Platinum Japan Fund

Jacob Mitchell Portfolio Manager

Disposition of Assets

REGION	JUN 2014	MAR 2014
Japan	90%	88%
Korea	7%	7%
Cash	3%	5%
Shorts	5%	5%

The Fund also has a 12% short position in Japanese Government Bonds.

Source: Platinum. Refer to Note 3, page 5.

Portfolio Position

Changes in the quarterly long portfolio composition:

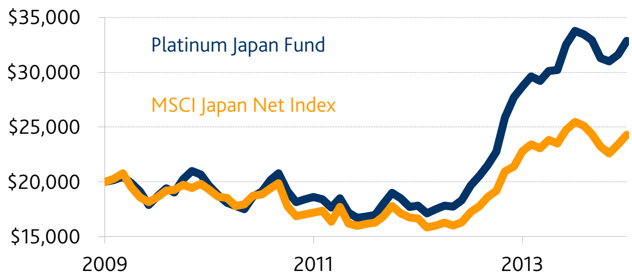
Sector Breakdown

SECTOR	JUN 2014	MAR 2014
DOMESTIC	50%	52%
Consumer and Retail	13%	14%
Financials	12%	12%
Healthcare	9%	10%
Services	7%	7%
Telco and Utilities	6%	6%
Property and Construction	3%	3%
EXPORT	47%	43%
Tech/Capital Equipment	19%	22%
Durables	17%	15%
Commodities	11%	6%
Gross Long	97%	95%

Source: Platinum

Value of $20,000 Invested Over Five Years

30 June 2009 to 30 June 2014



Source: Platinum and MSCI. Refer to Note 2, page 5.

Whilst we build the portfolio one idea at a time, some themes that are represented prominently within the Fund include:

- Emergent industrials with leading global positions.
- Corporate revitalisation, industry reorganisation and potential merger and acquisition targets.
- Potential policy change beneficiaries (e.g. industry deregulation, labour market reform, tax reform, new business incubation incentives).
- Internet 2.0 and service sector growth opportunities.
- Emergent energy management opportunities (smart cities/grids/buildings).
- Cheap real asset exposures that domestic investors are likely to seek as inflation hedges.

Performance

(compound pa, to 30 June 2014)

	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum Japan Fund	5%	14%	21%	10%	14%
MSCI AC Japan Index	5%	7%	12%	4%	0%

Source: Platinum and MSCI. Refer to Note 1, page 5.

The Japanese market remains range-bound, significantly underperforming global markets over both the short and longer-term with the heady outperformance of late 2012, early 2013 fading. Early in the quarter the impact of the consumption tax weighed on investor sentiment. However, as evidence that end-demand was normalising, the market, especially the domestic exposed consumption sectors (retail, financials and property) rebounded. We find it interesting that locals turned into buyers throughout the weakness, evidence of growing belief in the recovery. Anecdotally, the market is rewarding companies that are showing greater respect for capital allocation; this is more of a factor for outperformance than growth per se.

Key performance contributors included our more recent purchases (Sumitomo Metal Mining and Inpex; severely beaten down cyclicals with fortunes changing for the better; detailed below), large holdings such as Nippon Telegraph and Telephone (update below), Panasonic and Rohm, and mid-sized exporters such as TopCon and Glory. The major detractor from performance was DeNA. Having reviewed the original thesis that the company would ultimately navigate the transition from feature to smartphone gaming, we see no reason to alter course even though near-term earnings have disappointed.

Shorts and currency positions had negligible impact on performance.

Changes to the Portfolio

We sold out of Ryohin Keikaku as the valuation started to price in some relatively enthusiastic expectations of overseas growth. The company's Muji-Rushi (literally "no-brand") retail format offers a unique minimalist design ethos across a broad range of high quality household furniture, apparel and food items at reasonable prices (think kikki.K/IKEA with a Japanese flavour). Over the past three years, the stock price has close to tripled as the company delivered on promises to ramp up its international store rollout and reinvigorate the product offering. However, we see growth pangs emerging as the development of its internal supply chain lags the Asian store expansion. Whilst the longer term story remains a good one, the valuation no longer affords a real margin of safety.

Last quarter we alluded to opportunities of a more cyclical nature that were moving onto our radar; of the three stocks we acquired, we'll detail Inpex and Sumitomo Metal Mining, leaving Nippon Electric Glass for another day.

Our investment in **Inpex** is based on a scenario analysis around the development of the massive $34 billion Ichthys 8.4 mt LNG/condensate project (Browse Basin, Timor Sea, located approximately 820 km west of Darwin). Single project risk is high with Ichthys representing 60% of likely future production value and by any estimate this is an audacious project. Further, the inability of seasoned campaigners such as Shell, Chevron etc to deliver a North West Shelf project on time and on budget has led most to conclude that Inpex will suffer a similar fate. However, even under a scenario of a +45% capital spending over-run (i.e. the Gorgon experience) and a three year delay, we still have a margin of safety afforded by the valuation. Further, we think this scenario is avoidable given the combination of high fixed-price construction contract cover, a falling Australian dollar and easing contractor rates.

Even though the project is now 50% complete and currently on budget with first gas expected in late 2016, given the propensity for most cost issues to arise in the final stages, a discussion around valuation is best framed by way of scenario analysis. Our entry price and a 15% cost over-run equates to a March 2019 P/E of around 5 times and cash-flow yield of 26%. Whilst a cost and time overrun at Ichthys would seem inevitable, what could really hurt this investment, is the failure of a major component/system which impacts the critical path to production. Accordingly, though the current price provides a large margin of error, the only way to account for this tail-risk is to maintain a commensurate position size. Furthermore, we wouldn't want to promote the attractiveness of Inpex in isolation given the general neglect around oil stocks globally, combined with what appears to be a generally tight oil market given the likelihood of ongoing Middle Eastern production disruptions.

The second cyclical **Sumitomo Metal Mining** is based on our bullish outlook for nickel. The origins of this idea are to be found in a piece of Indonesian legislation dating back to 2009 when the government passed a law to ban all exports of unrefined nickel ore by early 2014. Its goal was to encourage investment in the local smelting/refining industry (unrefined ore sells for \$20-\$100/tonne versus refined nickel at a current price of around \$19,000/tonne). The interesting aspect of this was that many industry participants assumed the law would never be enacted and the Chinese proceeded to create some 7mt of stainless steel capacity fed by Indonesian nickel ore exports. However, as testament to Indonesia's growing reform and good governance credentials, the export ban is holding (and there's a net financial benefit to Indonesia if this continues). China represents 50% of 40mt of global stainless production and the Indonesian export ban has left a third of this Chinese capacity short nickel without a medium-term replacement. That's clearly bullish for the nickel price and the primary reason behind the recent rise in the metal.

Sumitomo Metal Mining offers exposure to 56,000 tonnes of refined nickel production and we estimate a 25% move in the nickel price would result in a 50% rise in after-tax profits. The company has used its processing technology where it is acknowledged as one of two global leaders in HPAL (High Pressure Acid Leach for processing low grade laterite ores) to negotiate decent equity positions in nickel producers such as Nickel Asia (Philippines) and Vale Inco (Indonesia). The company has a good long-term record. Importantly, it has not overpaid for assets during the commodities boom, instead growing via organic mine development and opportunistic acquisitions.

Overriding concerns about the sustainability of Chinese investment and related commodity issues allowed us to acquire a holding at less than book. We acknowledge that the investment intensity of Chinese growth must fall and with Chinese construction directly accounting for some 10% of nickel use, demand will likely disappoint. However, the market is not paying sufficient heed to the emerging Indonesian supply-side shock with the high likelihood of a long-term structural shortage supporting a much higher clearing price for nickel.

Commentary and Outlook

As we have stated in the past, the reforms most likely to succeed in Japan are those of a Trojan Horse nature. We see this in government and institutional support of the new Return on Equity (RoE), growth and governance based JPX-Nikkei 400 Index, with corporates now using the shame of omission as grounds for better capital management. For example, serial capital hoarder and machine tool maker Amada's decision to target a 100% pay out of profits via dividends and buybacks to lift RoE, was specifically made so as to qualify for index inclusion. At one level it's a little sad that common sense behaviour requires an institutional imperative, though we are not complaining.

The other Trojan Horse can be found in the clear political support lent to GPIF's (\$1.3 trillion government pension manager) reform process. Behind the guise of some erudite academic thought pieces, a very simple consensus has coalesced. That is, with the Bank of Japan (BOJ) now committed to a hard inflation target, it makes logical sense for the national pension fund to cut exposure to nominal assets such as bonds. Whilst details are still hazy (not surprising given the market sensitive nature of such a large asset allocation decision), GPIF's current 60% allocation to domestic bonds is likely to fall to around 40% in preference for domestic equities and foreign assets. The government clearly believes domestic asset price wealth effects, and the likely Yen weakness that should result from GPIF's offshore portfolio shift, are important to achieving its reflationary goals.

Whilst we see these top-down changes as important, what is more encouraging is renewal at the corporate level e.g. Panasonic, Asahi Group, Takeda, Hitachi, Mitsubishi Heavy, and Nippon Telegraph and Telephone (NTT). In the case of NTT, whilst the market is celebrating the now obvious commitment to earnings targets and capital efficiency (with 100% of free cash flow now channelled into dividends and buybacks), the surprising news for us was the company's plan to move its fibre (broadband/fixed line) business to a wholesale structure. Pricing details will be announced next quarter. It is impressive that NTT is proposing to effectively self-regulate by cutting interconnect and converting this to a wholesale deal for resellers before the regulator forces some other deal on them. Simplistically this allows NTT to focus on cutting infrastructure headcount/costs and leaves others to fight it out at the retail level, discourages KDDI from becoming too aggressive in its own fibre rollout and realistically shuts the door on any other competition. So assuming NTT gets the wholesale pricing right, it will have DoCoMo, Softbank, electronic retailers etc all selling the service to the 24 million households that are yet to take it. On pricing, a balancing act is required; cut it enough to get resellers interested but not so far that these resellers can eat into our existing 18 million sub core. NTT can bundle cable TV and other services to keep the core loyal. From an NTT perspective, any move that accelerates take-up of the fibre network and brings forward the date that the copper network is shut down, is good news.

In summary, NTT is just one example of the sensible and somewhat overdue reforms that are taking place across a range of Japanese companies. These reforms ultimately underpin our generally optimistic view of the portfolio.

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$20,000 invested in the relevant Fund over five years from 30 June 2009 to 30 June 2014 relative to their Index (in A$) 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. Invested position represents the exposure of physical holdings and long stock derivatives.

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