Platinum Asia Fund

Andrew Clifford Portfolio Manager

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Disposition of Assets

REGION	MAR 2013	DEC 2012
China (Listed Ex PRC)	19%	20%
China (Listed PRC)	6%	7%
Taiwan	4%	4%
Hong Kong	1%	1%
Greater China total	**30%**	**32%**
Korea	15%	16%
Thailand	13%	13%
India	9%	10%
Philippines	9%	8%
Malaysia	6%	6%
Singapore	5%	6%
Vietnam	2%	2%
Indonesia	2%	2%
Canada	1%	1%
Cash	8%	4%
Shorts	1%	1%

Source: Platinum

Performance

(compound pa, to 31 March 2013)

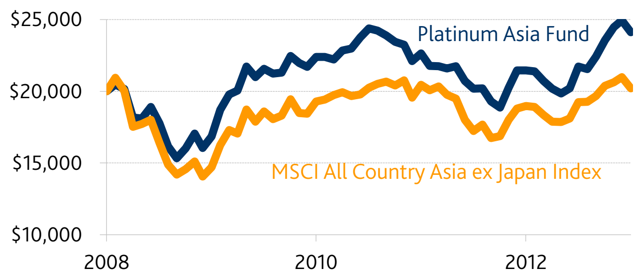
	QUARTER	1 YR	3 YRS	5 YRS	SINCE INCEPTION
Platinum Asia Fund	2%	12%	2%	4%	15%
MSCI AC Asia ex Jp Index	-1%	6%	2%	0%	9%

Source: Platinum and MSCI. Refer to Note 1, page 8.

After a strong finish to 2012, Asian stock markets had a quiet start to the year posting a relatively flat first three months. Underlying this result though was a significant divergence of moves within the markets; with the key regional markets of China, whether that be the Hong Kong listed H shares (down 5%) or the Shanghai listed A shares (down 1%); India (down 4%); and Korea (flat) performing poorly. On the other side of the ledger were the ASEAN markets of Thailand (up 12%); Indonesia (up 14%); and the Philippines (up 18%) continuing their strong performance of 2012.

Value of $20,000 Invested Over Five Years

31 March 2008 to 31 March 2013



Source: Platinum and MSCI. Refer to Note 2, page 8.

The performance of markets such as the Philippines and Thailand can be attributed to a number of factors. Generally, a rising level of competitiveness against China and India, at a time of improving political stability, has seen both countries once again attracting foreign investment. Together, with relatively low levels of indebtedness in these countries and reasonable stock market valuations in early 2012, this has provided an attractive investment case, in a region (or world?) where there are few simple investment stories.

Meanwhile, the current sentiment regarding Chinese stocks appears to be 180 degrees away from where markets were in late 2007, when despite signs of economic slowing after a period of policy tightening, the China growth story was seen as unbreakable and investors were valuing highly companies that were poised to benefit from that growth. Today, a strong recovery throughout 2012 in the pre-sales of residential property (a key driver of construction activity) and in credit growth, is being ignored by the market due to various concerns around the sustainability of the recovery and the impact of new government rules aimed at dampening speculation in the property market. With many economic indicators yet to reflect a pick-up in activity and many companies struggling with excessive capacity or inventories, the market today refuses to pay up for Chinese corporate earnings of 2013!

India remains mired in the same problems as it has for much of the last 18 months with high current account and fiscal deficits continuing to drive higher levels of inflation and thus interest rates are higher than ideal. While the recently delivered federal budget made some improvements on the fiscal front it is likely much more is required to place government finances on a stable footing. As for Korea, the key concerns have been a combination of the weak Japanese yen impacting competitiveness for the country's exporters as well as general concerns regarding China's growth.

The performance of the Fund's holdings has largely mirrored that of their home markets. The biggest contributors to performance have come from a number of our ASEAN holdings. In particular property related holdings such as Land and House (Thailand), Ayala Land (Philippines), Amata Corp (Thailand), and Ciputra Development (Indonesia) appreciated in the order of 20% to 50% during the quarter. Of course, offsetting these good returns were weak performances from the Fund's holdings in China, India and Korea. The net result is an outperformance by the Fund over the last quarter and last year by 3% and 6% respectively, and the Fund is now marginally ahead of the market on a three year basis.

Outlook

Our expectation is that we will continue to see an improving economic performance from China over the course of the next 12 months or so, though probably not back to the breakneck speed we saw in the recovery post the GFC. The Chinese economy is a large and complex economy and not particularly transparent so such predictions are clearly fraught with danger. However, given the expansion in credit we have already seen we would think that this is the most likely outcome. Of course, economic performance may bear little resemblance to stock market performance, but in this case we would also expect better earnings for many of the Fund's Chinese holdings and given their attractive starting valuations, we also expect better share price performance. Even if we are incorrect in these shorter term predictions, the valuations of many of our Chinese stocks augur well for medium to long-term returns. A stronger economic performance from China should also be beneficial for the rest of the region, though after the strong performance we have seen from the ASEAN markets one would not be surprised to see some setback in share prices.

The exception to this is India where intransigence from the government in getting its finances in order makes for a much less clear-cut view for the next year or so. Nevertheless there have been significant developmental benefits from the roll-out of critical infrastructure such as power generation, roads and mobile telephony, and the rural economy clearly has a momentum of its own. The roll-out of a national ID card promises some significant benefits in the administration of subsidies programs. As such we remain optimistic that India will ultimately provide investors with good returns. For a more in-depth look at what is happening in India, please see our trip note on page 13 from our field visit to India in February 2013.

Indian Field Trip

Changes to the Portfolio

During the quarter we began to slowly trim a number of our strongly performing holdings in Thailand, the Philippines and Indonesia. While an examination of the portfolio's geographical disposition may not show much change in holdings, this simply reflects the rapid appreciation of stocks in these markets. If these markets continue to hold or improve on current levels, one would expect the portfolio weightings in these markets to reduce. Funds arising from these disposals and inflows have been put to work across a number of new and existing holdings in China, India and Korea.

New holdings include SAIC Motor Corp, a joint venture partner of both General Motors and Volkswagen in China. These joint ventures were amongst the first foreign auto producers in China and as such have strongly positioned sales and distribution networks and well-recognised brands. PICC is China's leading general insurer and is well-positioned to benefit from a new regulatory regime that will allow them much greater freedom in pricing. Mahindra and Mahindra is India's largest producer of tractors as well as a manufacturer of commercial vehicles.

The net invested position of the portfolio at the end of the quarter was 91%, down from 95% at the end of 2012, but still reflecting an optimistic long-term outlook.

Over six days in February 2013, we visited Bangalore, Chennai, Ahmedabad, Chandigarh, Delhi and Agra.

It is said that for a foreigner to understand India is impossible, I concur! The film 'Slum Dog Millionaire' captures some sense of the corruption that pervades Indian life but it falls well short of revealing the immensity of the problem and the degree to which **corruption is accepted as a part of everyday life** across all strata of society. Whenever we came across some inexplicable contortion of logic which was to the benefit of one group but at the expense of another, those we asked felt it perfectly adequate to answer, "**it is a political issue**". The scale of kickbacks is colossal. For example, facilitation fees involved in the recent Augusta Westland bribery scandal are put at about 10% of the face value of the contract which was USS$720 million for the 12 helicopters. As one ranges over the social spectrum one comes across rent extraction at every level, be it teachers paying to procure jobs where the capital outlay is a multiple of their annual earnings which might be say, US$1,800 per year. Even on leaving this earth, there are reports of surviving family members needing to bribe the issuer for a death certificate!

Some argue that corruption has become even more entrenched, if that is possible, and that the system is more dysfunctional than ever. Our own observation is that this greed breeds huge uncertainty down the entire line of command as subordinates are unable to follow the logical course of action in performing their jobs for fear of treading on a deal that has been negotiated by their superiors and some influence peddler. The cost to the economy is enormous as it causes significant delays and invariably stifles competition. In case you feel that these claims are exaggerated, please note that some 160 MPs in the Lok Sabha, or lower house, have criminal cases pending. In total there are over 500 criminal cases against MPs and while the BJP MPs head the list, they by no means monopolise the rankings[1]. **Transparency International** provides a corruption perceptions index (CPI) which ranks India among the lowest for countries of large population at 3.1, this is slightly better than Indonesia at 3.0 and worse than China and Brazil at 3.6 and 3.8 respectively. For context, the least corrupt countries are considered to be Sweden and Finland in the 9s and most West European nations are in the 7 to 8s.

[1] There is a terrific site, http://www.Indiaassuperpower.blogspot.com that maps the location of 128 MPs currently facing legal proceedings, their parties and their alleged crimes.

Indian Subsidies * (Rupees bns)

	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012Est
Fertiliser subsidy	262	325	766	613	623	672
Food subsidy	240	313	438	584	638	728
Petroleum subsidy	27	28	29	150	384	685

Source: Credit Lyonnaise
* These account for 95% of state subsidies, equivalent to 2.3% of GDP. See too how they have accelerated since the GFC! (Current exchange rate Rs54 = US$1).

One could argue that for all this apparent interference in the marketplace, the country has grown at 6% in real terms over the last 20 years and should we not simply ignore it. The problem with this view is that moneyed self-interest is eroding decision-making across the entire economy. Quick fix solutions take precedence over long-term planning; party rivalry results in delays in approval in those states in opposition to the Centre and hard decisions on matters such as labour law reform, transparent pricing and the reduction of distortions caused by subsidies are all deferred, seemingly in perpetuity. The legal system is used to thwart opposition and drag out resolution[2].

In the meantime, the economic environment is soft even with a fall in the savings rate, down from 34% in 2011 to 30% last year and exports are flat in the face of a 20% decline in the value of the rupee. In 2012, the current account deficit was met by strong foreign share purchases on the Indian market in the order of $20 billion. Some are projecting the current account deficit gap to widen to perhaps $80 billion in 2013 which indeed will be a challenge without further weakness in the rupee. We heard a lot about the high level of gold imports which have been running at an annual rate of 900 tonnes. This represents approximately half the current account deficit of about 5%. Considering that this preference for gold may principally reflect distrust of the rupee, and the money printing activities of the Central Bank, it is amusing to hear quite sensible people talking about mobilising this wealth via paper claims in order to improve the productivity of savings!

Now that we have set the scenario for India to face a miserable future, let us look at the **positive changes** that have been taking place within the country.

1. The country has reappointed Mr Chidambaram as Minister of Finance and he is acting as the Prime Minister's enforcer. Manmohan Singh has hitherto struggled to lead the coalition government led by the Congress Party. Helped by the threat of a sovereign downgrading to junk by the rating agencies, the finance minister has managed to convince the Cabinet of the need for a reduction in the budget deficit to 5.3% this current year, dropping to 4.4% in 2013/14. The budget will be delivered this week.

2. Steps have already been taken to cap the subsidies on fertilisers though the leader of the Congress Party, Sonia Gandhi, is pressing for greater food subsidies. The table above highlights the magnitude of these distortions within the Indian economy.

   We learned that the changeover to fixed subsidies based on the nutritional value has resulted in a fall in the use of phosphorus and potassium. Essentially by capping the rupee amount of the subsidy on these nutrients, the Indian government has removed the arbitrage that existed which enabled traders to acquire subsidised fertilisers in India which they then smuggled out of the country for sale to the likes of Indonesia, Vietnam etc. There has been a meaningful drop in the domestic demand for potash even as its global price has come off. Urea remains highly subsidised selling for about Rs5.5kg versus common salt which sells at Rs12kg. At US$100 a tonne, it is a quarter of the world price and is resulting in imbalanced application by farmers. The ideal ratio is 4:2:1 but at present it is running at 9:2:1. If this continues, there will be systematic degradation of the soil

[2] Indian judiciary would take 320 years to clear the backlog of 31.28 million cases pending in various courts including High Courts in the country. Andhra Pradhesh High Court judge Justice V V Rao said. "If one considers the total pendency of cases in the Indian judicial system, every judge in the country will have an average load of about 2,147 cases," while delivering the keynote address on 'E-Governance in Judiciary' from The Times of India, 6 March 2010.

and a decline in output. Why is urea sold so cheaply when 20% is imported and there are inadequate supplies of gas? Answer, “It is a political issue”.

3. Through the canny use of the **judicial powers granted to Cabinet committees**, Mr Chidambaram is forcing through price increases for electricity distributed by the State Distribution Boards (SDB). There is a plan to fund these entities out of their debt problems but associated with this is the requirement for them to raise prices to fully reflect the current and rising costs of inputs, notably thermal coal. As we identified in previous visits to India, the problem with electricity deficiency lies in low plant load factors, which run at around 65% of installed capacity of 210 GW. They are under-utilised for several reasons but the most important by far is the unwillingness of politicians to pass through the full costs of electricity to their electorates which has resulted in a chronic rise in losses and hence of indebtedness of the SDB’s. At present, sensible states such as Gujarat have fully funded Distribution Boards and are selling electricity at around Rs4.5kWh to the householder and Rs6kWh, which is around US11 cents, to industry. To date, all the distribution boards have complied to raise their prices and last year saw the more inefficient boards raising prices by as much as 37%. The idea is that they continue to raise prices progressively over the next several years to eventually eradicate their debt.

   The second issue around **power supply**, which is deficient to perhaps 10% in the interlinked grid of the North and 20% in the separate grid in the Southern states, relates to the availability of coal from Coal India and the pass-through provisions of earlier IPP (independent power producer) contracts which use imported coal. IPP’s, like Tata Power and the Andani group, have suffered from changes in the cost of imported coal either because of the falling exchange rate or because of export pricing parity demanded by the Indonesians. This may well be resolved this year to the benefit of the IPP operators.

4. An important breakthrough is taking place with the work pursued by the **Unique Identification Authority of India** (UIDAI). This organisation, led by the retired head of Infosys, comprising only 300 employees and 10 offices has set up the so-called **AADHAAR scheme** to provide an ID number and card to all inhabitants of India. Using both fingerprints and an image of a person's iris, UIDAI, working in conjunction with local government, post offices and the like, has already signed up 245 million people to the system. The process is totally scalable and relies on a PC, printer, modem and camera to record and transmit details of each individual to a central repository. As we were reminded frequently, change in India invariably comes by stealth. The scheme has already faced its share of hurdles, in particular in states not controlled by the Congress coalition, there has been a reluctance to comply because of fears about the loss of power to the Centre. Even Sonia Gandhi was slow to appreciate the value of this registration system until the penny dropped. Congress has always believed that voters respond to the handouts at the local level and have little interest in the grand designs of the Centre. Having initially been lukewarm on unique identification, Congress now understands the benefits that can be derived from direct payments to the individual (voter) from Delhi, to the exclusion of middlemen. Ultimately,

this identification scheme is seen as a way of paying cash directly into the appropriate beneficiary's bank account be it supplementary food grants, entitlements for fertiliser inputs or the payment of bursaries for education. As always, nothing flows smoothly in India, and in this case the fact that some 600 million Indians do not yet have bank accounts will prove a hindrance.

In addition, registration takes around 15 minutes per person and in some cases labourers have so worn down their fingerprints, through toil, that it is hard to achieve a strong biometric image. One can expect resistance from non-complying states but it seems as though the Congress Party is going to use this as a large carrot to the great Indian peasantry in the forthcoming 2014 election. Various pilot schemes have been initiated in specific districts where direct cash transfers have been made in the place of subsidised products such as kerosene. In one district, kerosene consumption has fallen by over 80% as the subsidy was given to genuine users and not siphoned off as a supplement to dieseline.

5. **Periodic violent outbursts remind** the masters at the Centre of the molten fury of the underclass, an awareness perhaps amplified by the recent unrest in North Africa. This may be helping the proposals to changes in the land acquisition law. Should it go through it is likely to reduce compulsory acquisition provisions that have hitherto allowed cunning, greedy politicians to acquire and assemble parcels of land which are then rezoned and passed on to property developers in exchange for favours and participation. The early draft provides for compensation that is up to four times the appraised value, but the latter tends to be significantly understated as most transactions are executed at one price with the true value being completed with a cash payment. An example of this type of compulsory land acquisition is the Yamuna Expressway from Delhi to Agra which was built by Jaiprakash in exchange for some 6,250 acres of rezoned farmland in five separate parcels along the 165km route.

6. An older scheme, MRNREGA, the Mahatma Gandhi National Rural Employment scheme, that has had a huge effect on the labour market, is the provision of **100 days work a year for a minimum of Rs120 per day** for the adult member of any rural household willing to do public unskilled manual work. Even though they earn little, it has allowed workers who would otherwise be migrants seeking work in other states to stay at home and tend their own fields. This has reduced the migrant population and had interesting implications. For example, rice production in Bihar, now a well-led state, has risen from 3.1 mt to 8.2 mt in 2012. (This significant rise can in part be attributed to changes in land husbandry and cultivation techniques.) On several occasions we were told by disgruntled employers about the effects of the scheme and making rural workers lazy etc. It is evident from relative wage changes that the lot of rural workers has improved.

   One important side benefit has been the building of rural roads. This improvement in vital infrastructure has palpable benefits to local communities by enhancing trade and interaction with the 'outside' world.

7. When in Gujarat, we were given presentations by various **government bodies that are pro-business in terms of speeding-up approvals, providing serviced land** parcels to industry and so forth. The First Minister, Mr Modi, is consequently held in great esteem by the business sector for his ability to get things done and is seen as a promising future Prime Minister of India. Importantly, there are four or five other First Ministers who are running their states effectively and understand the importance voters attach to the reliable supply of electricity, water and sanitation rather than hearing

extravagant promises and receiving pathetic handouts. We feel that this will **gradually have a domino effect** across India. Rather like China, where provincial governors have enormous powers, it could be said that many First Ministers in India's 28 states, follow a similar pattern of crony capitalism with the least talented First Minister’s tending to be more concerned about near-term gratification than national development.

8. There are still many hurdles and it is noticeable that the discussion of the Hindu influence on the economy has diminished. However, the labour laws act as a huge impediment to industrialisation and a disincentive to hiring. Interestingly, only 50 million workers are registered taxpayers and my guess would be that half of these are probably government or semi-government employees. As we have noted previously, the tax take in India is simply too low at around 17% of GDP. The proposed introduction of a value added tax is way behind schedule and looks like being diluted by obstreperous state governments. Even so it could have the effect of raising the tax take by 3 to 4% of GDP. This could remove the money printing proclivities of the Central Bank.

9. Several commentators reflected on the threat from Chinese competition; our take is somewhat more optimistic and we suspect that the gradual improvement in infrastructure such as the **two new rail corridors**, which are admittedly some years off, combined with a relatively weak rupee may lead to some positive surprises for India. It is important to remember that recorded GDP per head is barely over US$1,000 pa though this is probably under-stated by a third, with few rural workers earning a couple of dollars a day and engineering graduates working in the IT sector, earning only US$6,500 a year. There is a clear distinction between the haves and have-nots as portrayed by Bollywood but the striking observation is that companies that have managed to survive and prosper in this environment are, in a perverse way, protected from new competition.

In summary, India faces gigantic hurdles, but this old and deep civilisation with its enormous diversity has achieved remarkable feats in the last 20 years with real growth of 6.7% pa, never mind its contribution to humanity over the ages. It has grown despite the machinations of its politicians and this gives one confidence that growth is unlikely to stop. Land values are continuing to rise and with 40% of households said to own at least one acre of land, one should expect this roller-coaster to be driven from the bottom-up. The unleashing of the great energy of the Indian people, is likely to surprise long-time observers.

Kerr Neilson
February 2013

Notes

1. The investment returns are calculated using the Fund's unit price and represent the combined income and capital return for the specific period. They are net of fees and costs (excluding the buy-sell spread and any investment performance fee payable), are pre-tax, and assume the reinvestment of distributions. The investment returns shown are historical and no warranty can be given for future performance. You should be aware that historical performance is not a reliable indicator of future performance. Due to the volatility of underlying assets of the Funds and other risk factors associated with investing, investment returns can be negative (particularly in the short-term).

   The inception dates for each Fund are as follows:
   Platinum International Fund: 30 April 1995
   Platinum Unhedged Fund: 31 January 2005
   Platinum Asia Fund: 4 March 2003
   Platinum European Fund: 30 June 1998
   Platinum Japan Fund: 30 June 1998
   Platinum International Brands Fund: 18 May 2000
   Platinum International Health Care Fund: 10 November 2003
   Platinum International Technology Fund: 18 May 2000

2. The investment returns depicted in this graph are cumulative on A$20,000 invested in the relevant Fund over five years from 31 March 2008 to 31 March 2013 relative to their Index (in A$) as per below:
   Platinum International Fund - MSCI All Country World Net Index
   Platinum Unhedged Fund - MSCI All Country World Net Index
   Platinum Asia Fund - MSCI All Country Asia ex Japan Net Index
   Platinum European Fund - MSCI All Country Europe Net Index
   Platinum Japan Fund - MSCI Japan Net Index
   Platinum International Brands Fund - MSCI All Country World Net Index
   Platinum International Health Care Fund - MSCI All Country World Health Care Net Index
   Platinum International Technology Fund - MSCI All Country World Information Technology Net Index
   (nb. the gross MSCI Index was used prior to 31 December 1998 as the net MSCI Index did not exist).

   The investment returns are calculated using the Fund's unit price. They are net of fees and costs (excluding the buy-sell spread and any investment performance fee payable), pre-tax and assume the reinvestment of distributions. It should be noted that Platinum does not invest by reference to the weightings of the Index. Underlying assets are chosen through Platinum's individual stock selection process and as a result holdings will vary considerably to the make-up of the Index. The Index is provided as a reference only.

3. Long invested position represents the exposure of physical holdings and long stock derivatives. The net invested position represents the exposure of physical holdings and both long and short derivatives.

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