



StockVal informer

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"The investor of today does not profit from yesterday's growth" -

Warren Buffett



StockVal: INFORMED

Find out why StockVal is the best value
investment tool in the world

Why invest amid confusion, incomplete information and hope when you can access the same tool used by professional fund managers to manage almost one quarter of a billion dollars with exceptional results?

Roger Montgomery of boutique fund manager Clime Asset Management, along with many other fund managers, tip sheet publishers, accountants and financial planners, use **StockVal** to invest like Warren Buffett in Aussie stocks. Buffett is arguably the world's greatest and most successful value investor.

Like Warren Buffett, Roger values businesses based on economic performance to determine intrinsic value. He then waits patiently for the market price of the business to fall below the value, at which point he buys.

You do things when the opportunities come along. I've had periods in my life when I've had a bundle of ideas come along, and I've had long dry spells. If I get an idea next week, I'll do something. If not, I won't do a damn thing - Warren Buffett

Value investors seek to purchase wonderful businesses only when their shares trade below an estimate of intrinsic value.

A truly wonderful business generates a consistently high return on incremental equity – the ability to turn a dollar of retained earnings into a dollar of market value, has a high level of earnings, the ability to gain market share without compromising margins, relatively little or no debt, bright prospects and management that is candid with shareholders and rational in decisions

regarding the allocation of capital.

If we have good long-term expectations, short-term price changes are meaningless except to the extent that they offer an opportunity to increase ownership at an attractive price – Warren Buffett

In Australia, **StockVal** is the tool serious value investors use to identify wonderful investment opportunities in the stock market. **StockVal** is a powerful online investment tool that compares valuations of over 400 ASX-listed businesses with the actual market price at any time, clearly showing which stocks are overpriced and which stocks represent investment opportunities.

With patience and **StockVal**, you can have the most powerful tool for investing in the Australian stock market.

To be more market wise, save time and obtain professional value based share market ideas to help you with your share investing, **StockVal** is the professional's choice. It's the only value based investment tool of its kind in the world based on the proven investment philosophy of Warren Buffett.

Join StockVal and you will

- Save time
- Make investment decisions based on economic performance
- Avoid overpriced and speculative stocks
- Obtain phone access to a team of analysts & fund managers
- Receive a fortnightly newsletter written by experts
- Be certain and successful





The following article was written by Roger Montgomery, Managing Director and founder of Clime Asset Management and Chairman of Clime Capital Limited (ASX: CAM).

Value investing: rational profits in the 'sub-prime' mess

Our story begins with a stock market simultaneously spooked and surprised by news that borrowers in the United States who couldn't afford a mortgage, borrowed the money anyway and can't afford to pay it back. Scene two begins with stock market experts - many too young to know the difference between sub-prime and prime fillet - appearing on television, radio and in the press, conducting a post mortem of the event and scene three reveals fortune tellers predicting the future.

Irrespective of whether you are a professional, full time or part time investor, the behaviour and arithmetic that leads to success in investing over time remains the same. Indeed it has never changed.

So that you are never dumbstruck by a falling market and are ready to act decisively when the opportunity presents itself, there are three simple steps and they will lead to success in the field of value investing. First, you must separate yourself from the market, the noise and the focus on all things related to price. Second, you must be able to identify a wonderful business and third, you need to be able to value the business.

Steps two and three can be taught but step one is more challenging, requiring discipline, confidence and independent thought.

To separate yourself from the market, you must realise that the market is not an omniscient creature, all-wise and all seeing. The market is made up of people like those you see at the airport, at the supermarket or filling their cars up at the petrol station. The market is a place where often irrational and emotional people get together with money the focus of their attention. Put irrational people and money together in the one place and, at times, you get anything but an efficient market. Indeed you get completely crazy outcomes and it is at these times - when everyone about you is losing their heads - that being a true value investor is really rewarding. On Thursday 16 August, when the market was in just such a state, Clime purchased for our Clime Value Growth Fund, shares in MND, MBL, QBE, ANZ and WBC. We simply bought the same dollar of earnings at much more attractive prices than that same dollar of earnings was available for only a few days earlier. Within the next ten days shares in our newly acquired businesses were up 26%, 28%, 32%, 9% and 16% respectively. Such returns are something to crow about if made over a

year. To generate them over a week or two is only possible if you act sensibly and with a long term focus when the market is incapable of doing so. The next two steps will help explain how to act sensibly.

Stick to quality at all times

Because we have no predictive ability (nobody does), we didn't have any idea about whether the market would offer us shares in those same businesses at even cheaper prices the next day, the next week or next month so we didn't buy just anything on 16 August. What we did was take out our wallet and buy what we think are good businesses, with good prospects when they were trading at prices below our estimate of intrinsic value. Warren Buffett says that it wouldn't disturb him at all if the markets were closed for three years. He is referring to having the ability to switch the market off and focus on the business. If you can cease being enamoured with rising prices or stunned like a kangaroo in the headlights of a car when prices are falling, your next step is to be able to discern a mediocre business from a great one.

Quite simply a truly great business generates a high return on its equity, will continue to do so on incremental equity, has very little or no debt, wonderful prospects for unit sales volume and margins and is run by management of the highest calibre in terms of ability and integrity. At Clime, we also prefer businesses that don't need to keep tapping their owners on the shoulder for additional capital either for growth or worse, to just maintain their current competitive position and run in the same spot. Perhaps surprisingly such businesses do exist in Australia although their capital management programs must change when they reach saturation or maturity in what is admittedly a relatively small market.

Of all of the above, we put greatest value on management and return on equity.

The final step is to be able to estimate what that business is worth. Suppose you have a glass containing a dollar and each year a 20% return is produced. Clearly you would pay more for that glass than another with the same dollar inside, generating 10% per year. And if you had two glasses each producing 20% but one paid all of the earnings out to you as a dividend and the other retained and compounded those 20% returns, the latter would be more valuable. Conversely if the two glasses were returning 5% each year, the glass paying all the earnings out to you as a dividend would be worth more. Now let's imagine that the Australian government offered a tax-free bond paying 10%. Let's further assume that you are on a marginal tax rate of 50%. Finally let's imagine that a business - we'll use **www.StockVal.com.au** - is generating a 10% return on its equity. If **StockVal** could continue to generate a 10% return on equity until the end of time and it paid all of its earnings out as unfranked dividends, then the business is worth no more than 50 cents in the dollar.



A Dangerous Climb

by Clime Investment Management (ASX: CIW)
Managing Director John Abernethy. Edited by Alan Kholer.

The shudder through debt markets in recent times could well be minor when compared to the one that will eventually hit.

It is extraordinary that leading up to the interest rate cut in the USA last week the equity markets were within 5% of recent and all time highs, so claims that the market has recovered from fears of a recession seem incredible.

The equity markets have shown a blind eye to risk. Consider the news ignored in recent weeks:

1. A run on deposits of a leading UK lending institution;
2. The refusal of debt markets to roll billions of loans by mortgage financiers;
3. The injection of billions by Central Banks to keep the inter bank market liquid;
4. The numerous announcements of margin compression by Banks leading to repricing of loans;
5. A review by JP Morgan of the Australian Mortgage Market showing there are 600,000 Australian households which are under mortgage stress;
6. Announcements by US listed companies of writedowns of loan investments which were not previously disclosed;
7. The imminent redemption of billions from International hedge funds to be met by 30 September; and
8. The Tsunami wave of repricing of Sub Prime Mortgages from honeymoon rates to market rates in the next three months.

While it is true that the equity markets always climb a wall of worry, at Clime, it seems to us that this market is climbing blind with no rope.

Should we be excited by the Dow Jones rising by 3.5% in two days last week? Maybe not when you note that the US dollar devalued by 3.5% against the Australian dollar at the same time.

It is universally agreed that there was extraordinary mispricing of risk in debt markets. In recent months the participants in debt markets have adjusted their view on pricing of risk.

In simple terms this has resulted in interest rate increases to borrowers commensurate with their risk profile.

Thus, borrowers with poor balance sheets and cashflows will now pay a higher interest rate for their loans. This only relates to floating loans that can be immediately adjusted by the lender due to market price changes.

Fixed rate loans to substandard borrowers cannot be adjusted. However, their face value or security value will drop. Thus, floating rate borrowers will bare the cost of the adjustment and lenders will bear the cost of adjustment to fixed rate loans.

Hence the upheaval in debt markets as different types of loans and securities are repriced or renegotiated. Where repricing or renegotiation can't be agreed or set then the market becomes a vacuum. We saw instances of this in recent weeks and particularly in the sub prime markets in the USA and UK.

So what is a sub prime loan? Well it appears to be loan negotiated by a financial institution (the originating lender) directly or through an intermediary (the broker) to a borrower whom has a poor balance sheet or suspect cashflows. Such a borrower is normally a household whose balance sheet represents a highly geared house and whose salary is low. Thus sub prime is a synonym for sub standard.

The interesting thing about the sub prime market is that neither the financial institution nor the broker actually lends their money to the borrower. The loans are "securitised" by Investment Banks ("the structurers") into funds and resold to "investors". These investors are made up of pension funds, councils, hedge funds, Government entities, private individuals and others. The beauty of this system is that fees are generated to the originator, the broker and the structurer. These fees are deducted from the interest payments made by the lenders. This results in the investors receiving a lower return than they would have by lending direct to sub standard borrowers. So for being transferred all the risk the investor receives a lower return than the actual market rates.

The Equity Market

If the debt market has mispriced risk, has the equity market similarly mispriced risk?

If the participants in the debt market are also participants in the equity market then ipso facto the pricing of risk in the equity market must be flawed.

Equity is the ultimate unsecured investment. It is serviced only after lenders and creditors are paid. Employees are paid before equity holders. Executive payments and payouts are made before equity is serviced. An equity holder cannot redeem their investment. An equity holder need not receive a dividend. An equity holder ranks behind all debt holders and creditors in a wind up.

The mispricing of risk in the equity can be shown by numerous illogical equity structures. A telling example is a toll road development. An equity investor in a toll road investment is invited to contribute \$1.00 per unit. The development is to take 5 years and during construction the developer agrees to pay 5 cents per year in tax deferred distributions.

In affect the investor has subscribed 75 cents of equity (which will yield nothing for 5 years) and 25 cents as



zero coupon loan note which has principal repayments of 5 cents per annum.

Would any sensible lender lend money for no interest and no security? No, but an equity investor would and this is the ultimate mispricing of risk. Further, who creates these equity structures? The same Investment Bankers whom created sub prime securitisation.

So what is the better loan? One to a sub prime borrower at honeymoon rates with security or one to road builder for no interest and no security?

In light of these perceived risks, and the fact that our leading and second tier financial institutions are not immune from their effects, it is prudent that investors demand a higher return to compensate for this risk. With this in mind, the valuation on s.v for ANZ, WBC, NAB, CBA, SGB etc... will be adjusted over the coming week after our weekly investment committee meeting.



INFORMER bulletin board

Where's the Value? seminars

Where's the Value? is a two hour evening seminar presented by **Roger Montgomery** and covers everything you need to know to become a more certain and more successful value investor.

Over two hours you will learn how to apply Clime's common sense, long-term approach to investing that aims to purchase part shares of wonderful businesses at rational prices. Using case studies as examples, you will discover the importance of return on equity in calculating a company's value and learn how to distinguish a wonderful company from a mediocre company.

Cost: \$65 per seat and includes Roger Montgomery's DVD on value investing that explains how to use StockVal to value businesses and invest in wonderful companies.

Date	City	Venue
Thursday 8 November	Parramatta	Parramatta RSL Club
Wednesday 21 November	Wollongong	Steelers Club
Wednesday 5 December	Manly	Manly Golf Club
Wednesday 20 February	Gold Coast	Courtyard by Marriott

Thursday 21 February	Brisbane	Brisbane Polo Club
Thursday 13 March	Penrith	Penrith Panthers
Thursday 1 April	Gosford	Gosford Golf Club
Thursday 15 May	Albury	Sundowner Albury Paddlesteamer
Thursday 5 June	North Sydney	Vibe Hotel North Sydney
Thursday 12 June	Sans Souci	St George Motor Boat Club
Thursday 19 June	Melbourne	Telstra Conference Centre
Thursday 31 July	Perth	The Chifley on the Terrace
Thursday 14 August	Adelaide	Mecure Grosvenor Hotel Adelaide
Thursday 28 August	Bowral	Bowral Golf Club
Tuesday 21 – Thursday 23 October	Ballina, Tweed Coast, Maroochydore	TBC
Thursday 20 November	Orange	Orange Ex-Services' Club

Would you like to meet the StockVal Team in your town?

If you are involved in an investment group or know of investors in your area who would like to attend a **StockVal** Q&A, Where's the Value? or Insider Valuation seminar, please email Vanessa – vanessa@clime.com.au with your selected location.

Climb with Clime seminars

Do you have an experienced investment partner?

If you prefer to spend your spare time enjoying life rather than managing a share portfolio, an investment partnership with Clime may offer the perfect solution.

At **Climb with Clime**, Investor Services Managers Matthew Perreau and Daniel Sciberras provide an insight into how Clime employs a long-term value based investment philosophy to manage one quarter of a billion dollars for clients, shareholders and family interests. They will explain how Clime successfully navigated the recent market turmoil, provide an overview of Clime's managed investment services, including the Discrete Share Portfolio Service and Clime Value Growth Fund, and explain how you can begin an investment relationship with Clime.



Location	Date	Time
Sydney	Wednesday 21 November	Lunch session - 12pm
		Evening session – 6pm

Please note that seats are limited so bookings are essential - call Investor Services on 1300 788 568 to reserve your place today.

Would you like to meet the StockVal Team in your town?

If you are involved in an investment group or know of investors in your area who would like to attend a Where's the Value? or Becoming an Insider seminar, please email Vanessa – vanessa@clime.com.au with your selected location.



INFORMER feedback

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