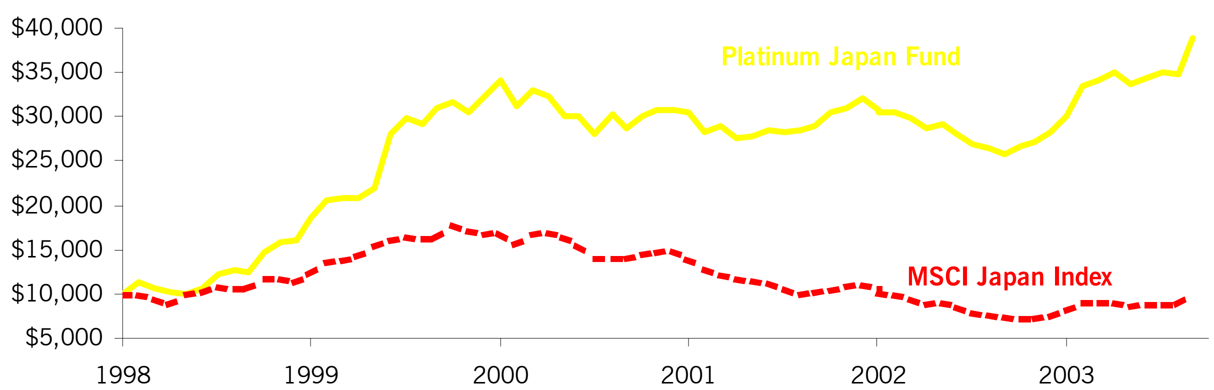
Platinum Japan Fund

Performance

REDEMPTION PRICE: $2.0098

VALUE OF $10,000 INVESTED SINCE INCEPTION (1 JULY 1998 – 31 MARCH 2004)



Source: Platinum and FactSet

Refer to Note 2

Japanese stocks registered very sharp gains during the quarter with the MSCI Japan index rising by 15.1% in US$ terms. The main factor driving the market was signs of stronger domestic consumption as wages improved on the back of strong company profits in the export sector. In addition, local institutional selling of stocks eased considerably as the normal financial year-end influences waned and this allowed foreign buying to reassert itself. Unusually, all sectors of the market rose with particularly strong gains in property, banking and retail shares. The Fund managed to perform reasonably well during the quarter rising by 12.8% in A$ terms as against a 13.6% rise for the MSCI Japan index. Over the year to 31 March 2004, the Fund rose by 50.3% in A$ terms whereas the index rose by 34.4%.

Changes to the Portfolio

With some of our price targets being exceeded the major changes in the portfolio this quarter were driven by value migration. Sales included Yamanouchi, Citizen Watch and Mitsui Engineering. Purchases included NEC, NTT Docomo and Suzuki Motor. In Korea we have been adding small and medium sized stocks where we see values typically only seen in times of great distress.

We have removed all of our currency hedges and are now fully exposed to the Japanese yen and the Korean won. Our feeling is that the emerging domestic recovery in Japan will lend support to the currency through both rising foreign inflows and the Bank of Japan which is much less inclined to intervene to weaken the currency.

DISPOSITION OF ASSETS

Region	Mar 2004	Dec 2003
Japan	68%	76%
Korea	15%	10%
Cash	18%	14%
Short Derivatives	-7%	-13%
Long Derivatives	5%	5%
Net Derivatives	-2%	-8%
Net Invested	80%	78%

Source: Platinum

Commentary

We have recently returned from a business trip to Japan during which we visited a number of our long term holdings and attended the inaugural CLSA Japan Investors Forum which saw around 60 corporate presenters and over 500 people in attendance. The forum was an invaluable experience as we were able to meet directly with senior management. It also provided us with an opportunity to gain a reading on other managers sentiment toward Japan. The key takeaways from our week in Japan were:

1. The general mood of the market is much more bullish than for some time. One need look no further than the attendance at the forum which exceeded all expectations. Whilst this gives us pause for thought, it is also hard to believe that everyone is on board given the length of the bear market. Certainly domestic investors are still quite bearish and this would suggest room to move higher.
2. The theme of the conference was Japan's place in Asia and the importance of China. Nearly every company enunciated a China strategy although some clearly don't believe in it as much as the investors! Our feeling is that the China theme has been well exposed by the market and rather than chase China-related-plays we will continue to look for quality names that can participate in global growth generally.
3. The attitude of the domestic insurance companies to the equity market is classic bear-market-bottom behaviour. Having been in a long dark tunnel and driven by actuaries who emphasise only the risk of equities, they continue to sell. But the reality is that they have already sold a lot of equities over the years and from here they have cut too deeply into relationships for further sales to be made. This would suggest selling may at the very least slow.
4. The Bank of Japan appears to believe that we finally have a self-sustaining recovery underway and indeed its recent public statements have supported this view. This may lead to declining currency intervention going forward which would support the yen. Whether this optimism is misplaced remains to be seen but it is unusual for them to be so up-beat.
5. We have mentioned this before but there was a quiet confidence in almost all corporates that things were getting better. Although after such a long time no one is getting carried away, but backed by strong cash flows, this confidence could permeate further through the economy.

Hybrid Electric Vehicles (HEV)

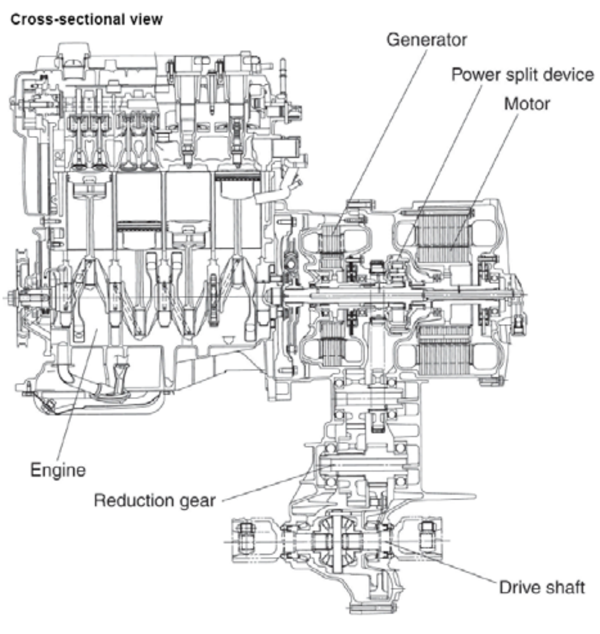
A major theme at the forum was the rising importance of the Chinese economy to world growth. Nowhere is this issue more important than in the area of global oil supplies and regular readers will recall our concerns regarding the replacement rate for global oil reserves. Given the large weighting of car usage in oil demand (about 50%), one technology that may serve to cushion this impact is the "Hybrid Electric Vehicle" or HEV.

Essentially a HEV is a combination of a standard gasoline powered engine with an electric motor to provide much greater fuel efficiency. Whilst the technology for the engine and the motor is well understood, the complexity lies in the mechanical linking mechanisms and the attendant software that optimises the drive. In simple terms the electric motor relies on stored battery power, largely free energy due to its creation during vehicle braking, to replace the gasoline engine during start-up and initial acceleration of a vehicle, where gasoline engines are at their least efficient.

We think a number of factors make this technology more realistic than solar or fuel cell powered vehicles. Firstly, the core technologies have been around for some time so we are not making a giant technological leap. Secondly, the product requires little or no change of behaviour on the part of the buyer or in terms of the infrastructure required. Part of the problem with fuel cell vehicles is the need for alternative fuel supplies. Thirdly, the product is being backed by the most powerful auto maker in the world today, Toyota. Lastly, it is not a concept but a reality. Toyota expects to ship 100,000 units in 2004 and is having trouble meeting back orders. From the end of 2004 Toyota will offer some models of the Lexus luxury car range in hybrid form. This is a very rapid pace of rollout.

Toyota Prius

The Prius is Toyota's primary dedicated HEV model and represents the bulk of worldwide HEV shipments currently made by any auto maker. It uses a highly fuel efficient 1.5L Atkinson cycle petrol engine that runs within an optimised RPM range and turns off when the vehicle is stationary or at slow speeds. Atkinson engines have been around for some time but have never really been used due to lack of torque at low RPM (slow off the mark but very efficient when up and running). It is for this reason that the electric motor is generally used to initiate motion while the petrol engine is started once optimal running speed has been reached – dependent on certain variables.



Toyota Hybrid Engine

As mentioned, the key technology lies in the components and software that splits the load between the engine and the motor. In the Prius a component called the Power Splitting Device or PSD is used. At the core of the PSD is an epicyclic gear set. Otherwise known as a planetary gear mechanism, this device achieves the improbable solution of allowing the petrol engine and electric motor to work in tandem to drive the wheels and/or independently to provide the drive or indeed to use the generator in reverse to act as a starter motor for the petrol engine.

By having this multiplicity of choices, software can be employed to optimise fuel efficiency by making decisions between the two power sources – electricity or hydrocarbon. When the battery is fully charged, the electric engine alone may suffice, alternatively if a fast getaway is required, both engine and electric motor will be engaged. On account of the cunning configuration of gear ratios, the generator will operate when the petrol engine is running and/or will also charge the battery when braking or coasting down hill.

The practical effect of this is demonstrated in the following table. As the car accelerates to 20kmh only the electric motor is running and it is drawing power from the battery. At a certain point the gasoline engine will kick in providing power to the electric motor. When the car brakes, electrical energy is released and the battery charge is replenished.

DRIVING SCENARIOS

	Engine Speed rpm	Motor Speed rpm	Generator Speed rpm
Accelerating to 20kmh	0	734	-1909
Accelerating to 80kmh	4000	2936	6764
Cruising at 60kmh	1590	2202	0

Source: Toyota

MODEL COMPARISON

Maker	Honda	Honda	VW	Toyota
Model	Civic Hybrid	Civic	Jetta (Diesel)	Prius II
Class	4-door sedan	4-door sedan	4-door sedan	4-door sedan
Price (US$)	20,000	15,000	20,000	20,000
Miles per gallon city	47	29	38	60
Miles per gallon highway	48	38	46	51
Displacement	1340	1700	1900	1500
Total power		105hp (77kw)	100hp (74kw)	110hp (82kw)

Source: Company websites

Why will HEV's sell?

The primary selling proposition for the Prius is energy conservation. The Prius is about 2x as energy efficient as the equivalently sized Honda Civic under city driving conditions. Taking the US market as an example, this adds up to about a US$350 pa annual saving for the average driver. At the current price premium for the Prius of around 33% or US$5,000 that is a 14 year payback. This may not seem so attractive but it is likely that this price premium will close as volumes ramp up. It also should be remembered that Toyota introduced the Prius Mark 1 in 1997 and the recently released model claims 26% more power and 15% more fuel efficiency over its predecessor.

The negatives at this stage seem to be the usual aversion to new technology, lower resale values, as well as questions about battery life. There has traditionally been an aversion to the idea of electric cars as toys but very high torque at low speeds provided by the electric motor of the HEV is now being appreciated. This means the car is much quicker off a standing start than a traditional petrol powered vehicle. The advertising literature is starting to reflect this angle and could provide greater appeal.

From the global perspective the savings from oil usage could be large. If say 5% of the US car fleet converted to HEV over the next five years (about 7.5 million vehicles), this could save some 250,000 barrels of oil per day or 1.25% of total daily requirements. Whilst that might seem a small saving, the key point is that we now have a working model that could fairly cheaply replace a large part of oil consumption if the circumstances required. When we extrapolate the evolution of the technology, especially with the introduction of super capacitors to deliver bursts of energy to the electric motor and more sophisticated battery storage, we will inevitably move closer to the fully electric vehicle thereby lessening the dependence of oil further.

The position of Toyota

As readers will be aware we have liked the Toyota group for some time and have represented this in our portfolios via Denso, the leading parts supplier. However the leadership that the group is displaying in HEV is another very strong indicator of the depth of the organisation and focuses our interest in the parent company and other parts subsidiaries like Aisin Seiki. We observe that other auto makers are moving quickly to secure access to the technology for fear that they will be left behind. Nissan recently agreed to source a hybrid power train from Toyota for supply to the US Altima in 2006. Meanwhile Ford has licensed basic patents on the PSD and is likely to take some fully built-up power trains from Aisin Seiki. Aisin Seiki, as the transmission specialist in the Toyota group and a core developer of the PSD, seems to be quite an interesting company!

Outlook

As we have stated on many occasions we are bullish on Japan whilst harbouring concerns about the build-up of debt in the western countries. We believe that Japan can experience a better economic period on the back of rising Asian consumption with the primary risk being the negative feedback loop provided by a debt shock in the US. Another risk is the political risk related to events in Taiwan and in North Korea. It is with this in mind that we run the portfolio with an element of risk aversion. On balance though we are optimistic about the Japanese market and expect 2004 to be most rewarding.

Jim Simpson
Portfolio Manager

Notes

1. The returns represent the combined income and capital return for the specified period. They have been calculated using withdrawal prices, after taking into account management fees (excluding any performance fees), pre-tax, and assuming reinvestment of distributions. The returns shown represent past returns of the Fund only. Past 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, returns can be negative (particularly in the short-term).

2. The investment returns depicted in the graphs are cumulative on A$10,000 invested in the Funds since inception and relative to their Index (in A$) as per below:

   Platinum Japan Fund:
   Inception 1 July 1998, MSCI Japan Accumulation Net Return Index in A$

   The investment return in the Funds is calculated using withdrawal prices, after taking into account management fees (excluding performance fees), pre-tax and assuming 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.