brings with it a certain cache but I wonder how long before it is replaced with Shanghai, Beijing and Guangzhou.

Last week I returned from a self-funded trip - this time to China. The contrast to the US trip could not have been starker.

What first impressed me were the modernity and scale. Train stations that made Sydney International Airport look like a rural hub and a transport system that rendered the architects of Sydney's system seem woefully under-qualified. Bullet trains travelled at 400km/hr, the ports - filled with containers arriving and leaving - looked like cities from the air and spread out from the water's edge like the tentacles of urban sprawl.

I travelled an hour along an eight lane freeway (eight lanes in each direction!) and saw nothing but high rise apartments and office towers.

I realised I was witnessing the industrialisation of a country and the planning of cities all at the same time. John's Batman's journal entry on 8 June, 1835; "this will be the place for a village" was followed in 1841 by a formal incorporation of the town of Melbourne, the reservation of land for public parks and Robert Hoddle laid out the grid upon which Melbourne was built. What is going on today in China is no different. It's just the scale and the pace that varies from what people must have witnessed in Melbourne in the mid 1800's.

China's economic growth is the fastest in recorded world history and at street level it is palpable. Building construction continued to the horizon (on the days I could see the horizon) and while my first thought was 'speculative bubble' I remain cognisant of the fact that 500 million rural Chinese are expected to move into the cities over the next 20 years. These people will need cars, appliances, heating, electricity and food and lots of it.

Indeed all these buildings – offices, apartments, factories, wholesale markets, exhibition centres, ports, tunnels and roads and far too many casinos – to service a population of 1,500 million people will need power just to keep the lights on.

I marveled at the demand for energy that will be required even after all the nation-building is done – and that alone is going to take decades. Uranium, oil, thermal coal and when that all runs out, wind and solar will all enjoy their very long day in the sun. While I was there, two European car manufacturers announced they had increased production by 15% in a month to meet rising demand from 'emerging' markets. Once these cars are sold, they will need fuel to power them on top of the fuel required to manufacture them.

While I was there the government was also musing publicly about mandating more holidays, which you could take only if you travelled domestically.

China's wealth has been built on being the western world's contract manufacturer but I noticed a growing number of brands in which the owners, store staff and customers took great pride in the 'Made in China' label. Brands like Shanghai Tang and 361 could cut it against Abercrombie & Fitch, Adidas and Puma on the global stage and reflect the development of intellectual property upon which higher returns on equity can be sustained.

People were driven, eager to help and nothing was too hard. Mao's 'serve the people' mandate remains entrenched despite the enthusiastic adoption of the more selfish capitalist model. Everyone displayed entrepreneurial spirit. Even the two homeless men who were pointed out to me by my interpreter were each reading the business pages of the local newspaper.

For the Chinese, the US isn't in recession. For many Chinese, the US doesn't even exist. You could see it in shopping malls. The European stores were bigger drawcards than US brands although KFC and McDonalds were ubiquitous. When the Chinese middle class can afford to purchase their own value-added output, the currency can rise significantly without a detrimental impact on aggregate manufactured output from the likely decline in exports.

While the western world has feasted in China's exported deflation, unfortunately we will soon see the reverse. As any stationary importer can tell you, China has already begun to export inflation (internal inflation at over 8% is at a 12-year high) and the impact on Australian businesses will be magnified as their currency appreciates.

On top of this is a snowballing financial crisis as well as a global food crisis. Add an oil crisis in the next decade and you have a challenging environment in which to invest.

I will make one final observation. I spent a day in the Special Economic Zone of Macao and while I enjoyed the Portuguese-inspired food, it was the scale once again – this time in the casinos – that bowled me over. I visited the Venetian Casino which opened in August last year as part of the Macao "mega-tourism" development. Its website understates the grandeur: "The Venetian Macao boasts the world's biggest casino (some 600,000 square feet of gambling space, about five times the size of your state-of-the-art Vegas gaming floor), 3,000 hotel suites and acres of swimming pools, 850,000 square feet of shopping, a 15,000-seat showroom, and a 1.2-million-square-foot convention center."

I should remind you that all of this was *inside* a building, with ceilings, carpets, powerpoints and halogen lights. I should also add an international soccer field is about 77,000 square feet.

In 2004 China's power consumption was 2050 billion kWh more than 10 times Australia's total consumption. Per capita statistics however reveal that each person in China consumed just 1590 kwh. Australians, in the same year individually consumed 11,200 kWh, (Americans 13,500 kWh each and India 457 kWh each).

At Clime we are continuing to invest in those businesses that offer bright prospects and a substantial discount to intrinsic value. Our 51% cash weighting and the discussion above should tell you something of what we think about the present market's ability to offer both.

Roger Montgomery

Clime Capital Limited

14 April 2008

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