Platinum Japan Fund

Jacob Mitchell Portfolio Manager

Disposition of Assets *

REGION	DEC 2013	SEP 2013
Japan	90%	91%
Korea	9%	8%
Cash	1%	1%
Shorts	14%	14%

The Fund also has a 10% short position in Japanese Government Bonds.

* The invested position represents the exposure of physical holdings and long stock derivatives.

Source: Platinum

Portfolio Position

Changes in the quarterly long portfolio composition:

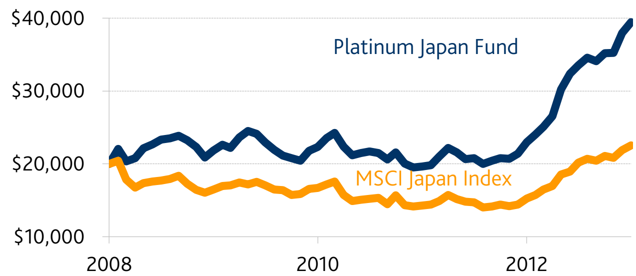
Sector Breakdown

SECTOR	DEC 2013	SEP 2013
DOMESTIC	61%	58%
Consumer and Retail	15%	15%
Financials	15%	15%
Services	13%	11%
Healthcare	8%	8%
Telco and Utilities	6%	5%
Property and Construction	4%	4%
EXPORT	38%	41%
Tech/Capital Equipment	22%	24%
Durables	13%	13%
Commodities	3%	4%
Gross Long	99%	99%

Source: Platinum

Value of $20,000 Invested Over Five Years

31 December 2008 to 31 December 2013



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

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, smart buildings).
- Cheap real asset exposures that domestic investors will seek as inflation hedges.

Performance

(compound pa, to 31 December 2013)

	QUARTER	1 YR	3 YRS	5 YRS	SINCE INCEPTION
Platinum Japan Fund	12%	72%	21%	15%	15%
MSCI Japan Index	7%	48%	11%	2%	1%

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

Key contributors to quarterly performance included Panasonic +29%, SK Hynix +22% and our internet 2.0 stocks such as CyberAgent +58%, Naver Corp +37% and the tangentially related Daifuku +27% (production line and warehouse automation provider benefitting from both a cyclical rebound in orders from auto assemblers and secular growth in e-commerce customers). Detractors included recently acquired Avex, as subscriber growth within the smartphone video streaming business disappointed. Our shorts also cost around 1% of performance.

Changes to the Portfolio

Longs

Whilst we reshuffled some exposures, including adding to our mega-bank holdings and Daiichi Sankyo, in terms of new stocks or complete divestments, the quarter was relatively quiet. We acquired a holding in internet gaming company Dena, a stock that we have tracked through two previous cycles of neglect-euphoria and back to neglect. In a similar manner that CyberAgent fell out-of-favour as investors questioned relevance of their on-line content business in the ‘smartphone’ era, Dena has de-rated on concerns regarding new competition within its core on-line gaming platform business. We have weighed the reality of the challenges against the company’s historic ability to capitalise on new opportunities forming a view that the current issues are transitory and more than accounted for by a starting P/E multiple of 7 times.

Over the past nine months Nippon Telegraph and Telecom (NTT) group has steadily crept up our holdings rank and now represents our second largest investment (when included with our direct holding in 63% owned mobile subsidiary NTT DoCoMo). This is an inherently dull but changing company with some 95% share of the Japanese fixed line market, 46% mobile share and a large and growing global data-centre/corporate backbone business. A cursory outline of the investment case would make the following points:

- Apparent commitment to lift a pitifully low 3% margin in core fixed line business via headcount reductions within the legacy copper infrastructure in favour of the recently completed Fibre to the Home (FTTH) network with every 1% improvement in this margin equivalent to a 3.5% increment to earnings per share (EPS).
- Japanese mobile industry ARPU is now expanding 1% year-on-year, a nice turnaround from the historical 2-5% pa declines and we expect growth to accelerate for two reasons: 1. Growing recognition within the industry that customers are prepared to pay-up for the significant benefits created by smart mobile devices when connected to quality, high speed networks; 2. Softbank's focus switches from customer acquisition to domestic cash-flow generation to fund global expansion.
- Management comments regarding mobile subsidiary DoCoMo's underperformance are becoming more strident by the day and rather than making excuses for the subsidiary, the parent company is upping the ante by demanding greater cost cuts to offset top-line misses. Potentially they have worked out that a 46% market share business should earn an operating margin closer to Verizon Mobile i.e. 30% rather than 20%.
- With a growing need for mobile operators to divert data off the radio network via Wifi to fixed line, the company's FTTH business is under-appreciated and Softbank's decision to extend bundling of NTT's FTTH service lends support to this.

The two key risks that require monitoring are:

- Overpayment for 'Cloud' acquisitions in achieving managements' goal of lifting overseas revenues from $12 billion to $20 billion over the next three years and poor contract execution within one of the key subsidiaries responsible for this, NTT Data.
- Key competitor's KDDI cyclical tendency to over-reach pushes its mobile-FTTH bundling strategy from niche to mainstream and disrupts recent industry ARPU growth.

Offsetting these risks is the fact that this historically insular company is now responding to market expectations for a greater level of management accountability with some of the first EPS targets in its corporate history and, importantly, our margin of error remains high with a starting cash flow yield of 11%. We find it puzzling that in a market that has celebrated Kuroda's massive easing by chasing so-called inflation protected real assets such as property stocks, that NTT's long-life (and relatively new) infrastructure assets trade on such a high yield (with over 3% paid as dividends and the same again in buybacks). Further, Japan is one of the few telecom markets globally where spectrum licenses are offered on what amounts to an evergreen basis and fees are immaterial making the duration profile of these assets extremely long-life; NTT represents a natural core holding for the Japanese pension fund industry.

Shorts

Our aggregate short position remained relatively unchanged over the period though we switched some of the Nikkei Index short into some stock and sector specific components that offer a better risk reward trade-off.

Currency

Our Yen exposure remains relatively unchanged over the quarter though we switched some of our US dollar exposure to Korean won as that country's record trade surpluses should retain appreciation pressure on the currency; it remains undervalued on a growth adjusted purchasing power parity basis.

Commentary and Outlook

Japanese policy makers continue to eschew big bang micro economic reform, favouring a Trojan Horse approach, hoping that relatively inoffensive policy initiatives morph into something far more revolutionary. An example of this includes Professor Ito's review of the national pension manager, Government Pension Investment Fund's (GPIF) investment process. In Japan, more than ¥200 trillion in financial assets are held by public pension funds with the largest of these the GPIF at ¥120 trillion. Ito's review was triggered mid-last year as part of Abe's announced growth strategy for stimulating private investment. The report is unusual in its conciseness (only 18 pages), breadth and boldness in addressing both process issues and offering some direct advice on asset allocation. On the latter, the whole thrust of the report is that Japan's public pension industry should prepare for coming inflation and reduce its weight in domestic fixed income assets. On process, a clear framework is proposed under which management of these funds would be modernised in-line with global best practice. Along the way Ito offers some gems that would warm every intermediary's heart such as the observation that GPIF's fixation with brokerage and fee minimisation may have been counterproductive in isolation of any assessment of performance forgone.

The core process recommendations include adoption of a far more prospective approach to risk return assessment, greater active management and most interestingly, for passive allocations, the consideration of more shareholder friendly benchmarks such as the JPX-Nikkei Index 400 instead of the banal, market capitalisation weighted Topix 1st Section (over 1,700 companies). This is where the Trojan Horse part comes in. Index inclusion within JPX-Nikkei 400 Index (an initiative of the Japan Exchange Group and Nikkei that goes live this year) is open to any TSE listed issue (1st Section, 2nd Section, Mothers, JASDAQ), which is a total of over 3,000 companies. However, membership will be restricted to the top 400 companies ranked on the following quantitative and qualitative factors; the quantitative factors include:

- Three year average return on equity (RoE) (40% weighting).
- Three year cumulative operating profit growth (40%).
- Market capitalisation on the base date for selection (20%).

The qualitative factors include appointment of independent outside directors, adoption or scheduled adoption of IFRS and disclosure of English language earnings information.

For long time Japan observers such as ourselves, the idea that the domestic pension industry could be forced to invest in high RoE companies is deliciously intriguing. Clearly, there are potential behavioural implications for underperforming corporate management that has historically relied on these pension funds for protection against foreign calls for greater accountability. Now Ito's report is at the same stage of many of the 'Third Arrow' reforms in that it represents a template for proposed change; for it to have any real impact it will need endorsement by the 'elite'.

Since the 'Abenomic's' rally began, Japanese equities are up over 70% in Yen terms and around half this when measured in US dollar terms, highlighting just how much of this rally has been currency related. At around 1.3 times book value, in aggregate the stock market is no longer in the 'deep value' zone. However, we are pleasantly surprised by the growing list of self-help opportunities presenting themselves. It would seem that many corporates rather than using the weaker Yen to delay much needed reform are starting to buy into a general need to modernise to remain relevant.

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$20,000 invested in the relevant Fund over five years from 31 December 2008 to 31 December 2013 relative to their Index (in A$) 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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