

Platinum Japan Fund



Scott Gilchrist Portfolio Manager

Quarterly Haiku

Markets roil, oil drops

Toshiba pile driver

OLED disruption

Disposition of Assets

REGION	DEC 2015	SEP 2015
Japan	71%	61%
Korea	3%	5%
Cash	26%	34%
Shorts	-5%	-6%

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

Portfolio Position

Sector Breakdown

SECTOR	DEC 2015
JAPANESE INTERNATIONAL FOCUS	36%
Electronics (Canon, Panasonic, Nitto Denko)	24%
Autos (Toyota, Nissan, Sumitomo Electric)	5%
Industrials (JSR, Mitsubishi Corp)	7%
JAPANESE DOMESTIC FOCUS	35%
Internet (NTT DoCoMo, Recruit, Rakuten, Nexon)	14%
Financials (Mitsubishi UFJ)	9%
Consumer (Asahi)	7%
Health Care (Mitsubishi Tanabe, Ain)	4%
Property	1%
KOREA	3%
Electronics (Samsung Electronics)	3%
GROSS LONG	74%

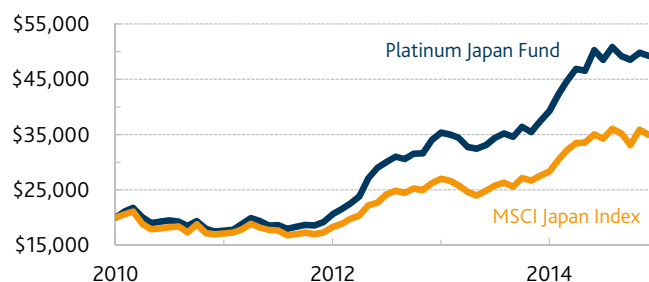
Currency Position

Japanese yen	90%
Australian dollar	6%
Korean won	3%
US dollar	1%

Source: Platinum

Value of \$20,000 Invested Over Five Years

31 December 2010 to 31 December 2015



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

Performance

(compound pa, to 31 December 2015)

	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum Japan Fund	1%	25%	34%	20%	15%
MSCI Japan Index	6%	23%	24%	12%	2%

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

Portfolio performance for the quarter was positive, lagging the rising market due to cash holdings and a small market short position. The strength of some large positions such as NTT DoCoMo, Nitto Denko and Samsung and a strong rebound in some cyclical holdings was offset by weakness of some recent acquisitions. The Australian dollar strengthened against the Yen, which reduced returns.

Changes to the Portfolio

As described in our last quarterly report, the portfolio's asset mix is predominantly Yen based Japanese equities with a sizeable cash holding and a small market short position. There were limited structural changes to the portfolio during the quarter. The Japanese stock market has seen a bifurcation of valuation, thus stocks such as Next and En-Japan were sold. On the flip side, small initial positions were taken in a range of "value stocks" which are generally trading at low multiples, often below half book value.

Commentary

Hans Rosling extols the beauty and majesty of the humble washing machine. The day his mother was relieved of the chore of washing the family's clothes in the icy Swedish watercourse was the first day he visited the library. "We loaded the laundry. And what do you get out of the machine? You get books." The humble smartphone has the potential to make a similar difference to lives all around the globe. In the latest quarter, Indian smartphone shipments grew 20% and are now approaching levels of the USA although they are still nowhere near saturation. From the LCD display to the many other components and the equipment used to assemble the phones, Japanese suppliers occupy a critical part of the smartphone supply chain.

JSR was founded as Japanese Synthetic Rubber by Bridgestone and the Japanese government in 1957 to establish a local rubber industry. While rubber is still a core business, the most important division is one of the leading suppliers of wafer manufacturing chemicals to the global semiconductor industry, in particular the industry leaders Intel, TSMC and Samsung Electronics. While the many predictions of the end of Moore's law have been wrong, it is becoming increasingly complex to double the performance of semiconductor chips every two years, and JSR plays a critical role in this ongoing effort.

Recent months have highlighted some of the retrograde behaviour of Japanese corporates with the accounting scandals at Toshiba and the substandard construction work at Asahi Kasei. JSR stands at the other end of the spectrum. CEO Nobu Koshiba speaks English and has a global perspective, having worked in the USA for many years. There are three external directors on the board of seven. Current payout is above 50%, a combination of a 2.6% dividend yield and reasonably well-timed share buybacks. The history has been that these shares are cancelled and consequently the outstanding share count has reduced over time.

The current valuation of JSR is certainly not expensive. At the current market capitalisation of JPY430 billion, it is priced at a P/B of 1.2, a P/S of 1.1 and a P/E of 15. The balance sheet is very strong, with current assets being more than three times total liabilities. Debt is minimal. It is not aggressive to assume that cash holdings of JPY40 billion, short-term investments of JPY74 billion and long-term equity investments of JPY74 billion could easily be returned to shareholders with no negative influence on the long-term progression of the business. Thus the EV is almost half the current market value, and the valuation appears anomalous, especially considering the quality of the underlying businesses and accompanying cashflow generation and long-term growth prospects.

Intel is JSR's favourite customer. While the past of desktop PCs and WiFi-enabled laptops belongs to Intel together with their dominance of server farms, the future is less certain. ARM's architecture, combined with a dynamic foundry manufacturing ecosystem, dominates the mobile phone processor business. Otellini, the former CEO of Intel, was offered the opportunity to develop a smartphone processor for Apple, but declined – surely one of the great strategic blunders of the last decade. In the latest Intel manufacturing transition to 14 nanometre (nm) "second generation" 3D

transistors, JSR has a majority share of photoresists and multilayer materials. The supplier mix for 10 nm and 7 nm has not yet been decided. This is an important position as the delay to extreme ultraviolet lithography (EUV) means that multiple patterning is required on an increasing number of critical layers and ArF immersion lithography requires reinforcing materials below the photoresist. JSR also has a leading photoresist and multilayer material supply position at TSMC and a lower market share at Samsung. These two products are part of a wide portfolio of products developed over the last two decades as the semiconductor industry has grown exponentially.

Photoresists are complex and extremely pure mixes of organic polymers, catalysts and carriers. The basic organic chemistry originally had commonality with JSR's rubber business. The chemical mix has changed over the many generations as the light wavelength has decreased. The next major transition is to EUV. ASML has been developing the required light source and machine for many years and commercialisation now appears to be in sight. Nikon and Canon both failed in this endeavour and ASML now has a monopoly on these US\$100+ million machines. JSR has been working diligently with IMEC, the Dutch research lab, to develop a completely new photoresist for EUV and at this stage seems to be far ahead of the competitors Tokyo Ohka, Shin-Etsu and the Koreans. These transitions highlight one of the key risks to the business. However, the CEO is from this division and is well aware of the situation, having spent a lot of time at Intel's Oregon fab himself. Pricing for this product is likely to be very attractive, unlike the relentless price deflation seen across most of the tech industry. Even before this transition, sales should continue to grow at double digit rates at high incremental margins.

The majority of JSR's original business of synthetic rubber is commoditised as the key grades were first developed many decades ago. Nevertheless, JSR manages to achieve reasonable returns in this business for two reasons – butadiene and solution styrene-butadiene rubber (S-SBR). There are three main butadiene extraction technologies in use, one of which was developed by JSR. They use this process in their own plants where they extract the chemical from a mixed stream of C4 sourced from adjacent crackers before returning the spent stream back across the fence. The butadiene price and spread over naphtha are very cyclical and the industry is currently passing through a deep trough as new capacity comes online and tyre demand is weak.

However, even at trough pricing, JSR is profitable as their sales are based on favourable terms as off-takers prefer security of supply.

JSR's key petrochemical plants are now over 40 years old and in need of higher ongoing maintenance to bring them up to modern standards so that they can operate at the high levels of safety and reliability expected by clients. It seems as though the petrochemical division has been somewhat neglected for the last few years and further development is required. This will partly come through expansion of capacity for S-SBR, a high-end product where JSR has over 40% market share. JSR is expanding capacity in Thailand and Hungary to supplement their production in Japan. S-SBR is used to reduce rolling resistance of tyres, thereby increasing fuel efficiency. Governments are increasingly mandating tyre efficiency. The combination of a trough in butadiene pricing and increased sales of high-end artificial rubber could result in decent profit growth over the medium-term.

JSR was present at the birth of the LCD display industry and their chemicals and films are critical enabling components for the industry. They dominate supply of alignment film for large LCD panels with only one other supplier. Their wide product range includes colour photoresists, spacers, etc. While the transition to higher quality TVs seems ongoing with the transition to 4K displays underway, the looming threat is that of organic light-emitting diode (OLED). Samsung is the main supplier of small OLED displays for their own phones and also to the Chinese ecosystem, while LG Display is the key supplier of large OLED displays. If this transition were to occur quickly, then it would be a severe setback for JSR. For the moment, the growth in Chinese panel capacity had led JSR to build a supply facility in China, and global square metreage should continue to grow after the current lull.

JSR is working on a third key business to complement their semiconductor and petrochemical activities. They have been involved in medical chemical development and supply for many decades and are now focusing more heavily in this area through both internal development and acquisition. As expected, the outlook for this is uncertain, as evidenced by their expansion into lithium ion capacitors. The new factory opened in March 2015 and, at last report, was operating at less than 10% utilisation as promised orders had not arrived and customer acceptance and design wins had been slow. While the core of JSR appears strong with world leading products and strong financials, the overall corporate strategy for the next 20 to 30 years is still a work in progress.

Outlook

Globally, stock markets seem willing to look through the roiling currents and project a rosier future than the recent past. Bond markets are less complacent, with Japanese government bond yields falling to new lows. Recent Yen strength looks likely to continue, especially against the Australian dollar, at least for the short to medium term. Any further weakness in the equity markets will be used as an opportunity to acquire assets with long-term attractive fundamentals at low valuations.

Notes

1. The investment returns are calculated using the relevant 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: 28 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

(NB: The gross MSCI Index was used prior to 31 December 1998 as the net MSCI Index did not exist.)

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 2010 to 31 December 2015 relative to its benchmark 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

The investment returns are calculated using the relevant 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 benchmark 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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