

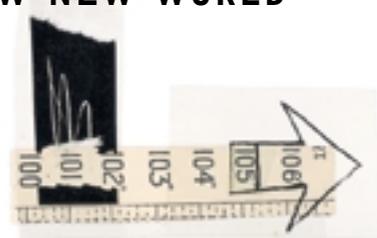


# re:evolution

PLATINUM CAPITAL LIMITED

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**FAST FORWARD, TO THE NEW NEW WORLD**



**PREFACE** Given the current excited market conditions we thought you might enjoy the two following essays. Regular readers will know our *penchant* for history and the lessons that can be drawn from earlier experiences. We often take too cynical a view of the behaviour of crowds because of this, but social and economic history are littered with evidence of excess.

When studying the great booms of the past, there is a common thread that runs through them all. Without exception, money is plentiful and large segments of the population become involved in the pursuit of wealth. The excitement of the moment tends to dull critical faculties. At the height of the rush it is very difficult to stand aside with self-confidence and defeat the case that is being made. This is so because invariably the object of enthusiasm has elements which are irrefutable.

The greatest impediment to retaining one's judgement is the way most of us take comfort in numbers. Worse still, those who are in sync with the mood of the day are also enjoying and enriching themselves. The doubter cannot help asking whether he is being a mirthless kill-joy – particularly since as a sceptic he may have had contrary views early in the piece.

Apart from credit, the second most important characteristic of a boom is the emergence of a new idea, technology or, in earlier times, the exploitation of distant lands. Invariably, the concept is not initially fully understood by all the market participants but as familiarity grows, so does the tendency to extrapolate.

More and more adherents exchange views about the future potential and opportunities for profit. Information and disinformation soon intertwine as the stories grow about the fabulous wealth made by various participants in the boom.

As the excitement builds and the critics point to the dangers, the case is made for the uniqueness of the situation. Protagonists claim that things are different this time. The cruelest paradox of all is the sublimated admission that the boom can't go on forever. This is expressed in the so-called 'greater fool theory' – the notion that each participant through some miraculous prescience will exit before the music stops.

As the excitement grows, there is the accompanying growth in the stature of the financial alchemist of the day. He is anointed by the media to have extraordinary powers, the clarity of vision and a grasp of the situation with which only gods can compare. There are usually lesser lights who move in the same esteemed circle but seldom is there confusion about the towering colossus of the day.

So in the excitement, many lose sight of first principles and are swayed by the emotions of the crowd. The blinding vision of great opportunities discourages critical analysis. Finally, reality intervenes; the underlying concept can no longer support the superstructure of hope and glory that the crowd has burdened upon it. The trigger usually comes from an unexpected quarter but is subsequently held responsible for the end of the boom. In practice, this is seldom the case – for in the final stages many of those who had identified the opportunity earlier, recognised the changing tone of the crowd and understood that the chatter was no longer grounded in reality. The end comes as the hordes of poor new recruits are met by the phalanx of shrewd sellers.

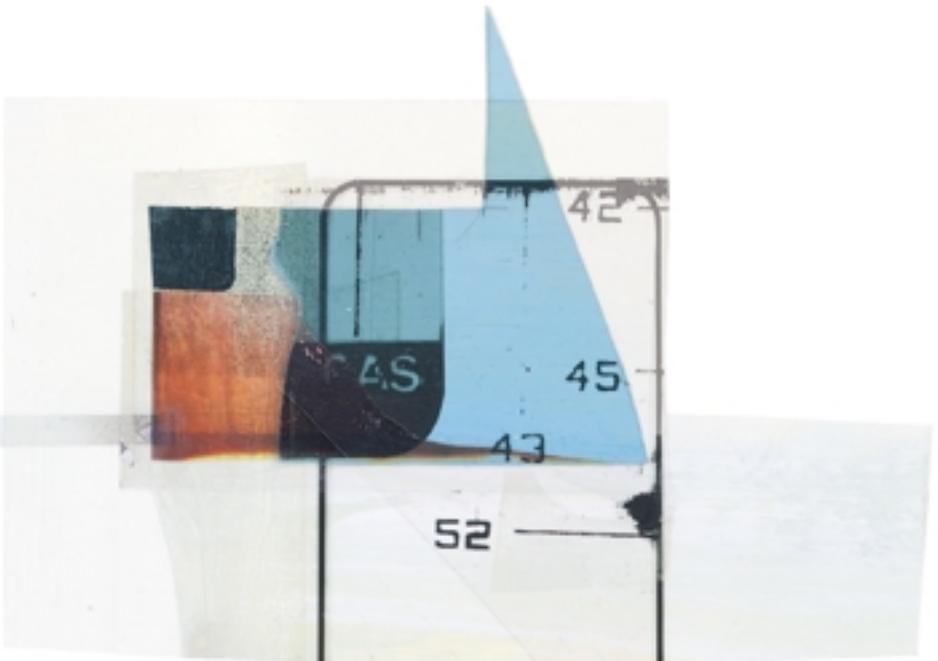
The excruciating dilemma that all investors face is their inability to predetermine the extent of a boom even if they are early participants. Our first piece '*New Economy:Yes New Metrics:No*' puts three successive US stock market booms into perspective. The article highlights the shared characteristics: the great excitement generated by the new thing; the initial success that leads to excess; and, as greed supersedes reason, how fundamental considerations get cast aside. The excess ultimately leads to disaster and invariably, when it is far too late, the machines of State grind into action to 'ensure that such an event shall never occur again'.

'*A Tale of Two Botanies*' tells a far more chilling tale of the same boom-bust mechanism at work. In this instance, the consequences could be far more devastating than mere financial distress. The excitement here is driven by new discoveries in science which carry with them consequences not witnessed since the cold war concept of the nuclear deterrent. Scientific curiosity and greed – both stylistic and monetary – are propelling a frenzy of potentially harmful activity. Voices raised in caution are often condemned as ignorant.

The sentence that left me with an eerie sense of foreboding says 'Transgenics may let pathogens vault the species barrier and enter new realms where they have no idea how to behave'.

I hope you enjoy these pieces and do bear in mind that such patterns are not confined to finance and biotechnology alone. Like the fractal patterns that can be described by relatively simple mathematical formulae, the perils of folly and avarice have the same simple root, but can vary greatly in their enormity.

**KERR NELSON** MANAGING DIRECTOR







# New Economy: Yes New Metrics: No

BY PAINEWEBBER 12 MARCH 2000

Edward Kerschner CFA, Thomas Doerflinger Ph.D & Michael Geraghty



### THE 'NEW NEW INDUSTRIALS'

It was almost a year ago that we made the case for the 'new industrials'. In *'The Information Revolution Wars'* (May 9,1999) we wrote that:

'The companies that are building the DGDP [Digitisable GDP] economy are the 'new industrials'. Like Carnegie Steel, Ford Motor Company and General Electric, they are *building the infrastructure for the DGDP economy*. The New Industrials are one of the very best ways to invest in the DGDP Revolution. There is not a large retailer, manufacturer, financial institution or government agency that can avoid moving onto the Web – whether or not the investment is profitable in the near term. Companies that build the DGDP infrastructure should enjoy explosive unit growth over the next decade. Among the best positioned: Cisco Systems, IBM, Lucent [and] Microsoft. These are all powerful and profitable companies with strong positions in fast-growing markets'.

A year is, of course, an eternity in Internet time. Today these 'new industrials' are so passé they could well be referred to as the 'old new industrials'. In the minds of many investors, these 'old new industrials' have been surpassed by the 'new new industrials', which are those companies that are *perceived* to be the builders of the DGDP economy *of the future*. But because they are prized for their *potential* earnings power five or ten years from now, these 'new new industrials' cannot be valued by traditional metrics such as price-to-earnings multiples.

Instead, many investors have turned to new metrics, such as price-to-sales (or its equivalent, market cap-to-revenue), revenues per customer, gross profit per customer etc.

The rise of these 'new new industrials' has fragmented the US stock market by creating categories of stocks valued by different metrics. To address this problem, Table 1 shows, to the extent possible, the same valuation metrics for three groups of companies:

- 'Old old industrials' such as Alcoa, Caterpillar, Deere, Du Pont, Ford, PPG etc.
- 'Old new industrials' such as AOL, Applied Materials, Cisco, Dell, EMC, Intel, Lucent, Nextel, Oracle, Sun Microsystems and Texas Instruments.
- 'New new industrials' such as Amazon, Ariba, Broadcom, Ciena, Infospace, Level 3, Sycamore Networks and VeriSign.

Based on estimated 2000 EPS, the 'old old industrials' are trading at 11x, the 'old new' at 54x, and the 'new new' at infinity, since they have no earnings. In terms of 1999 sales, the 'old old' are at 0.6x, the 'old new' at 7.3x, and the 'new new' at 85.7x. Many investors have convinced themselves that, because of the rapid growth of the Web, the 'new new' will *eventually* grow into valuation levels that are reasonable by traditional metrics, such as price-to-earnings multiples. In the meantime, those investors argue, the new metrics support continued purchases of these shares. That seems a very risky bet.

**Table 1: 'Old Old Industrials', 'Old New Industrials' and 'New New Industrials' Old and new metrics**

	PRICE/EARNINGS		PRICE/SALES	
	1999	2000	1999	2000
<b>Old Old Industrials</b>	12.6x	10.8x	0.6x	Na
<b>Old New Industrials</b>	69.2	54.3	7.3	Na
<b>New New Industrials</b>	Nmf	Nmf	85.7	Na
<b>Nasdaq 100</b>	147.1	110.8	11.0	Na
<b>Nasdaq 100 CW*</b>	111.4	85.2	11.2	Na
<b>S&amp;P 500</b>	28.3	24.1	2.1	Na
<b>DJIA</b>	21.9	19.1	1.7	Na
<b>DJIA CW**</b>	29.1	25.3	2.6	Na

Source: PaineWebber

\* Nasdaq 100 cap weighted ie. weighted by the market capitalisations of the 100 constituent companies. Nasdaq 100 is a modified capitalisation-weighted index. \*\* DJIA cap weighted ie. weighted by the market capitalisations of the 30 constituent companies. DJIA is sum of per share stock prices divided by a divisor.

## IN THE BEGINNING

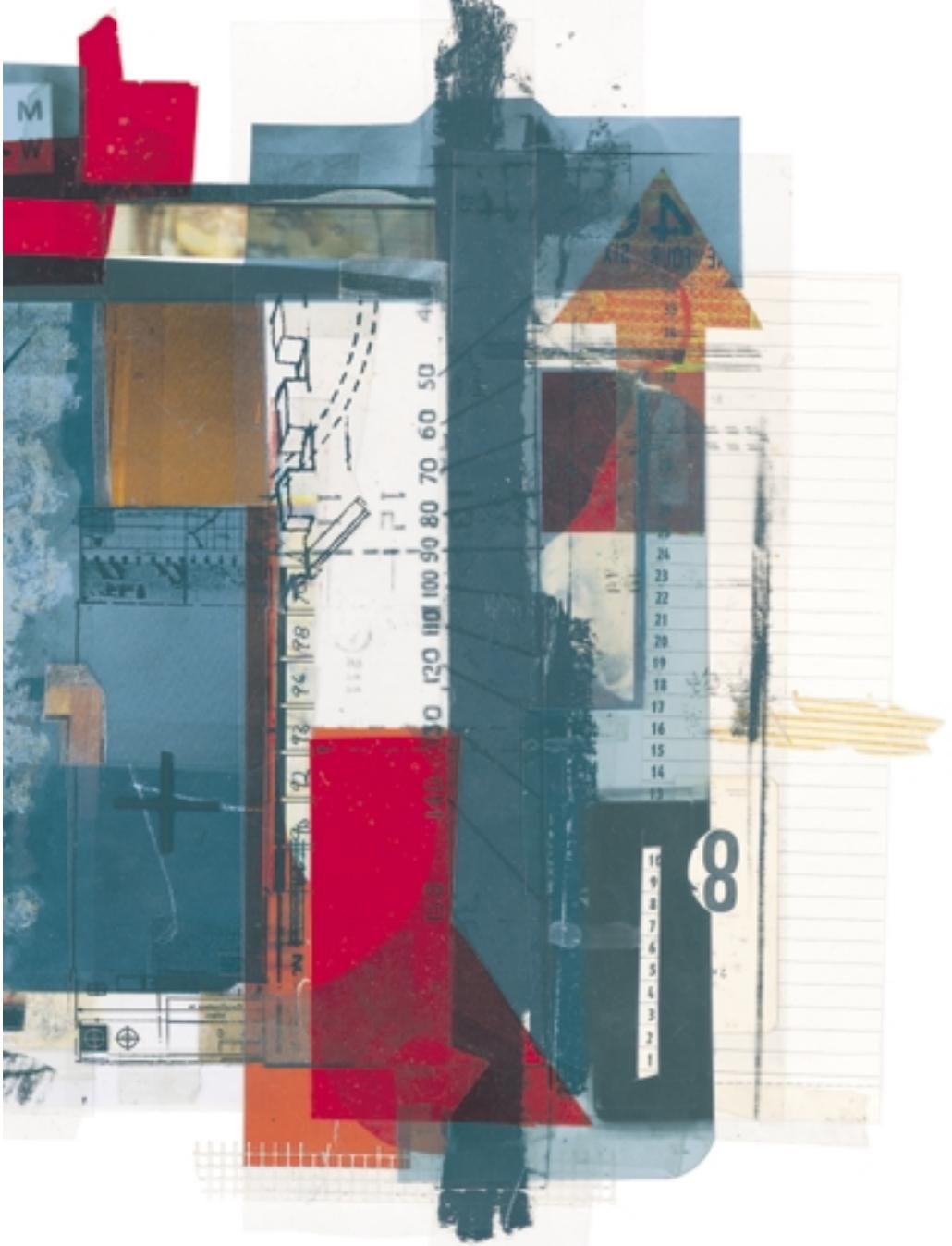
When did the phenomenon of IPOs of technology companies without profits begin? As Michael Lewis writes in his book 'The New New Thing', it started where the Internet began to really take-off. With Netscape. And because Jim Clark wanted a big boat!

'Six months after he founded Netscape, Clark agitated for the company to go public. The company had few revenues, no profits, and a lot of new employees. No one else inside the company thought it should do anything but keep its head down and try to become a viable enterprise. 'Jim was pressing for us to go public way before anyone else', recalls Marc Andreessen. It turned out there was a reason for this. He'd seen a boat called Juliet. He wanted one just like it, only bigger. To get it he needed more money.

'By then the decision was not Clark's alone to make. The company had hired a big-name CEO, Jim Barksdale, and had a proper board of directors. Barksdale didn't want to go public. He thought the company had enough problems trying to figure out how to turn a profit without having to explain itself to irate shareholders. But this time Clark had power, through his equity stake. He called a meeting to discuss the initial public offering (IPO), and stacked it with lawyers and bankers who stood to reap big fees from a public share offering and who were, as a result, enthusiastic about his initiative. At that meeting Barksdale finally capitulated. Eighteen months after Netscape was created, and before it had made a dime, Netscape sold shares in itself to the public. On the first day of trading the price of those shares rose from \$12 apiece to \$48. Three months later it was at \$140. It was one of the most successful share offerings in the history of the US stock markets, and possibly the most famous.

'There was only one explanation for its success: the market now saw the future through Clark's eyes. 'People started drinking my Kool-Aid', says Clark. 'Netscape obviously didn't create the Internet. But if Netscape had not forced the issue on the Internet, it would have just burbled in the background. It would have remained this counter-intuitive kind of thing. The criticism of it was that it was anarchy. What the IPO did was give anarchy credibility.'

'In the frenzy that followed, a lot of the old rules of capitalism were suspended. For instance, it had long been a rule of thumb with the Silicon Valley venture capitalists that they didn't peddle a new technology company to the



investing public until it had had at least four consecutive profitable quarters. Netscape had nothing to show investors but massive losses. But its fabulous stock market success created a precedent. No longer did you need to show profits; you needed to show rapid growth. Having a past actually counted against a company, for a past was a record and a record was a sign of a company's limitations. Never mind that you weren't actually making money – there'd be time for that later, assuming someone eventually figured out how to make money from the Internet. For the moment you needed to plow all of your revenues back into growth. You had to show that you were the company not of the present but of the future. The most appealing companies became those in a state of pure possibility. Which is to say that the US capital markets acquired the personal predilections of Jim Clark.'

#### THE 'M' WORD

Webster's gives the following definition: Mania (n) excessive or unreasonable enthusiasm.

Today's mania for high-tech Nasdaq stocks is reminiscent of other manias. In the 1960s conglomerates were the rage because the new metric of the day suggested that, when a conglomerate acquired a traditional company, their combined value exceeded the sum of the stand-alone values. In the late 1980s, the mania was for leveraged buyouts (LBOs), as investors incorrectly assumed that the private market value of *most* companies far exceeded their public market value.

As we detail below, in their early stages both the conglomerate and LBO concepts had some merit. Some conglomerates created in the early 1960s were fine companies, and LBOs were a brilliant and lucrative way to arbitrage the gap in the early 1980s between the depressed stock market valuation and the private market value of certain companies. But both innovations were taken to absurd extremes, which were justified with the use of new metrics. Likewise, as the Internet began to evolve, new valuation techniques needed to be applied to the *handful* of rapidly growing companies that were developing real franchises (such as America Online). But these new metrics are being indiscriminately applied today to justify extremely high valuations for companies with no earnings and no well-defined path to ever reaching profitability. And, as in past manias, these valuation realities are being overlooked because the stocks have momentum.

### 'THAT DOESN'T MATTER'

A classic 'red flag' warning that a mania is under way is when the new metrics bulls dismiss a worrisome valuation or economic indicator because 'that doesn't matter'. The reasoning behind today's mania for high-tech Nasdaq stocks is eerily reminiscent of the reasoning behind 1987's mania for private market values.

As mentioned, because the earnings of the 'new new industrials' are (at best) way off in the future, those companies cannot be valued using traditional metrics such as price-to-earnings multiples. So earnings 'don't matter'. But even though basic finance teaches that long duration assets are very sensitive to interest rates, the 'new metrics' bulls argue that interest rates also 'don't matter'. Specifically, because the equity- (not debt-) financed growth of the 'new new industrials' is so rapid, it's argued that their potential returns are far superior to those of bonds yielding a paltry 6%. (Nevertheless, our asset allocation model suggests that ten year Treasuries have close to an 80% probability of outperforming the S&P 500 over the next 12 months). In addition, the new metrics bulls argue that, even if the Fed continues to raise interest rates, that won't slow the cyber economy, although it may slow growth in 'old old industrial' America. This logic is problematic *because old economy companies are the major customers of the new economy.*

### No Exit

Perhaps the most worrisome parallel between today and 1987 is, however, the belief of many investors in the 'new new industrials' that they won't incur heavy stock market losses. It's argued that, thanks in large part to day trading over the Web, stocks today can be bought and sold quickly and easily. This, it is believed, ensures quick profits on the way up, and also avoids steep losses on the way down. In 1987 many very sophisticated investors (including large institutions) were also convinced that 'portfolio insurance' offered them protection from serious stock market losses.

What was true in 1987 remains true today: The price of a stock at any point in time is determined by the forces of supply and demand. If there are only sellers, and no buyers, prices plunge. Such a situation led to record volatility in 1987. While Nasdaq volatility has, in recent years, surpassed the levels reached in 1987 (largely reflecting a rush to *buy* stocks at literally any price), those record

Nasdaq volatility levels could well be exceeded if a *selling* frenzy were to occur today, i.e. the speed of any drop in Nasdaq prices could make the pace of recent gains seem modest.

### **It *Always* Comes Down to P/E and Earnings**

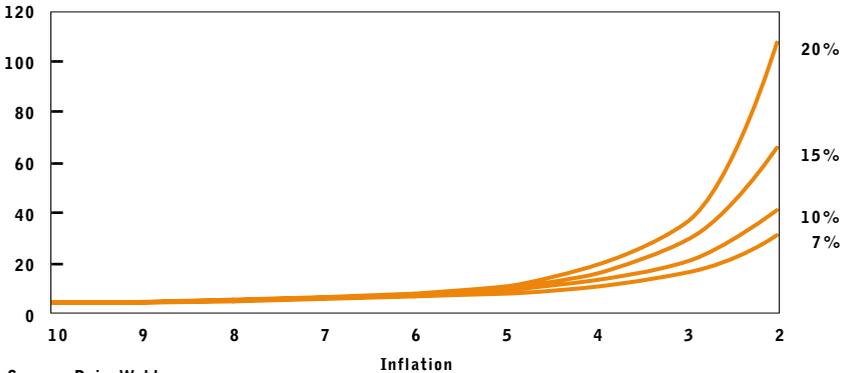
Today the best growth/value proposition is found among the 'old new industrials'. As we have pointed out many times in the past, in the long run only two things determine stock prices: earnings and P/E (with P/Es, in turn, a function of expected earnings growth). The relationship between P/E and earnings growth is geometric, *not linear*, so that a very fast growth rate is worth a very high P/E multiple (Chart 1). *But there is always a limit to that P/E multiple.* 'New metrics' can lead to astronomic valuations for a short period of time but, in the end, the market value of a company is based on some constant multiple of that company's sustainable earnings power.

### **The Beginning of the End of a New Metrics Era Does *Not* Necessarily Signal the End of a Bull Market ...**

As discussed below, the events that triggered the *beginning of the end* of previous new metrics eras were relatively minor. The Fed-induced shallow recession of 1970 clobbered the earnings of conglomerates, and the stocks quickly fell out of favour. And what ultimately led to the crash on Monday, October 19, 1987, were comments by Treasury Secretary Baker the previous Sunday about what he viewed as inappropriate German monetary policy. The coup-de-grace for LBOs in 1989 was the failure of just one deal, involving UAL Corp., to get financing. What will trigger the beginning of the end of the current new metrics era remains unclear. But, as was the case with the two prior manias, the *complete* demise of this new metrics era will likely (but not assuredly) be a gradual process, and one that occurs over the course of a few years. But, the initial corrective stage will likely be quite damaging just the same.

As long as this mania for high-tech Nasdaq stocks continues, however, long-term investors with portfolios of high-quality companies with strong franchises could well continue to underperform. But just as the crash of 1987 did not signal the end of that decade's bull market, *a meaningful correction among 'new new industrials' would likely not indicate the end of the current bull market.* The

Chart 1: P/E Multiples For varying growth rates



Source: PaineWebber

fundamentals for equity investing remain *perfect*: a federal government budget surplus; low inflation; consistent corporate profit growth; a demographically driven ‘big shift’ by households into equities that is likely to continue for at least another 10-15 years.

### . . . And Can Present a Good Buying Opportunity

After the stock market crash in 1987, the Wall Street economic consensus immediately shifted to a shallow recession in 1988 caused by the ‘wealth effect’ of the crash. As is often true after a financial panic, investors focused on the risks while ignoring all the positives. But economic growth was solid in 1988, corporate profits rose over 40% and inflation remained moderate. As investors discounted this positive news, stock prices rose 12% in 1988 and 27% in 1989.

If there is a sharp correction in the prices of some egregiously overvalued Nasdaq stocks, that could well engender a bout of doom-mongering similar to that which occurred in 1987. Some prominent economists might once again predict a recession caused by the ‘wealth effect’ of the correction. That school of thinking could spark further selling in the already battered shares of companies with exposure to the economic cycle, particularly the consumer sector. In addition, the stock prices of some ‘old new industrials’ might also fall if it were feared that the ‘new new industrials’ could no longer use equity financing to fund their purchases of the servers, routers and chips produced by the ‘old new industrials’.

However, an important point to bear in mind is, whereas conglomerates were basically an accounting and stock market charade that added no economic value, and LBOs were a useful financial technique that was inappropriately and indiscriminately utilised, *the benefits of the Internet are for real*. A collapse in the stock prices of some egregiously overvalued Nasdaq stocks *would not end the information revolution*. The US economy would still continue to reap the benefits of the information revolution, namely a muted business cycle, productivity gains and low inflation. And the forces that have been driving the consumer sector for the past several years (rising real wages in the context of a muted business cycle) would also remain unaffected by a sharp Nasdaq correction.

### **THE CONGLOMERATE: 1 + 1 = 3 (BUT ONLY IN A BULL MARKET)**

For the United States, the 1960s was a prosperous, confident decade that ultimately lapsed into overconfidence and catastrophe during the inflationary 1970s, when living standards plunged. In the realm of public and economic policy, overconfidence was reflected in the belief that the country could afford simultaneously to fight the War in Vietnam and the War on Poverty – without raising taxes. On Wall Street, overconfidence was reflected by a rising faith in ‘conglomerates’ or ‘multi-industry companies’. Relatively conservative conglomerates such as Litton Industries and Textron appeared in the early ‘60s and expanded during the decade. As the concept gained credibility in financial markets, other conglomerates were created by young and aggressive financiers including James Ling (LTV), Charlie Bludhorn (Gulf + Western), Harold Geneen (ITT) and Meshulam Riklis (Rapid American).

Conglomerates placed under one management businesses as diverse as (in ITT’s case) baking bread, selling insurance, renting cars and operating telephone systems. Even though they were glamorous companies with high P/Es that seemed to embody the ‘new economy’ of the 1960s, conglomerates frequently purchased humdrum, low-tech businesses such as shipyards and auto parts manufacturers. Conglomerates drove an acquisition boom during the ‘go-go years’ of the late 1960s; in 1968 there were three times as many acquisitions as in a typical year in the early ‘60s.



### **The Conglomerates' New Metric**

The new metric that justified conglomerates' acquisition binge had both a financial and a managerial/ideological dimension. Financially, a glamorous conglomerate with a high P/E ratio of, let us say, 40x could approach a target company trading at a P/E of 10x, acquire the target at a 50% premium (a P/E of 15x) and still have the deal be very accretive to earnings. These deals were often financed with debt, convertible debt and warrants (a.k.a. 'funny money') rather than common stock, which made them even more accretive to earnings. Thus in the strong economy of the 1960s even a mediocre conglomerate with uninspiring internal growth could produce very impressive EPS growth by doing many accretive deals while leveraging the balance sheet.

The new metric of conglomerate accounting was no secret formula; it was widely discussed in the press. For example, in February 1969 *Fortune* summarised the fear of critics:

'What disturbs them all is that if the conglomerate movement keeps on expanding as it has been, a large percentage of values in the stock market will consist of conglomerate shares whose prices depend partly on false growth rates. Therefore they will be highly vulnerable to a revaluation; and since the market usually runs to extremes, swinging from overvaluation to undervaluation, the price-earnings multiple of conglomerate stocks could drop catastrophically'.

That was a good call – the average price *decline* of ten conglomerates from the market top in early 1969 to the trough in May 1970 was 86%.

### **'The Best and the Brightest'**

Investors embraced the new metric of conglomerate accounting because they embraced the managerial ideology that went with it. Just as Americans thought the Vietnam War could be won by the 'best and the brightest' leaders using scientific management techniques in Washington, so did they believe that conglomerates strengthened the American economy by replacing stodgy managers who had mastered the operations of a particular industry with fast-moving, farsighted, entrepreneurial businessmen who were not overburdened with detailed knowledge. Summarising this viewpoint in 1968, *Business Week* wrote:

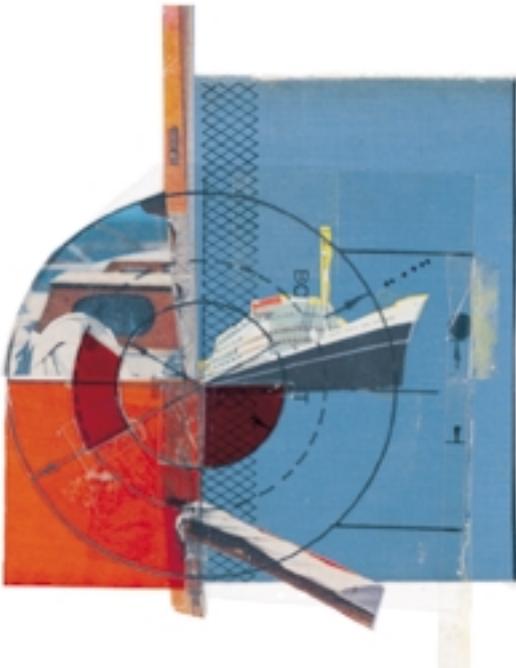
'The business schools are creating a generation of managers who believe that effective management techniques transcend industrial categories...

[Diversification] liberates management's thinking about expansion: uncommitted to any individual industry, management can swing capital quickly into any business field that looks profitable enough'.

And of course, managers were expected to realise 'synergies' between disparate businesses that made the whole company greater than the sum of its parts. In theory, managerial insights learned in defence contracting could be applied to the manufacture of consumer products. It is hard to exaggerate the degree of naive enthusiasm about the unlimited power of smart managers with big new ideas to work wonders. For example, in 1966, when America was beginning to focus on the 'urban crisis', Roy Ash, CEO of Litton Industries, told *Fortune* how his company was thinking of addressing the problem-with a 'de novo city':

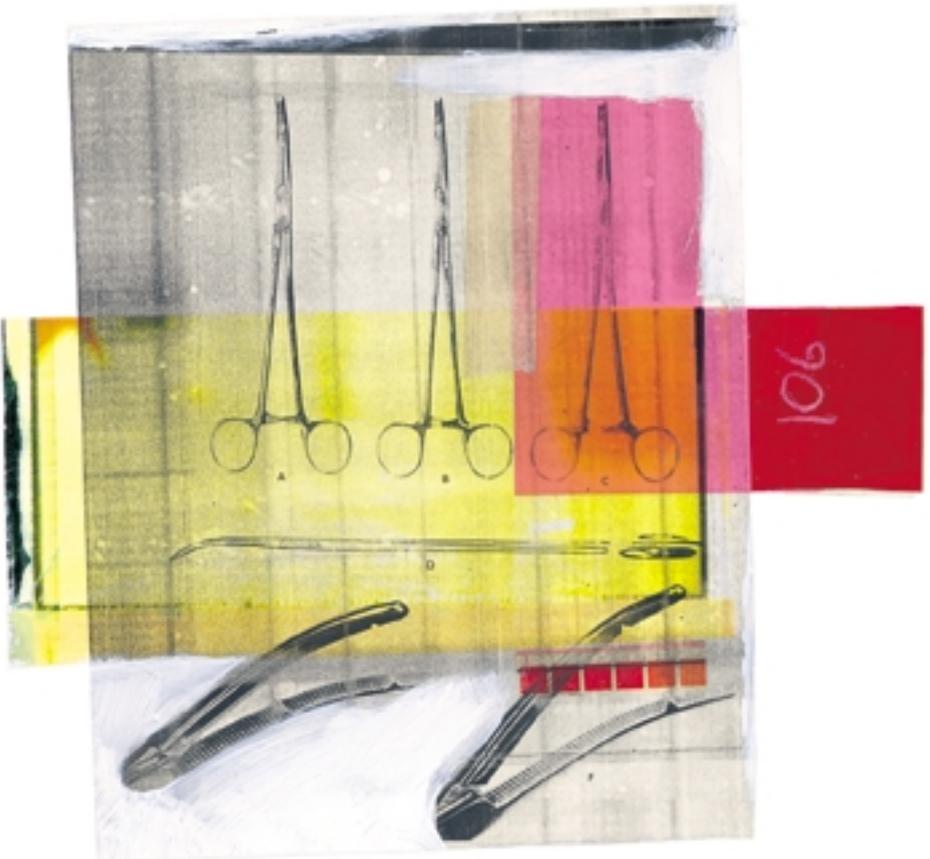
'Now maybe this is one of those situations in which the solution lies in integrating the problem and raising it to a higher level... There's no reason why you can't take 200 square miles some place that has the natural resources, which means primarily water – and even the water problem can be solved separately if it has to be – and create an ideal city with solutions for all these urban problems before it's even built'.

Mr. Ash did not mention how this ambitious project, presumably geared toward poor people, would generate earnings.



### A Cult of Youth

A cult of youth was part and parcel of the conglomerate movement; financially savvy young managers aimed to revitalise old-fashioned companies. One conglomerateur projected that in ten years corporate America would be consolidated into just 200 conglomerates. Established corporate managers bristled at such forecasts – Du Pont’s CEO once remarked, ‘Running a conglomerate is a job for management geniuses, not for ordinary mortals like us at Du Pont’. The CEOs of ‘old-line companies’ – the ‘brick and mortar companies’ of their day – feared that they would be acquired by ‘high-flying conglomerates’. Thus a *Wall Street Journal* ‘Heard on the Street’ column of February 1969 reported that the stock price of US Steel was up on rumours of a takeover – perhaps by Laurence Tisch’s Loews Corporation.



## A Post-Mortem for Conglomerates

The new metric of the conglomerate was fully embraced by Wall Street for about four years in the late '60s, but the companies performed very poorly after 1968. *Business Week* later reported:

'According to a study by economists David J. Ravenscraft and F. M. Schere, anyone investing \$1,000 in Teledyne Inc. and a dozen other budding 'free form' conglomerates in 1965 did 3.6 times better than the Standard & Poor's 400 industrials index by their banner year of 1968. But by 1974, these investors' gains had been more than wiped out. Those who bought at the 1968 peak fared even worse: They lost 56% of their investment by 1974, though the market was up 10% at the same time.'

As detailed below, many conglomerates were disassembled in the 1980s. What went wrong? Corporate executives who assumed the role of portfolio manager usually excelled as neither industrialists nor investors and ended up with a collection of businesses they did not understand. CEOs were too preoccupied with deal-making to run their businesses effectively (especially in a weak economy). And the performance of acquired companies often deteriorated once they were saddled with headquarters costs, the founding entrepreneur departed, and morale slumped. Once their profits turned disappointing, conglomerates' stock prices collapsed – particularly because conglomerates were favourite holdings of aggressive growth mutual funds that lost assets in the bear markets of the early 1970s. And because their EPS growth depended in large part on using their high-P/E shares to make acquisitions, their weak share prices further damaged their earnings growth. Their high debt levels further undermined earnings.

Although conglomerates lost their 'glamour' with the 1970 recession and no longer had the currency to make accretive acquisitions, they did not disappear. They continued to operate during the 1970s, when inefficiency was not a serious issue for most corporations because they could raise prices at will. Furthermore, accelerating inflation kept the real, after-tax cost of debt low. Meanwhile, in the 1970s many corporations made acquisitions in an attempt to diversify into higher-growth businesses. Consequently, by the beginning of the 1980s corporate America had a large number of highly diversified companies.

## THE LBO: 4 / 2 = 6

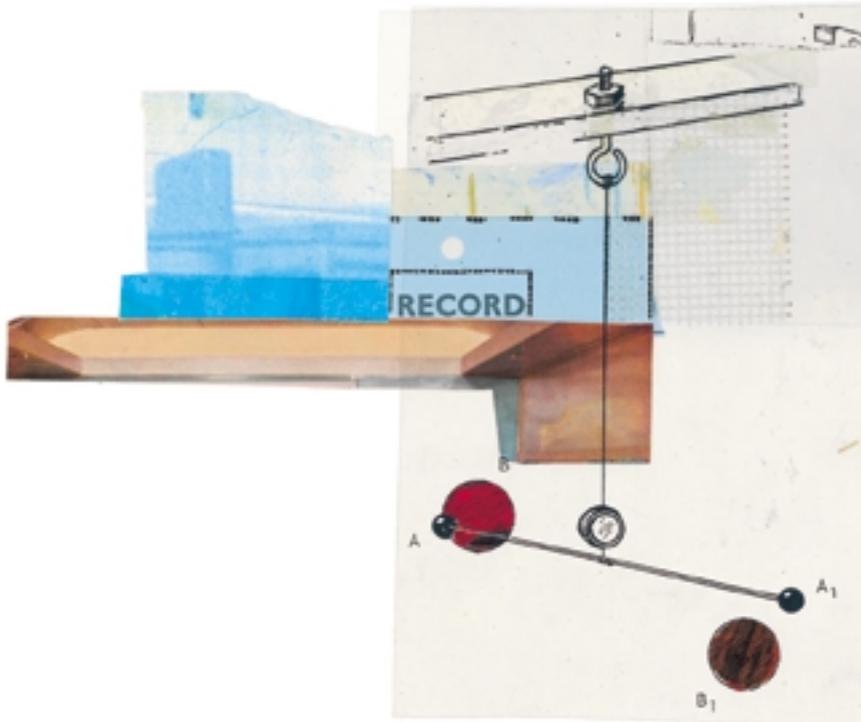
In the spring of 1989 a PaineWebber analyst who had just upgraded McDonald's from 'attractive' to 'buy' was recommending the stock to a portfolio manager who remarked, 'It's a fine company, but what has it done for shareholders?' The PM was thinking in terms of the new metric that governed the stock market in the late 1980s – one did not buy a stock just because it was cheap in comparison to its growth rate, but rather because it was likely to benefit from a 'strategic action' such as a leveraged buyout, an acquisition by another company or a corporate raider, or a major restructuring (which might involve such moves as selling businesses, leveraging the balance sheet and buying back shares).

So Wall Street had come full circle. In the era of the conglomerate the whole was worth more than the sum of its parts; in the era of the LBO, the whole was worth less than its parts were worth if sold off individually. It would be incorrect to dismiss both ideas as stupid fads. Whereas the conglomerate idea was a dumb idea that added no economic value and only fooled gullible investors through the legerdemain of merger accounting, LBOs were a *good* idea that did add value to the economy. However, LBOs were a good idea that was taken to dangerous excess; investors who got involved with them in the late 1980s fared poorly, and LBO loans were a material cause of the banking crisis of 1990-91.

### The New Metric of LBOs

In the 1980s, LBOs arbitrated the gap between the stock market value and the private market value of companies. This gap was huge because of the impact of high inflation during the 1970s. The acceleration of inflation from the low single digits in the 1960s to 12% by 1980 caused P/E ratios to collapse; stock prices were flat from the late 1960s to the early 1980s. Meanwhile, thanks to inflation and economic growth, the private market value of corporate assets i.e. what they could sell their buildings, oil, or businesses for in the private market – continued to increase fairly rapidly. Federal Reserve data measure this gap. In 1968 corporations were valued in the stock market at 105% of their underlying assets, but the bear market of 1973-74 lowered the ratio to 33%. At year-end 1980 the figure was 44%, and at year-end 1985 it was still around 47%.

By the late 1970s smart financiers were taking advantage of the gap between public (i.e., stock market) and private market values by borrowing the capital to acquire a company. After the deal, they could sell some assets to pay down the debt, cut costs to increase cash flows, and use the cash flow to pay interest and pay down the debt. Because interest payments were tax-deductible, the tax burden was low. As the company deleveraged, its credit rating improved and it could be refinanced with lower-cost debt. Eventually the company could be taken public again, enriching the owners. The signature deal was Gibson Greetings Inc.; former Treasury Secretary William Simon invested \$330,000 in 1981 and received \$70 million two years later.

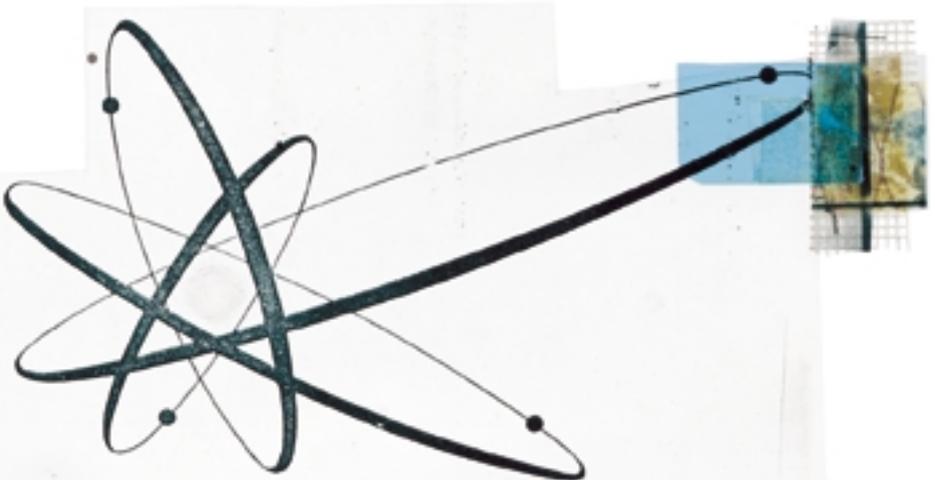


**Mr. Milken Becomes 'Highly Confident'**

At first LBOs were done by financial boutiques that minimised risk by purchasing companies with these characteristics:

- Established, mundane, proprietary product lines.
- Dominance or major share in a fragmented industry.
- Continuity of experienced managers (who were let into the deal).
- Consistent profitability, even during recessions.
- Minimal requirements for R&D and capital spending.
- Debt level not greater than 20%.
- Assets carried on the books well below fair market value.

The first year of the 1980s bull market (i.e. mid-1982 to mid-1983) was a high-tech/new-issue market focused on the personal computer industry. But by 1985, when high-tech excitement had died down but healthy economic growth was expanding corporate cash flows, LBOs and hostile acquisitions financed with junk bonds issued by Drexel Burnham Lambert's Michael Milken started to become a major theme in the stock market.



The financiers who flocked to the annual ‘predator’s ball’ were equivalent to the conglomerateurs of the 1960s: smart, ruthless, imaginative outsiders who threatened the hegemony of the colourless bureaucrats who ran corporate America. A raider could buy 4% of the shares of a target, get a letter from Milken stating he was ‘highly confident’ that bonds could be sold to finance a deal, and then attempt to acquire the target. In some cases the target paid ‘greenmail’ by buying the shares from the raider, who made a quick profit. In other cases, the raider was successful and made the deal work by:

- Writing up the assets to reflect the acquisition premium paid, then depreciating from this higher cost basis for tax purposes. This reduced taxes and increased cash flow.
- Sold off peripheral businesses, using the proceeds to pay down debt.
- Extracted excess funds from overfunded pension plans.
- Slashed expenses.

### **The New New Metric of the 1980s**

To avoid this fate, by 1985 companies were taking strategic actions – usually some combination of asset sales, cost cutting, debt issuance, and/or share buybacks – in order to boost their share price. So the *new new* metric on Wall Street was a company’s private market value – how much a leveraged buyer could afford to pay to acquire a company. No research report was complete without an estimate of this figure.

Unfortunately, this new metric became a conceptual trap in 1987, because it was a major reason why investors ignored the sharp rise in bond yields in the spring of 1987 that made stocks increasingly unattractive and risky – especially with the financial backdrop deteriorating as the dollar declined and the US trade deficit failed to shrink as policymakers hoped. By the fall of 1987, our Asset Allocation model was calculating that the probability that stocks outperform bonds had dropped to just 8%.

### **The Beginning of the End for ‘Private Market Value’**

Counterintuitively, the 1987 stock market crash extended the life of private market value as the market’s new metric, ultimately allowing it to do more damage to the financial markets and the economy. As a result of the crash, stock prices plunged

and the Federal Reserve cut interest rates to ameliorate the expected recession. In fact, however, the US economy was strong in 1988, while stock prices were fairly weak. By late 1988, US equities were on the bargain counter; S&P 500 earnings climbed 72% over the prior two years (i.e., 1987 and 1988), yet stock prices had climbed just 15% over the same period. Foreign buyers scooped up some of these bargains (e.g., Robert Maxwell bought MacMillan) and in the autumn Wall Street was rocked by Philip Morris' purchase of Kraft foods and – even more spectacular – KKR's leveraged buyout of RJR Nabisco.

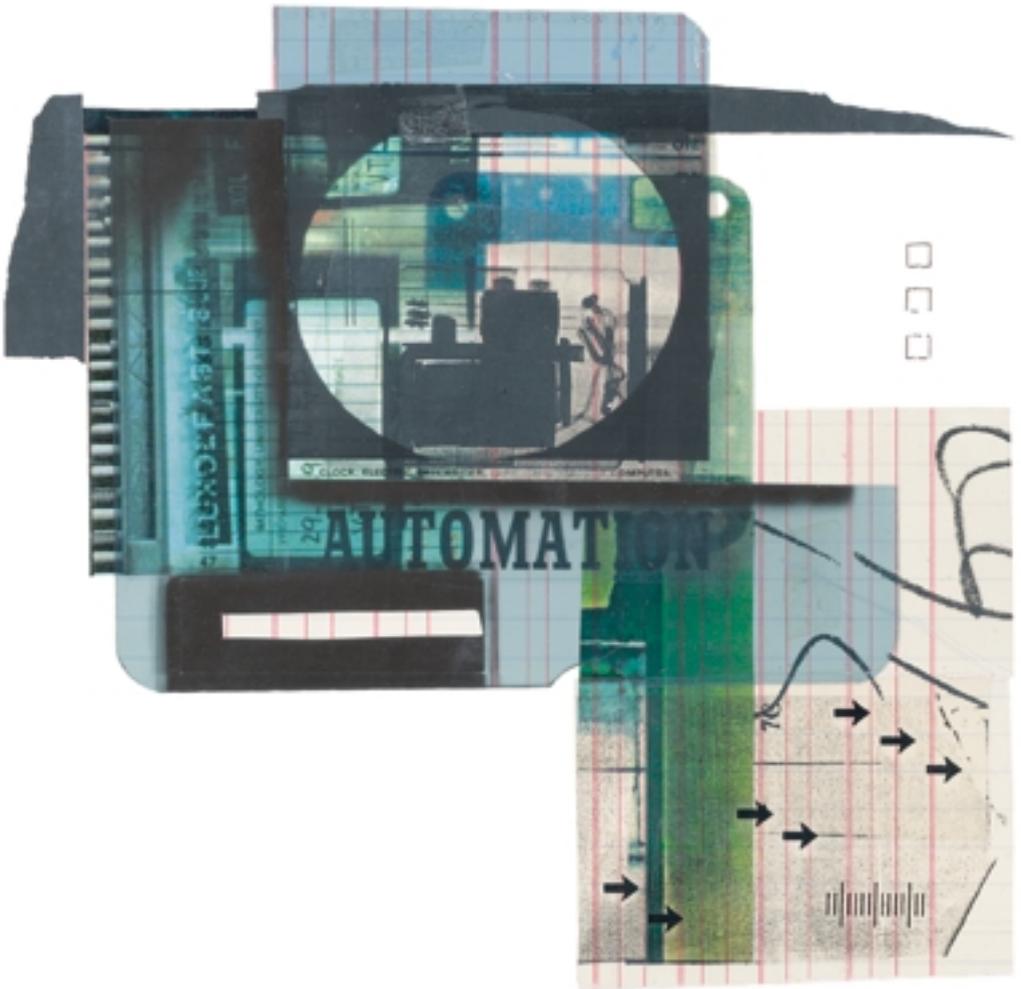
The RJR deal ignited a paroxysm of indignant outrage about the reckless, unbridled greed of Wall Street. Among the most scathing criticisms (and certainly the best informed because composed by an expert) was that of the respected financier Theodore J. Forstmann, who wrote an article in *The Wall Street Journal* called 'Leveraged to the Hilt – Violating Our Rules of Prudence'. Forstmann and others made these central points:

- Deals were being done not because they made economic and financial sense, but because investors, bankers and others were hungry for fees.
- Inappropriate companies were being taken private in leveraged transactions – one-product companies, companies subject to commodity price swings, technology companies with volatile markets and high R&D spending, among others.
- Investors were overpaying, and finessing the problem by issuing new instruments such as 'zero-coupon' debentures and PIK or 'payment in kind' securities. As Forstmann explained, PIKs were 'based on the notion that when a borrower is too broke to pay his interest in cash, he can 'pay' by issuing an additional note, which he also can't afford to service. This is the intellectual equivalent of doubling your money by folding it in half'.
- Risks were raised even further by the fact that we were late in the business cycle.

Forstmann was completely correct, but also a year early. The Wall Street deal machine continued to operate through most of 1989, applying the new metric of private market value to one company after another.

This was different from many market manias because there was a rising tide of evidence – not opinion about overvaluation, but specific evidence – that many LBOs were not working well, despite a strong economy. In December 1988 *The*

*Wall Street Journal* carried an article titled ‘Wobbly LBOs: Leveraged Buy-Outs That Appear Shaky Are on the Increase’. In September 1989 *Business Week* wrote, ‘No recession. Lower interest rates. Yet leverage, the financial alchemy of the 1980s, is fast losing its magic. Already, some of leverage’s best-known names are in dire financial straits’. Both of these articles mentioned many deals in which interest payments were missed, terms had to be revised, assets had been sold for less than expected, etc. – even in a good economy.



### **‘UAL Friday’ and the End of Private Market Value**

Yet many equity investors ignored this evidence and continued to speculate in stocks that might be acquired in leveraged transactions, including such airline stocks as AMR and UAL. The airline industry was very well suited for LBO – except for the fact that it is capital intensive and unionised, has low margins, is highly cyclical, and is vulnerable to swings in energy prices. In the fall of 1989 Wall Street was abuzz with rumours of airline deals. When the proposed LBO of United Airlines failed to get financing from bankers, the DJIA dropped 191 points (6.9%) on Friday, 13 October. Many ‘deal stocks’ collapsed, badly hurting those who were speculating in them with borrowed funds. UAL fell 70% from its LBO-mania peak over the next year.

‘UAL Friday’ officially ended private market value’s reign as the new metric on Wall Street. Unlike the illusory ‘synergies’ promised by conglomerates, this was a valuable concept that unlocked values and hastened the restructuring of the US economy in the 1980s. But, as often happens on Wall Street, success bred excess, which fed on itself until disaster struck.

As the warnings of Theodore Forstmann and many others show, it was not difficult to forecast that the LBO mania would end badly; in mid-1989 PaineWebber forecast a retrenchment in acquisitions/restructurings (see ‘Beyond the Debt Deluge: Growth Regains its Glamour in the 1990s’, 15 June, 1989). As in most manias, the rationale for continuing to invest in increasingly risky investments was what might be variously called the liquidity, weight of money, momentum, or greater fool theory – I am buying the stocks because they are going up, and they are going up because so many people are buying.

Participants in the Wall Street deal machine made comments like these:

‘Bankers keep calling on us, saying, ‘Here, take our money’.

‘The world is awash with cash’.

‘You can always get money for a deal’.

So long as they were looking for the ‘instant gratification’ of chasing deal stocks, investors ignored plain old growth stocks, which were quite cheap by the end of 1989. In ‘*Beyond the Debt Deluge*’, PaineWebber forecast that once the ‘debt deluge’ ended investors would gravitate from deal stocks to growth stocks, and there would be ‘growth stock relative P/E explosion’ in the 1990s. That is indeed what we have had for the last ten years.

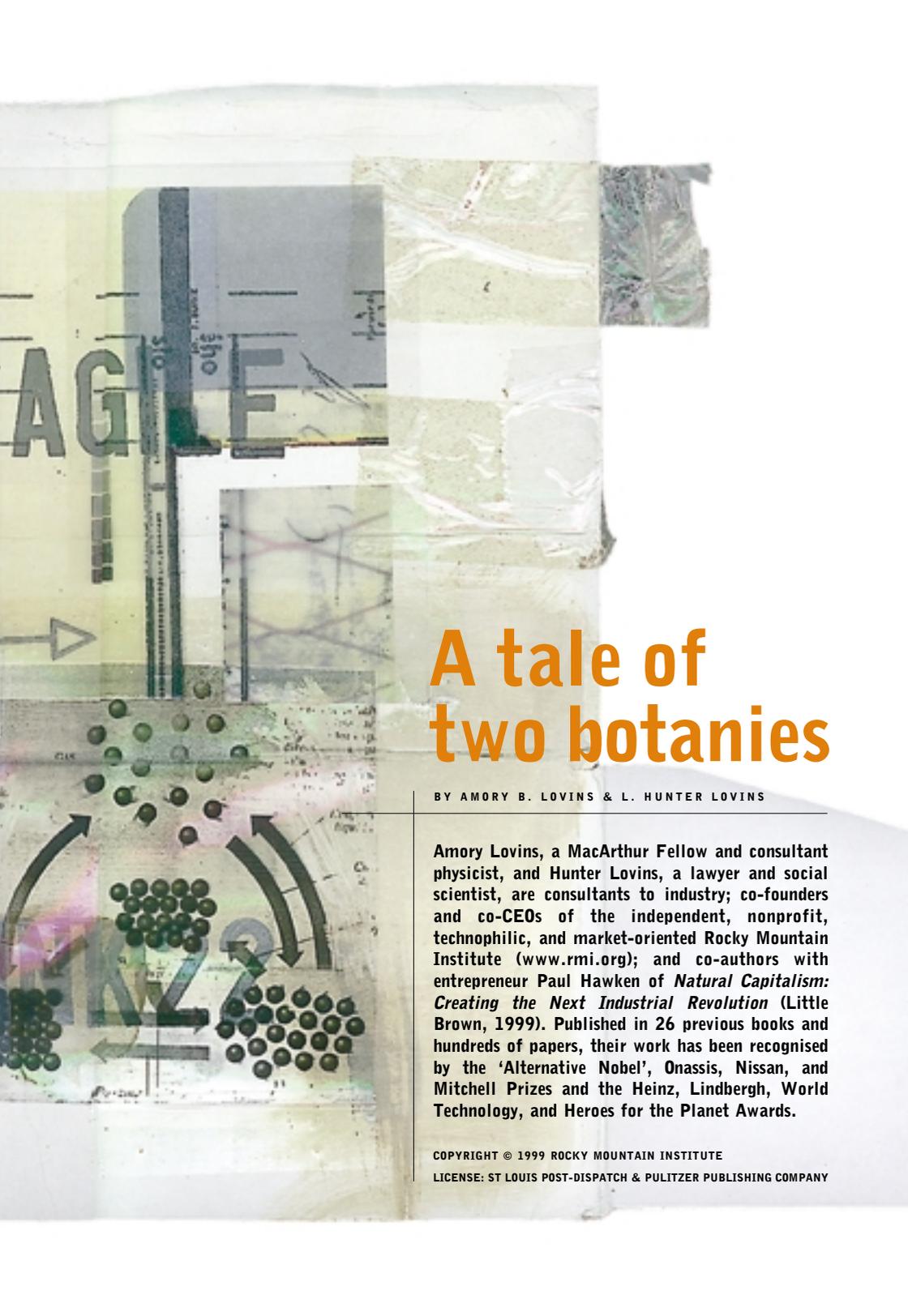




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MAY 2



# A tale of two botanies

BY AMORY B. LOVINS & L. HUNTER LOVINS

Amory Lovins, a MacArthur Fellow and consultant physicist, and Hunter Lovins, a lawyer and social scientist, are consultants to industry; co-founders and co-CEOs of the independent, nonprofit, technophilic, and market-oriented Rocky Mountain Institute ([www.rmi.org](http://www.rmi.org)); and co-authors with entrepreneur Paul Hawken of *Natural Capitalism: Creating the Next Industrial Revolution* (Little Brown, 1999). Published in 26 previous books and hundreds of papers, their work has been recognised by the 'Alternative Nobel', Onassis, Nissan, and Mitchell Prizes and the Heinz, Lindbergh, World Technology, and Heroes for the Planet Awards.

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We all owe a debt to the subject matter of the World Botanical Congress now meeting at the Missouri Botanical Garden. Plants, shaped into incredible diversity by 3.8 billion years of evolution, make possible all life, underpin every ecosystem, and are resilient against almost any threat – except human destructiveness. From botany came the genetics of Lamarck and Mendel, formalising the patient plant-breeding that's created 10,000 years of agriculture.

Now, however, in the name of feeding a growing human population, the process of biological evolution is being transformed. A St. Louis firm is practising a completely different kind of botany which, in the Cartesian tradition of reducing complex wholes to simple parts, strives to alter isolated genes while disregarding the interactive totality of ecosystems. Seeking what Sir Francis Bacon called 'the enlarging of the bounds of Human Empire, to the effecting of all things possible', its ambition is to replace nature's wisdom with people's cleverness; to treat nature not as model and mentor but as a set of limits to be evaded when inconvenient; not to study nature but to restructure it.

As biophysicist Dr. Donella Meadows notes, the new botany aims to align the development of plants not with their evolutionary success but with their economic success: survival not of the fittest but of the fattest, those best able to profit from wide sales of monopolised products. (High-yield, open-pollinated seeds abound; the new crops were created not because they're productive but because they're patentable.) Their economic value is mainly oriented, not toward helping subsistence farmers to feed themselves, but toward feeding more



livestock for the already overfed rich. Most worryingly, the transformation of plant genetics is being accelerated from the measured pace of biological evolution to the speed of next quarter's earnings report. Such haste makes it impossible to foresee and forestall: unintended consequences appear only later, when they may not be fixable, because novel lifeforms aren't recallable.

In nature, all experiments are rigorously tested over eons. Single mutations venture into an unforgiving ecosystem and test their mettle. Whatever doesn't work gets recalled by the manufacturer. What's alive today is what worked; only successes yield progeny. But in the brave new world of artifice, organisms are briefly tested by their creators in laboratory and field (no government agency systematically tests for nor certifies their long-term safety), then mass-marketed worldwide. The USDA has already approved about 50 genetically engineered crops for unlimited release; US researchers have tested about 4,500 more. Just during 1995-99, the non-Chinese farmland planted to such new crops expanded from zero to an eighth of a billion acres, about the size of Germany.

Over half the nation's soybeans and a third of the corn now contain genes spliced in from other forms of life. You've probably eaten some lately – unwittingly, since our government prohibits their labelling. The official assumption is that they're different enough to patent but similar enough to make identical food, so Europe's insistence on labelling, to let people choose what they're eating, is considered an irrational barrier to free trade.

Traditional agronomy transfers genes between plants whose kinship lets them interbreed. The new botany mechanically transfers genes between organisms that can never mate naturally: an antifreeze gene from a fish (Arctic flounder) rides a virus host to become part of a potato or a strawberry. Such patchwork, done by people who've seldom studied evolutionary biology and ecology, uses so-called 'genetic engineering' – a double misnomer. It moves genes but is not about genetics. 'Engineering' implies understanding of the causal mechanisms that link actions to effects, but nobody understands the mechanisms by which genes, interacting with each other and the environment, express traits. Transgenic manipulation inserts foreign genes into random locations in a plant's DNA to see what happens. That's not engineering; it's the industrialisation of life by people with a narrow understanding of it.

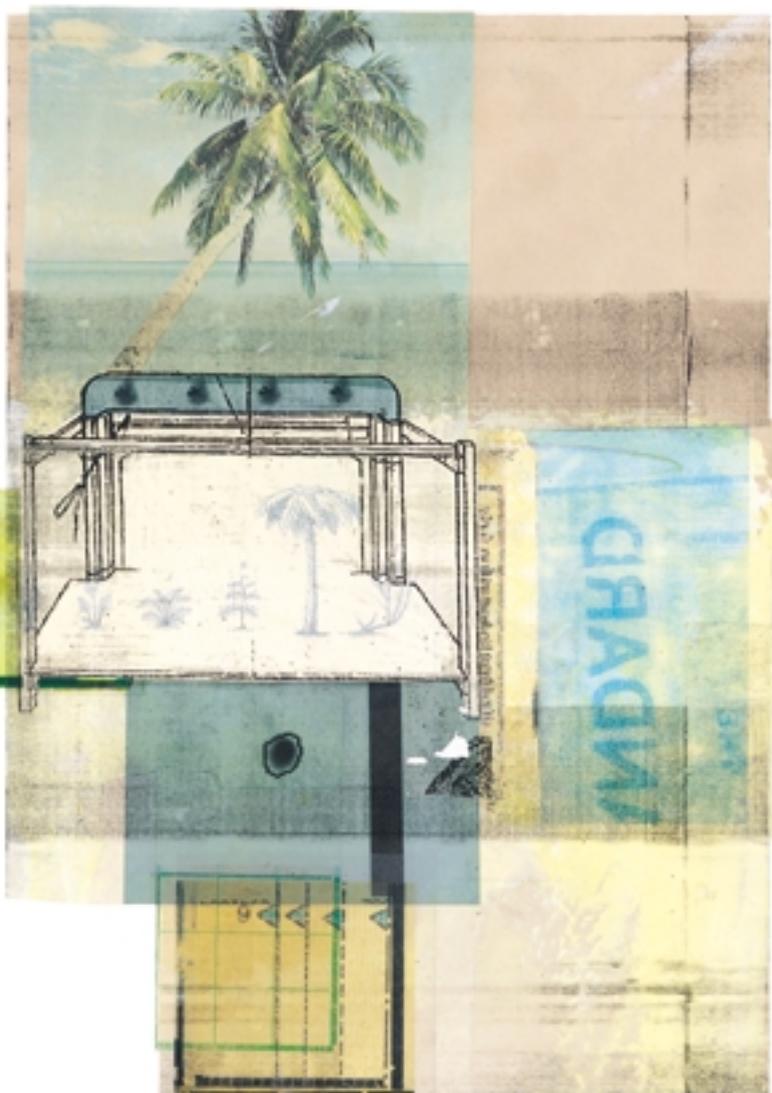
The results, too, are more worrisome than those of mere mechanical tinkering, because unlike mechanical contrivances, genetically modified organisms reproduce, genes spread, and mistakes literally take on a life of their own, extending like Africanised bees. Herbicide-resistance genes may escape to make 'superweeds'. Insecticide-making genes may kill beyond their intended targets. Both these problems have already occurred; their ecological effects are not yet known. Among other recent unpleasant surprises, spliced genes seem unusually likely to spread to other organisms. Canola pollen can waft spliced genes more than a mile, and common crops can rather rapidly swap genes with weeds. Gene-spliced Bt insecticide in corn pollen kills Monarch butterflies; that insecticide, unlike its natural forbear, can build up in soil; and corn borers' resistance to it is apparently a dominant trait, so planned anti-resistance procedures won't work.

It could get worse. Division into species seems to be nature's way of keeping pathogens in a box where they behave properly (they learn that it's a bad strategy to kill your host). Transgenics may let pathogens vault the species barrier and

enter new realms where they have no idea how to behave. It's so hard to eradicate unwanted wild genetic material that we've intentionally done it only once – with the smallpox virus.

Since evolution is a fundamental process, it must occur at every scale at which it's physically possible, down to and including the nanoecosystem of the genome. Shotgunning alien genes into the genome is thus like introducing exotic species into an ecosystem. (Such invasives are among the top threats to global biodiversity today.) It's unwise to assume, as 'genetic engineers' generally do, that 90+% of the genome is 'garbage' or 'junk' because they don't know its function. That mysterious, messy, ancient stuff is the context that influences how genes express traits. It's the genetic version of biodiversity, which in larger ecosystems is the source of resilience and endurance.



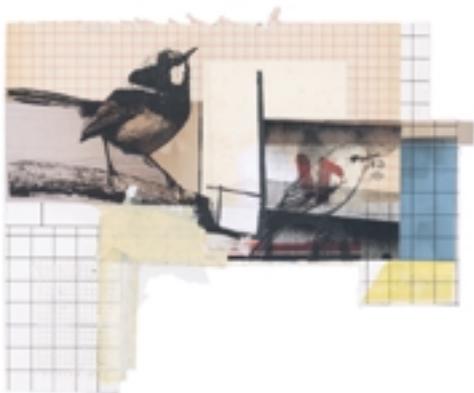


Transgenics is showing disturbing historical parallels to another problematic invention, nuclear fission – ‘a fit technology’, someone said, ‘for a wise, farseeing, and incorruptible people’. In both enterprises, technical ability has evolved faster than social institutions; skill has outrun wisdom. Both have overlooked fundamentals, often from other disciplines wrongly deemed irrelevant. Both have overreached – too far, too fast, too uncritical. Both have failed to take their values from their customers and their discipline from the market. The rise and fall of such technologies seems to go something like this:

- 1 Promoters promise public benefits. Gifted scientists relish the ‘sweet’ technology. Commercial enthusiasm and pride, bolstered by government promotion, draw huge investments. Advocates shield the promoters from political and market accountability, suppress dissent, and reject independent assessment. Rapid growth speeds industrial capture of the regulatory apparatus. (The combination of greedy firms, sleepy watchdogs, and sparse disinterested scrutiny is a recipe for trouble, since systems without feedback are by definition stupid.)
- 2 Initial technical stumbles and troublesome questions elicit public concern, deflected by PR. Public concern increases because the more people find out about the innovation, the less they like it. The PR grows stronger but less persuasive. Emergent whistleblowers raise awkward questions. Many bad surprises dwarf the few benefits.
- 3 Operational disappointments abound as it becomes clear that the problems with the innovation are fundamental. Simultaneously, many people realise that the alternatives, often long known, actually work better and cost less.
- 4 Smart money and insurance coverage exit; practitioners stop having fun; some have nightmares without a safe place to discuss them. The product can be sold only by concealing its identity – a mockery of economic principles. Almost everyone realises the business is dying of an incurable attack of market forces.
- 5 With insubstantial benefits, mediocre performance, real risks, and unrewarding economics finally undeniable, the technology fades away, leaving behind socialised hazards, failed firms, disappointed investors, delegitimised institutions, and a cynical public.

Where's the 'You Are Here' sign for transgenic crops? Europe is already at stage 4. The US is around stage 2, and moving rapidly in the same direction.

With transgenic crops as with nuclear fission, the key choices are not between unwelcome alternatives – nuclear warheads or subjugation, nuclear power or freezing in the dark, transgenic crops or starvation – but between those bad choices and attractive ones outside the orthodoxy. For crops, the best choice would be fairer distribution of food grown by a respectful and biologically informed agriculture that stops treating soil like dirt. But sound choices tend to emerge and get adopted in time only if we take seriously the discipline of mindful markets and the wisdom of informed democracy. The botanists now being welcomed to St. Louis can help us see beyond molecules and genes to plants, and beyond plants to ecosystems. Botanists have a professional duty to help us all understand the vital differences between biology and biotechnology – between the foundations of their traditional science and the smart-aleck, scientifically immature, but commercially hell-for-leather enterprise, a billion times younger, that aims to replace it.







PLATINUM CAPITAL LIMITED

ABN 51 063 975 431

ANNUAL REPORT TO SHAREHOLDERS

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**INVESTMENT PERFORMANCE** The net asset value of Platinum Capital grew by 35.79% last year. This figure is calculated after allowing for all tax liabilities, both realised and unrealised. On a pre-tax basis the growth was 43.07%.

This is the best absolute return in any one year since the Company began investing six years ago. This performance was also nearly double that of the benchmark index.

The table, left, sets out the performance of Platinum Capital for the last five years and compares these figures to the Morgan Stanley Capital World Accumulation (Net return) Index in A\$ (MSCI), which is often used as a benchmark for the performance of international funds.

The annualised five year return for Platinum Capital (20%) and the MSCI (21%) is very similar, but it has not been achieved in the same way. For most of the past five years, Platinum Capital has been weighted very differently from the MSCI, predominantly in respect of the US markets. This was true also for the 1999/2000 year where Platinum Capital had a relatively low weighting in the US market and a bias towards Europe and Japan. Platinum Capital's market weightings reflect the Manager's view of where real value can be found at any time. The Manager remains convinced that a disciplined approach to value will produce the best returns for shareholders over the longer term.

The overall return for the five years of 20.0% per annum is at the high end of what investors can reasonably expect from equity investment.

**DIVIDENDS** In February this year a dividend of 4 cents per share was paid. Directors are recommending a final dividend of 8 cents per share for a total of 12 cents per share for the year. (A total of 10 cents per share was paid in 1999.) All dividends are fully-franked.

It is the Directors intention to at least maintain these dividend rates if market conditions permit.

In the past, the Company has bought back some of its shares from the market. No shares were purchased in on-market buy-back offers over the past year.

**TAX** Last year the income tax basis of the Company was changed from capital to revenue account. This change was made after strong representations from the Australian Taxation Office which were initially resisted by the Company, but were agreed to in the light of other tax law changes implemented and foreshadowed as a result of the Government's review of corporate taxation.

Accordingly, tax returns for the years 1995-1998 were amended which resulted in a tax refund of about \$1.9 million and a reduction in the provision for tax of about \$3.2 million.

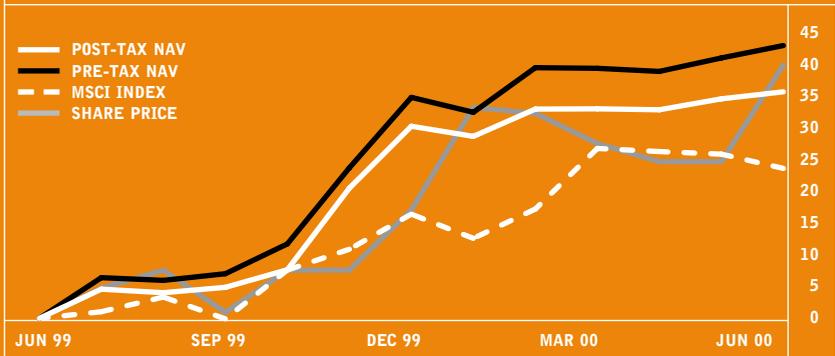
Platinum Capital's tax treatment as a Listed Investment Company (LIC) under the new tax system is not yet clear. The decision depends on the details of legislation not yet available. Changes in the way the Company operates and the ways in which it rewards shareholders may need to be made.

**OUTLOOK FOR 2000/2001** We have reached that stage in the investment cycle where for most world markets a judgement must be made on the likelihood of rises in interest rates. Inevitably this can create something of a headwind for equity markets and for the growth of the companies that comprise them.

Within this overall context the Manager will continue to seek out opportunity and it is likely that the current emphasis on the portfolio on Europe and Japan will continue.

**MICHAEL DARLING** CHAIRMAN

**PCL NAV (PRE & POST-TAX), SHARE PRICE VS MSCI INDEX  
(CUMULATIVE RETURN 30 JUNE 1999 – 30 JUNE 2000) %**



**PERFORMANCE** In the first half of the year 2000 there was a flattening of the yield curve. Short term interest rates rose in line with increases in central bank base rates while longer rates stabilised following reduced expectations of consumer demand growth. The main effects on equity markets were to enhance cyclical recovery prospects in some areas but to reduce speculative excesses in others, most particularly as regards so-called dot com companies, some of which crashed to extinction.

The worldwide benchmark, the Morgan Stanley Capital Index, rose by a modest 6.2% but this apparently staid performance disguised excellent returns from some previously depressed areas: Canada +34.2%, France +15.6%, Italy +13.3%, offset by declines in other countries which had previously moved ahead, perhaps too quickly: Indonesia -38.4%, Greece -19.1%. On an industry sector basis, good returns were to be had from healthcare +27%, capital equipment +12% and financial services +6%, offset by weak performances from materials -9% and services, mainly telecoms, media and technology -18%.

Platinum Capital Limited's net asset value grew by 6.1% pre-tax over the six months helped by earlier switches away from media and technology stocks; some benefit was also gained from the Company's short positions in speculative US stocks. In the last quarter, Platinum's net asset value continued to advance modestly even after provision for tax on both realised and unrealised income and capital gains. This is shown in the table below.

<b>NET ASSET VALUE</b>		
<b>30 APRIL 2000</b>	<b>31 MAY 2000</b>	<b>30 JUNE 2000</b>
<b>148.63 cents</b>	<b>150.57 cents</b>	<b>151.81 cents</b>

**CHANGES TO THE PORTFOLIO** Since our last quarterly report, activity has been principally directed at consolidating larger holdings at the expense of more recently acquired positions. Sales included Hyundai group companies, Komatsu, Nippon Express, Okumura and Galileo. Among the new ideas introduced were Ambac, a US-based financial insurer; Loews Corporation, a deep value contrary play on insurance, tobacco and oil drilling; Mercury General, an auto specialist establishing a presence in states outside California; Smiths Industries, a niche player in global avionics, disposable medical devices and specialist industrial connectors; and UPM, the Finnish-based paper products giant.

**BREAKDOWN BY INDUSTRY**

CATEGORIES	EXAMPLES OF STOCKS	JUN 2000	DEC 1999
Cyclicals	RMC, Akzo, Bayer, Stinnes, Sekisui Chemical	17%	12%
Telecoms	NTT, DDI, GTE, SK Telecom, Lucent, Alcatel	11%	16%
Technology	Toshiba, Samsung, AMD, Fujitsu	11%	12%
Software and Media	Novell, JD Edwards, PeopleSoft, Nippon & Tokyo Broadcasting	9%	19%
Financials	Lippo, Toro, Japanese Brokers, Nordic Baltic	9%	6%
Consumer Brands	Lotte Confectionary, Japanese Coke Bottlers	6%	5%
Medical	Acuson, Draegerwerk, Medison	5%	5%
Consumer Durables	MEI, Citizen Watch, Sony	4%	7%
Retail/Services	Douglas, Hornbach, Continente	3%	3%

**DISPOSITION OF ASSETS**

REGION	JUN 2000	DEC 1999
Japan	31.3%	36.6%
Western Europe	26.3%	25.0%
North America	19.2%	14.2%
Other Asia	7.1%	11.2%
South America	0.4%	0.5%
Russia and Eastern Europe	0.1%	0.4%
Australia	0.0%	0.5%
Cash	15.6%	11.6%

The Company's portfolio is now 5% short against the Nasdaq 100 index and 22% short against the S&P500 index. There are further shorts on individual companies totalling 9%.

**CURRENCY** At present 40% of Platinum's assets are hedged into A\$, 32% are in the Euro, Pound and Swiss Franc, 11% in Yen and the balancing 17%, in US\$ and related currencies.

**COMMENTARY** In the US, the Fed has raised short term interest rates quite aggressively which was the principal factor behind the recent violent, though short-lived, sell-off in the Nasdaq. The balance of opinion is that the earlier, excessively fast growth of the economy has moderated and is now somewhere within the bounds of its inherent capacity so the Fed has no need to tighten further. With a Presidential election looming there are political pressures too, for maintenance of the status quo.

This does not alter Platinum's opinion that in the financial area the US is dangerously extended. The main driving force behind the rapid and lengthy expansion of the economy has been growth of consumer spending and the main forces behind that have been capital gains and borrowings; both these by their essential nature have limits to their extent and are subject to reversals. The orders of magnitude are great. Over half of all households in the US own shares, by far the greatest proportion of any country at any time in history. The capitalisation of the stock market has risen from 54% of gross national product ten years ago to 170% now. Realised and unrealised capital gains account for close to 40% of all other forms of household income. Clearly, in Platinum's view, a significant fall in stock market values would have a sharp impact on consumer confidence and consumer spending which, in turn, would put further pressure on market values.

At present US consumer confidence remains high, although June witnessed the largest decline in 20 months. Other economic indicators, such as retail sales and housing starts have also turned down recently. Careful attention must be paid to whether these latest figures are merely a blip or whether they mark the beginning of a trend.

The position in Europe is complex. Reported levels of consumer confidence have been recovering steadily for 18 months and have reached a 15 year high. In some countries, Spain and Ireland for example, this confidence is reflected in strong consumer spending. Somewhat surprisingly, however, in Germany and Italy consumption remains depressed. Unemployment levels may be the key; certainly in France as unemployment has fallen from 12.5% of the labour force to around 10% so retail sales have expanded. The weak Euro has helped exports and industrial production is surging so employment, always a lagging indicator, may be on the verge of a good rise even in Germany and Italy.

The economies of the various countries of Europe are much less similar than the economies of the various states of the USA or Australia. A common currency and a one-size-fits-all monetary policy is, therefore, always likely to impose strains. The European Central Bank has not yet shown convincing evidence of being able to manage the Euro as effectively as, say, the Fed managed the US\$. Nevertheless, the prospects are that Europe will grow faster than the US over the next year or two and that the Euro will show at least some modest strength against most other currency blocks.

Most commentators on Japan still tend to the cautious side of neutral. Platinum is more optimistic, influenced by the current strong recovery of industrial production although acknowledging that the comparison will taper off over the second half of the year from the present 10% growth rate. The working through of earlier Government job creation schemes, the stabilisation of price levels and improving auto and housing sales all suggest a gradual broadening of

confidence and a strengthening of economic activity. Corporate profits are rebounding strongly, admittedly from low levels, and look set to rise by 20% or more both this year and next. False starts to a full economic recovery have been seen several times in the 1990s but a backdrop of strong conditions abroad should nurture the Japanese economic recovery.

As well as economic growth, it is the prospect of the corporate sector earning a more satisfactory return on invested capital which is at the heart of Platinum's exposure to companies in Japan. The legislative framework for corporate reform has improved immeasurably and if the pace is not yet urgent, it is quickening. Merger and acquisition activity is growing and various forms of buy-outs and divestments are becoming more common. Extraordinary opportunities surely exist when 50% of companies in the first section of the Tokyo Stock Exchange are still selling at below book value. Goldman Sachs has identified over 100 companies selling, quite remarkably, at less than cash backing. Your Company owns three such holdings. The magnitude of these discounts suggest wariness on the part of investors as they consider the many fundamental hurdles that still lie ahead, not least the future funding of government debt. This is at unsustainably high levels and will not be resolved easily.

Looking at the world at an enterprise level, the striking feature has been the magnitude of corporate activity. Mergers and acquisitions in the first half of the year totalled \$874 billion in the US and \$1,900 billion in Europe. Industry consolidation remains the catch phrase with mammoth deals in Telecoms, Vodafone acquired Mannesman and France Telecom acquired Orange; Entertainment, AOL acquired Time Warner, Vivendi bidding for Seagrams; Banking, Bank of Scotland acquired NatWest, Citibank acquired Schroders; Drugs, Glaxo bidding for SmithKline; Autos, Daimler Benz taking 33% of Mitsubishi Motor, GM 20% of Fiat and Volkswagen 19% of Scania. In food, Unilever has bid for Bestfoods having earlier revealed plans for slimming its

workforce by 25,000. In many cases, these deprecations signal an underlying deterioration of profit growth in the sectors concerned. This has led to highly dichotomous market valuations. For example, perceived high growth markets like Nasdaq sell at 130 times earnings while the S&P 500 index trades on 23 times this year's earnings. Further, within the S&P, smaller and/or traditional companies are rated well below the average with the median PE being about 15 times. The same pattern prevails in Europe where shares on the *Neuer* market sell at multiples of sales while more traditional shares are conservatively rated.

**CONCLUSION** Stock markets can look forward to a northern summer of debate about the strength or weakness of consumer spending and concern as to whether the central banks will push short term interest rates higher. Though outside the US, there is spare capacity, rising input costs will lead to some inflationary pressure in most countries. Overall, equity markets seem likely to be range bound at least until some of the generously priced growth expectations are met.

**KERR NEILSON** MANAGING DIRECTOR

# Financial Statements 2000

## DIRECTORS' REPORT

In respect of the year ended 30 June 2000 the Directors of Platinum Capital Limited (the Company) submit the following report made out in accordance with a resolution of the Directors.

### **DIRECTORS**

The following persons were Directors of the Company during the whole year and up to the date of this report

Michael Darling	<i>Chairman and Non-Executive Director</i>
Peter William Clarke	<i>Non-Executive Director</i>
Kerr Neilson	<i>Managing Director</i>
Andrew Clifford	<i>Director</i>
Malcolm Halstead	<i>Director and Secretary</i>

### **PRINCIPAL ACTIVITY**

The principal activity of the Company during the year was the investment of funds internationally into securities of companies which are perceived by the Investment Manager to be undervalued.

### **TRADING RESULTS**

The net profit of the Company for the year was \$33,431,000 (1999: \$6,975,000) after income tax expense of \$9,253,000 (1999: \$9,164,000).

### **DIVIDENDS**

In respect of the year ended 30 June 2000 the Directors recommend the payment of an 8 cents per share fully franked final dividend payable to Shareholders recorded on the Share Register as at 27 October 2000, the Ex-Dividend date.

A fully franked interim dividend of 4 cents per share was paid on 21 February 2000.

A fully franked final dividend of 6 cents per share for the year ended 30 June 1999 was paid on 2 November 1999.

### **REVIEW OF OPERATIONS**

#### **Operating Revenue**

The operating revenue for the year was \$158,621,000 (1999: \$138,492,000).

#### **Operating Profit**

The operating profit before tax was \$42,684,000 (1999: \$16,139,000) and \$33,431,000 (1999: \$6,975,000) after tax.

#### **Taxation**

Income tax expense for the year was \$9,253,000 (1999: \$9,164,000).

**CHANGES IN THE STATE OF AFFAIRS**

The goods and services tax (GST) introduced in Australia will apply to all supplies of goods and services to the Company from 1 July 2000. It is anticipated the GST effect will increase total expenses between 3.00% and 4.00% for the year ended 2001.

There were no other significant changes in the state of affairs of the Company that occurred during the year not otherwise disclosed in this report or the financial statements.

**EVENTS SUBSEQUENT TO BALANCE DATE**

Since the end of the financial year the Directors are not aware of any matter or circumstance not otherwise dealt with in this report or financial statements that has significantly or may significantly affect the operations of the Company, the results of those operations or the state of affairs of the Company in subsequent financial periods.

**LIKELY DEVELOPMENTS**

The Company will continue to pursue its investment objectives so as to increase the net asset value of the Company.

**ROUNDING OFF OF AMOUNTS**

The Company is of a kind referred to in the Australian Securities & Investments Commission's Class Order 98/0100, and consequently amounts in the Directors' report and financial report have been rounded off to the nearest thousand dollars.

**ENVIRONMENTAL REGULATION**

The Company has assessed whether it is subject to any significant environmental regulation and determined there are none.

**DIRECTORS' EMOLUMENTS**

The Executive Directors (WKS Neilson, AM Clifford and RM Halstead) are employees of the Investment Manager, Platinum Asset Management, and are not remunerated by the Company. The Executive Directors review and determine the remuneration of the Non-Executive Directors and may utilise the services of external advisors. It is the policy of the Board to remunerate at market rates commensurate with the responsibilities borne by the Non-Executive Directors.

The Non-Executive Directors received the following amounts from the Company during the financial year:

	FEE \$	SUPERANNUATION \$	TOTAL \$
MG Darling	25,000	1,750	26,750
PW Clarke	20,000	1,400	21,400
	45,000	3,150	48,150

**DIRECTORS' INTERESTS IN CONTRACTS**

The three Executive Directors are employees of and have a relevant interest in the Investment Manager and accordingly will receive some portion of the Management fee; they do not receive any Directors' remuneration from the Company.

**INSURANCE**

During the year the Company incurred a premium in respect of a contract for indemnity insurance for the directors and officers of the Company named in paragraph one of this report.

**INFORMATION ON DIRECTORS**

**Michael G Darling** BA Law (Oxon), MBA (Harvard)

**Chairman (Age 54)**

Mr Darling has extensive experience in international investment markets and has lived and worked in Japan, Europe, North America and Papua New Guinea.

He is Chairman of resource company Gympie Gold Limited and of portfolio investment company Caledonia Investments Limited. Other Directorships include Pilatus Capital Limited, Art Exhibitions Australia Limited and The Centre for Independent Studies Limited. He is a former Director of the Australian Stock Exchange (1986-1987).

**Peter William Clarke** BSc(Econ), AIIMR

**Non-Executive Director (Age 64)**

Mr Clarke brings to the Board over 30 years' experience in the investment management business. Until 1987 he held various directorships in the UK and was Managing Director of a stockbroking firm.

Other directorships include Canning Energy Limited and Climax Mining Limited.

**Kerr Neilson** BCom, AIIMR

**Managing Director (Age 50)**

Relevant interest in 1,384,356 shares in the Company.

Appointed as managing director upon incorporation. Mr Neilson is an experienced investment analyst and fund manager. He is a Director of Platinum Asset Management, the Company's Investment Manager. Previously to Platinum Asset Management he was an Executive Vice President at Bankers Trust Australia Limited.

Prior to BT he worked in both the UK and South Africa as an investment analyst and fund manager.

**Andrew M Clifford** BCom(Hons), ASIA, ASA

**Director (Age 34)**

Relevant interest in 1,204,164 shares in the Company.

Appointed a Director of the Company upon incorporation. He is also a Director of Platinum Asset Management, the Company's Investment Manager. Previously to Platinum Asset Management he was a Vice President at Bankers Trust Australia Limited.

**Malcolm Halstead** ACA**Director and Secretary (Age 42)**

Relevant interest in 1,192,152 shares in the Company.

Appointed a Director of the Company upon incorporation. He is also a Director of Platinum Asset Management, the Company's Investment Manager. Previously to Platinum Asset Management he was a Vice President at Bankers Trust Australia Limited. Prior to BT he was with Price Waterhouse, Sydney and Thornton Baker, London.

**DIRECTORS' MEETINGS**

The following table sets out the number of meetings of the Company's Directors held during the year ended 30 June 2000, and the number of meetings held and attended by each Director.

	BOARD MEETINGS	
	HELD WHILE A DIRECTOR	ATTENDED
MG Darling	6	6
PW Clarke	6	5
WK Neilson	6	6
AM Clifford	6	6
RM Halstead	6	6

This report is made in accordance with a resolution of the Directors.



**MG Darling** Director

Sydney 4 August 2000



**WK Neilson** Director

### **BOARD MEMBERSHIP**

The Board has a policy of having an equal number of Non-Executive and Executive Directors, excluding the Managing Director's role.

The Board may use external advisors to assist in such a process.

The Executive Directors were nominated by the Investment Manager, Platinum Asset Management.

The Managing Director is appointed in accordance with the Investment Management contract with Platinum Asset Management and the Constitution.

Under the Constitution Directors, other than the Managing Director, must retire from office no later than the third Annual General Meeting (AGM) following their last election and they may offer themselves for re-election.

### **DIRECTORS' ACCESS TO EXTERNAL ADVICE**

The Board has a policy of enabling Directors to seek external advice at the Company's expense after first notifying the Board.

The Board will review the estimated costs for reasonableness but will not impede the seeking of advice. The Board will not approve for payment costs that are unreasonable in amount.

### **DIRECTORS' COMPENSATION**

The Executive Directors are not remunerated by the Company. The Executive Directors review and determine the remuneration of the Non-Executive Directors and may utilise the services of external advisors. It is the policy of the Board to remunerate at market rates commensurate with the responsibilities borne by the Non-Executive Directors. Current fees amount to \$45,000 per annum.

### **ETHICAL STANDARDS**

The Board has instituted compliance with the Institute of Directors' Code of Conduct.

**AUDIT COMMITTEE**

The Company does not have an audit committee. It is the Directors' opinion that all matters of significance which would otherwise be dealt with by an audit committee are dealt with by the Board and that as a consequence, a separate audit committee is not warranted.

**SIGNIFICANT BUSINESS RISKS**

The Company is an Investment Company with a stated purpose and investment mandate. The Board has determined to regularly monitor the investment risks, including various derivative instrument risks, inherent in that investment mandate. This is achieved through regular reporting mechanisms from the Investment Manager to the Board.

**PROFIT AND LOSS STATEMENT**

YEAR ENDED 30 JUNE 2000

	Notes	2000 \$'000	1999 \$'000
<b>REVENUE FROM OPERATING ACTIVITIES</b>	3	<b>158,621</b>	138,492
<b>OPERATING PROFIT/(LOSS) BEFORE INCOME TAX</b>	4	<b>42,684</b>	16,139
Income tax attributable to operating profit/(loss)	5	<b>9,253</b>	9,164
<b>OPERATING PROFIT/(LOSS) AFTER INCOME TAX</b>		<b>33,431</b>	6,975
Retained earnings at the beginning of the financial year		<b>5,523</b>	8,649
Total available for appropriation		<b>38,954</b>	15,624
Dividends	17	<b>12,572</b>	10,101
<b>RETAINED EARNINGS AT THE END OF THE FINANCIAL YEAR</b>		<b>26,382</b>	5,523

The profit and loss statement should be read in conjunction with the accompanying notes

	Notes	2000 \$'000	1999 \$'000
<b>INVESTMENTS</b>	1(c), 6	<b>152,937</b>	124,404
Current Assets			
Cash at bank	12	<b>134</b>	95
Receivables	7	<b>367</b>	1,614
Future income tax benefit		<b>81</b>	45
<b>TOTAL CURRENT ASSETS</b>		<b>582</b>	1,754
<b>TOTAL ASSETS</b>		<b>153,519</b>	126,158
<b>CURRENT LIABILITIES</b>			
Payables	8	<b>514</b>	2,999
Provisions	9	<b>21,104</b>	15,772
<b>TOTAL CURRENT LIABILITIES</b>		<b>21,618</b>	18,771
<b>TOTAL LIABILITIES</b>		<b>21,618</b>	18,771
<b>NET ASSETS</b>		<b>131,901</b>	107,387
<b>SHAREHOLDERS' EQUITY</b>			
Share capital	10	<b>105,519</b>	101,864
Retained earnings		<b>26,382</b>	5,523
<b>TOTAL SHAREHOLDERS' EQUITY</b>		<b>131,901</b>	107,387

The balance sheet should be read in conjunction with the accompanying notes

## STATEMENT OF CASH FLOWS

YEAR ENDED 30 JUNE 2000

	Notes	2000 \$'000 Inflows (Outflows)	1999 \$'000 Inflows (Outflows)
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Dividends received		1,980	1,671
Interest received		825	424
Cost of purchases of investments and currencies		(127,576)	(132,218)
Proceeds from sale of investments and currencies		158,599	136,239
Management fees paid		(2,440)	(1,921)
Other expenses		(979)	(801)
Income tax paid		(6,258)	(3,821)
<b>NET CASH FROM OPERATING ACTIVITIES</b>	12(b)	<b>24,151</b>	(427)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from issue of shares	10	3,652	4,254
Dividends paid		(10,249)	(9,893)
Refund of stamp duty		3	-
Cash paid in share buyback		-	(385)
<b>NET CASH FROM FINANCING ACTIVITIES</b>		<b>(6,594)</b>	(6,024)
Net Increase/(decrease) in cash held		17,557	(6,451)
Cash held at the beginning of the financial year		10,285	16,896
Effects of exchange rate changes on cash		(477)	(160)
<b>CASH HELD AT 30 JUNE 2000</b>	12(a)	<b>27,365</b>	10,285

The statement of cash flows should be read in conjunction with the accompanying notes

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

This general purpose financial report has been prepared in accordance with Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board reporting requirements, Urgent Issues Group Consensus Views and the Corporations Law.

The accounting policies adopted have been consistently applied by the Company, except as otherwise indicated.

**(a) Basis of Accounting**

The financial statements have been prepared on the basis of historical cost, except where otherwise stated.

**(b) Foreign Currency Translation**

Transactions denominated in foreign currencies are translated into Australian Currency at the rates of exchange ruling on the date of the transaction. All realised exchange gains and losses are taken to account in the period in which they arise.

Foreign currency monetary assets and liabilities existing at balance date are revalued at the rates of exchange ruling at balance date. The resulting unrealised exchange differences are brought to account in determining the Profit or Loss for the year.

**(c) Investments****(i) Classification**

Investments have not been classified in the balance sheet as current or non-current assets. In the opinion of the Directors, having regard to the nature of the business conducted by the Company, the period of investment is not known at the time of purchase.

**(ii) Valuation**

Investments are valued at cost, with the exception of monetary items which are stated at net fair value.

Where, in the opinion of Directors, there has been a permanent diminution in the value of an investment, the carrying amount of such an investment is written down to its net fair value.

**(d) Risk Management****(i) Currency hedges**

Forward foreign exchange contracts, including options on forward contracts, are entered into, in the normal course of investing internationally, as a hedge against the currency risks associated with investments. Contracts open at balance date are accounted for as foreign currency monetary assets and liabilities – refer note 1(b) above.

Realised and unrealised gains or losses are brought to account in determining the Profit or Loss for the year.

Currency positions are disclosed in note 15(b).

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED**

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**(ii) Derivatives**

All derivative transactions – futures, options – are for risk management purposes; that is to protect the investment portfolio from either being invested or uninvested. All such contracts are primarily for the purpose of portfolio protection and are aimed at decreasing the level of market risk in the portfolio.

All derivatives are valued at cost. Where, in the opinion of Directors, there has been a permanent diminution in the value of a derivative, the carrying amount of such a derivative is written down to its recoverable amount.

Derivative positions are disclosed in note 15(a).

**(e) Income Recognition**

Interest income is recognised on an accruals basis.

Dividend income is brought to account on the applicable ex-dividend date.

Foreign exchange income is recognised as disclosed in notes 1(b) and (d).

Investment gains and losses are recognised on disposal of an investment, subject to note 1(c).

**(f) Directors' Entitlements**

Liabilities for Directors' entitlements to fees are accrued at nominal amounts calculated on the basis of current fees rates.

Contributions to Directors' superannuation plans are charged as an expense as the contributions are paid or become payable.

**(g) Income Tax**

Income tax has been brought to account using the liability method of tax effect accounting.

**(h) Earnings per Share**

Basic earnings per share is determined by dividing the operating profit after income tax by the weighted number of ordinary shares outstanding during the year.

**(i) Cash**

Refer to note 12(a).

**(j) Receivables**

Refer to note 7.

**(k) Payables**

Refer to note 8.

**2. COMPARATIVE FIGURES**

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Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

<b>3. REVENUE FROM OPERATING ACTIVITIES</b>	<b>2000 \$'000</b>	1999 \$'000
Gross proceeds from disposal of investments and currencies	<b>155,866</b>	136,239
Dividend income	<b>1,897</b>	1,823
Interest income	<b>858</b>	430
	<b>158,621</b>	138,492

#### **4. OPERATING PROFIT/(LOSS)**

Operating profit/(loss) before income tax has been determined after:

##### **CREDITING**

– Dividends from other entities	<b>1,897</b>	1,823
– Interest	<b>858</b>	430
– Net profit on sale of investments	<b>50,474</b>	18,332
– Foreign exchange gain/(loss):		
– Net profit/(loss) on foreign currency hedging transactions	<b>(8,429)</b>	(1,359)
– Other net foreign exchange profit/(loss)	<b>1,530</b>	(735)
– Net unrealised profit/(loss) on monetary items	<b>(1,664)</b>	1,542
– Reversal of prior periods' permanent diminution in the value of investments	<b>2,097</b>	926

##### **CHARGING AS EXPENSE**

– Auditors' remuneration		
– Auditing and review (\$26,250, 1999: \$25,050)	<b>26</b>	25
– Other	<b>49</b>	26
– Investment management fees	<b>2,500</b>	1,917
– Share registry, CHESS and custodian fees	<b>339</b>	353
– Directors' Remuneration		
– Fees	<b>45</b>	43
– Superannuation	<b>3</b>	3
– Permanent diminution in the value of investments	<b>613</b>	2,097

<b>5. INCOME TAX</b>	<b>2000 \$'000</b>	<b>1999 \$'000</b>
The aggregate amount of income tax attributable to the financial year differs from the prima facie amount payable on the operating profit/(loss). The difference is reconciled as follows:		
Prima facie income tax on operating profit/(loss) at 36%	<b>15,366</b>	5,810
Tax effect on permanent differences which:		
<b>REDUCE TAX PAYABLE</b>		
– Capital Gains Indexation	–	(191)
– Allowable credits	<b>(230)</b>	(6)
– Non-taxable receipts	–	(7)
Unrecognised future income tax benefit now deductible	<b>(1,020)</b>	–
Net adjustment to deferred income tax liabilities and assets to reflect the decrease in the company tax rate to 34%	<b>15</b>	–
Future income tax benefit not recognised	<b>208</b>	3,562
Abnormal tax items:		
– Income tax refund relating to prior periods	<b>(1,917)</b>	–
– Under/(over) provision of prior period tax	<b>(3,169)</b>	(4)
	<b>9,253</b>	9,164
The income tax expense attributable to operating profit/(loss) comprises:		
Current income tax provision	<b>15,376</b>	8,619
Deferred income tax provision	<b>(1,001)</b>	551
Future income tax benefit	<b>(36)</b>	(2)
Abnormal tax items:		
– Income tax refund relating to prior periods	<b>(1,917)</b>	–
– Under/(over) provision of prior period tax	<b>(3,169)</b>	(4)
	<b>9,253</b>	9,164

**ADJUSTMENT TO DEFERRED INCOME TAX BALANCES**

Legislation reducing the company tax rate from 36% to 34% in respect of the 2000-2001 income tax year and then to 30% from the 2001-2002 income year was announced on 21 September 1999 and received Royal Assent on 10 December 1999. As a consequence, deferred tax balances which are expected to reverse in the 2000-2001, or a later, income year have been remeasured using the appropriate new rates, depending on the timing of their reversal.

Future income tax benefits and the deferred income tax balances recognised in the financial statements have been restated using the company tax rate of 34% as the amounts relate to items which will reverse in the 2000-2001 income year.

**5. INCOME TAX CONTINUED****FUTURE INCOME TAX BENEFIT**

Potential future income tax benefits of \$208,000 (1999: \$6,859,000) arising from quarantined foreign losses \$Nil (1999: \$16,220,000) and a permanent diminution in the value of investments of \$613,000 (1999: \$2,833,000) have not been brought to account at balance date as the Directors do not believe it is appropriate to regard realisation of the future income tax benefits as virtually certain.

The benefit of the permanent diminution will be obtained if the investments are sold.

**ABNORMAL TAX ITEMS**

The abnormal tax items arise from the change in the income tax basis from capital to revenue account, for the recognition of gains/(losses) on sale of investments.

	NET FAIR VALUE 2000 \$'000	COST/CARRYING VALUE 2000 \$'000	NET FAIR VALUE 1999 \$'000	COST/CARRYING VALUE 1999 \$'000
<b>6. INVESTMENTS</b>				
Listed securities	154,200	124,811	122,919	111,650
Currency hedges	895	895	2,564	2,564
Cash on deposit note 12(a)	27,231	27,231	10,190	10,190
Total Investment Portfolio note 14	182,326	152,937	135,673	124,404

**7. RECEIVABLES****CURRENT**

Proceeds on sale of investments	194	1,394
Accrued dividends	120	203
Accrued interest	36	3
Prepayments	17	14
	<b>367</b>	<b>1,614</b>

Proceeds on sale of investments are usually received between two and five days after trade date.

Interest is usually received within three days of becoming due and receivable and dividends are usually received within approximately 30 days of the ex-dividend date.

The net fair value of receivables approximates their carrying value.

<b>7. RECEIVABLES CONTINUED</b>	<b>2000 \$'000</b>	1999 \$'000
Denomination of current receivables in foreign currencies:		
British pound	<b>60</b>	77
Greek drachma	–	23
Swiss francs	<b>1</b>	–
Euro dollars	<b>194</b>	51
Indonesian rupee	<b>5</b>	5
Japanese yen	<b>29</b>	113
Korean won	–	1,169
US dollar	<b>61</b>	163
	<b>350</b>	1,601

## **8. PAYABLES**

### **CURRENT**

Payables on purchase of investments	<b>5</b>	2,557
Trade creditors (unsecured)	<b>402</b>	357
Unclaimed dividends payable to shareholders	<b>107</b>	85
	<b>514</b>	2,999

Payables on purchase of investments are usually paid between two and five days after trade date.

Trade creditors are unsecured and payable between seven and thirty days after being incurred.

The net fair value of payables approximates their carrying value.

Current payables are non-interest bearing.

Denomination of current payables in foreign currencies:

US dollar	–	131
Japanese yen	<b>5</b>	2,426
	<b>5</b>	2,557

## **9. PROVISIONS**

### **CURRENT**

Dividends (note 17)	<b>8,409</b>	6,108
Taxation	<b>12,651</b>	8,619
Deferred income tax	<b>44</b>	1,045
	<b>21,104</b>	15,772

<b>10. SHARE CAPITAL</b>	<b>2000 QUANTITY</b>	<b>2000 \$'000</b>	<b>1999 QUANTITY</b>	<b>1999 \$'000</b>
<b>ISSUED SHARE CAPITAL</b>				
Opening balance	<b>101,797,679</b>	<b>101,864</b>	97,876,745	97,877
Shares cancelled on market buyback 17-Jul-98	-	-	(208,530)	(236)
Stamp duty refund – share buyback 23-Jul-98	-	-	-	3
Dividend reinvestment plan 6-Nov-98	-	-	2,485,216	2,560
Dividend reinvestment plan 26-Feb-99	-	-	1,677,363	1,694
Shares cancelled on market buyback 27-May-99	-	-	(33,115)	(34)
Dividend reinvestment plan 2-Nov-99	<b>2,295,877</b>	<b>2,342</b>	-	-
Stamp duty refund – share buyback 2-Dec-99	-	<b>3</b>	-	-
Dividend reinvestment plan 21-Feb-00	<b>1,023,863</b>	<b>1,310</b>	-	-
Closing Balance	<b>105,117,419</b>	<b>105,519</b>	101,797,679	101,864

During the year the Company did not buy back any shares. There is no current on-market buyback.

In 1999 241,645 shares were bought back which represented 0.23% of the issued share capital, for a consideration of \$269,759 at a net loss of \$28,114. This net loss was debited against share capital, in accordance with the Urgent Issues Group accounting requirements.

Shares are issued under the Dividend Reinvestment Plan at a 5% discount to the market price.

<b>11. EARNINGS PER SHARE</b>	<b>2000</b>	<b>1999</b>
Basic earnings per share – cents per share	<b>32.25</b>	6.91
Weighted average number of ordinary shares on issue used in the calculation of basic earnings per share	<b>103,668,195</b>	100,948,366

There have been no conversions to, calls of, or subscriptions for ordinary shares other than those issued under the dividend reinvestment plan, or issues of potential ordinary shares during the financial year.

As there are no potential ordinary shares, diluted earnings per share equals basic earnings per share.

**12. NOTES TO THE STATEMENT OF CASH FLOWS**

<b>2000</b>	1999
<b>\$'000</b>	\$'000

**(a) RECONCILIATION OF CASH**

For the purposes of the Statement of Cash Flows, cash includes deposits at call, and cash at bank which are readily convertible to cash on hand.

Cash at the end of the financial year, as shown in the Statement of Cash Flows, is reconciled to the related items in the Balance Sheet as follows:

Cash at bank *	<b>134</b>	95
Cash on deposit ** note 6	<b>27,231</b>	10,190
	<b>27,365</b>	10,285

\* Includes \$107,000 (1999: \$85,000) held in respect of unclaimed dividends on behalf of Shareholders or the Office of State Revenue.

\*\* Includes \$10,181,000 (1999: \$3,109,000) on deposit to 'cash cover' derivative contracts' deposits and margin calls. These amounts are held by the relevant derivative exchanges as security and are not available for use by the Company until the derivative contracts are closed out. If losses are realised on the close out of derivative contracts the cash balances are set off against those losses.

If profits are realised on the close out of derivative contracts the money is returned to the Company.

The net fair value of cash and deposits approximates their carrying value.

The Company maintains bank accounts at various locations throughout the world to enable the settlement of purchases and sales of investments and to conduct other normal banking transactions. All accounts are at call and the majority bear floating interest rates in the range of 2.25% to 3.50% (1999: 1.50% to 2.65%).

International and Australian deposits at call bear floating interest rates in the range of 0.50% to 5.00% (1999: 0.25% to 4.50%).

International deposits and margin calls at derivative exchanges bear floating interest rates in the range of 1.00% to 4.50% (1999: 0.50% to 4.00%).

<b>12. NOTES TO THE STATEMENT OF CASH FLOWS CONTINUED</b>	<b>2000 \$'000</b>	<b>1999 \$'000</b>
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**(b) RECONCILIATION OF NET CASH FROM OPERATING ACTIVITIES  
TO OPERATING PROFIT/(LOSS) AFTER INCOME TAX**

Operating profit/(loss) after income tax	<b>33,431</b>	6,975
Decrease/(increase) in investment securities and currency hedges	<b>(11,492)</b>	(11,492)
(Increase)/decrease in cash due to exchange rate movements	<b>477</b>	160
Decrease/(increase) in settlements receivable	<b>1,200</b>	(83)
Decrease/(increase) in dividends receivable	<b>83</b>	153
Decrease/(increase) in interest receivable	<b>(33)</b>	7
Decrease/(increase) in prepayments	<b>(3)</b>	1
(Decrease)/increase in accrued expenses	<b>45</b>	2
(Decrease)/increase in settlements payable	<b>(2,552)</b>	(1,493)
(Decrease)/increase in income tax payable	<b>4,032</b>	4,794
(Increase)/decrease in future income tax benefit	<b>(36)</b>	(2)
Increase/(decrease) in deferred income tax	<b>(1,001)</b>	551
<b>NET CASH FROM OPERATING ACTIVITIES</b>	<b>24,151</b>	(427)

**13. STATEMENT OF NET ASSET VALUE**

**TAKING INVESTMENTS AT MARKET VALUE\* AND PROVIDING  
FOR REALISED AND UNREALISED TAXES**

Net Asset Value per Balance Sheet (Historical cost basis)	<b>131,901</b>	107,387
Add:		
Revaluation of investments	<b>29,389</b>	11,269
Proposed dividends	<b>8,409</b>	6,108
Utilisation of losses on unrealised gains	-	498
Less:		
Deferred income tax on revaluation of investments	<b>(10,122)</b>	(2,818)
Net Asset Value	<b>159,577</b>	122,444
Net Asset Value – cents per share	<b>151.81</b>	120.28

\* All investments, currencies and derivatives are valued at net fair value.

<b>14. INVESTMENT PORTFOLIO</b>	<b>QUANTITY</b>	<b>NET FAIR VALUE \$'000</b>
<b>JAPAN</b>		
Anritsu	78,000	2,328
Citizen Watch	226,000	3,636
Coca-Cola West Japan	36,400	1,916
Daiwa Securities	102,000	2,243
DDI Corporation	146	2,339
Fujitsu	50,000	2,883
Kinki Coca-Cola Bottling	54,000	1,196
Kuraya Sanseido	227,100	3,693
Matsushita Denki Sangyo	109,000	4,709
Mikuni Coca-Cola Bottling	74,000	1,789
National House Industrial	64,000	692
Nikko Securities	153,000	2,524
Nippon Broadcasting System	26,000	2,667
Nomura Securities	54,000	2,201
NTT	242	5,360
Sekisui Chemical	275,000	1,763
Shikoku Coca-Cola Bottling	54,100	1,054
Shinko Electric Industries	19,700	1,507
Sony Corporation	18,300	2,846
Suzuken	30,200	1,945
Taikisha	56,000	968
Taiyo Yuden – Sold Short	(15,000)	243
Tokyo Broadcasting System	35,000	2,518
Toshiba	216,000	4,062
Toyota Motor – Sold Short	(20,000)	147
		<b>57,229</b>
<b>OTHER ASIA</b>		
<b>India</b>		
Videsh Sanchar Nigam – GDR	15,800	412
		<b>412</b>
<b>Indonesia</b>		
Lippo Bank	9,939,500	237
Lippo Life	11,150,000	743
Unilever Indonesia	15,000	309
		<b>1,289</b>

14. INVESTMENT PORTFOLIO CONTINUED	QUANTITY	NET FAIR VALUE \$'000
<b>Korea</b>		
LG Chemical	39,300	1,312
Lotte Confectionery	7,580	1,463
Medison	84,700	1,540
Samsung Electronics	3,980	2,198
Seoul Broadcasting	22,480	1,386
SK Telecom	6,240	3,409
		<b>11,308</b>
<b>TOTAL OTHER ASIA</b>		<b>13,009</b>
<b>EUROPE – Euro</b>		
<b>France</b>		
Alcatel Alsthom	34,200	3,746
Pernod Ricard	11,000	1,000
		<b>4,746</b>
<b>Germany</b>		
Bayer	41,500	2,697
Douglas Holding	14,000	692
Draegerwerk – Preferred	60,549	849
Escada – Preferred	6,620	1,098
Hornbach Baumarkt	28,905	1,019
Hornbach Holding	23,460	1,417
Linde	51,750	3,440
Merck KgAa	14,100	719
Siemens	15,500	3,892
Stinnes	65,000	2,176
Wella	28,236	1,305
Wella – Preferred	23,192	1,187
		<b>20,491</b>
<b>Italy</b>		
Le Rinascente	177,525	1,681
Le Rinascente – Savings	139,000	811
Toro Assicurazioni	33,000	842
		<b>3,334</b>

14. INVESTMENT PORTFOLIO CONTINUED	QUANTITY	NET FAIR VALUE \$'000
<b>Netherlands</b>		
Akzo Nobel	62,000	4,398
		<b>4,398</b>
<b>Spain</b>		
Continente	8,000	256
		<b>256</b>
<b>TOTAL EUROPE – Euro</b>		<b>33,225</b>
<b>EUROPE – Other</b>		
<b>Finland</b>		
Nokia – Sold Short	(20,000)	241
UPM-Kymmene	19,000	788
		<b>1,029</b>
<b>Greece</b>		
Hellenic Telecom	27,320	1,113
Hellenic Telecom – ADR	26,000	529
		<b>1,642</b>
<b>Kazakstan</b>		
Kazakstan Investment Fund – Partly Paid	77,000	179
		<b>179</b>
<b>Sweden</b>		
Ericsson – ADR	56,000	1,869
Nordic Baltic Holdings	210,000	2,645
		<b>4,514</b>
<b>Switzerland</b>		
Kuehne and Nagel	1,100	828
Schindler – Participating Certificates	546	1,363
Schindler – Registered	48	123
Schweizersche Industrie Gesellschaft Holdings – Registered	1,984	2,077
		<b>4,391</b>
<b>United Kingdom</b>		
Pilkington	662,135	1,575
RMC	52,649	1,145
Smiths Industries	27,000	587
		<b>3,307</b>
<b>TOTAL EUROPE – Other</b>		<b>15,062</b>

14. INVESTMENT PORTFOLIO CONTINUED	QUANTITY	NET FAIR VALUE \$'000
<b>NORTH AMERICA</b>		
<b>Canada</b>		
Ivanhoe Mines	30,900	42
		<b>42</b>
<b>United States</b>		
Acuson	122,140	2,751
Advanced Micro Devices	38,690	4,987
Ambac Financial	10,900	998
Diagnostic Products	38,400	2,050
Dupont Photomasks	8,500	972
General Electric – Sold Short	(84,900)	(360)
GTE	15,350	1,594
JD Edwards	102,700	2,581
Loews	18,900	1,892
Lucent Technologies	31,560	3,071
Mercury General	22,150	873
NASDAQ Sep 00	(13)	106
National Semiconductors	7,900	748
Netopia	4,830	324
Novell	82,850	1,279
Octel	13,300	173
Oracle – Sold Short	(27,790)	(300)
Peoplesoft	246,932	6,902
Raytheon – B	29,300	941
S&P 500 Sep 00	(67)	825
Silicon Valley Group	40,400	1,744
Spectrian	27,000	749
		<b>34,900</b>
<b>TOTAL NORTH AMERICA</b>		<b>34,942</b>

14. INVESTMENT PORTFOLIO CONTINUED	QUANTITY	NET FAIR VALUE \$'000
<b>SOUTH AMERICA</b>		
<b>Brasil</b>		
Oderbrech	72,800,000	323
		<b>323</b>
<b>Peru</b>		
Bayer Peru – Trabajo	77,287	107
Cerveceria Backus and Johnson – Trabajo	446,248	214
Peru Real Estate – B Common	776,746	89
		<b>410</b>
<b>TOTAL SOUTH AMERICA</b>		<b>733</b>
<b>LIQUIDS</b>		
Outstanding settlements		309
Foreign exchange contracts		895
Cast at bank and on deposit		27,231
		<b>28,435</b>
<b>TOTAL INVESTMENT PORTFOLIO (NOTE 15(a) AND (b))</b>		<b>182,635</b>
Accounted for in Payables (payables on purchase of investments)		5
Accounted for in Receivables (proceeds on sale of investments)		(194)
Accounted for in Receivables (dividends receivable)		(120)
<b>ACCOUNTED FOR IN INVESTMENTS (NOTE 6)</b>		<b>182,326</b>

Exchange traded investments' net fair value is determined from the quoted market price less an estimate for realisation costs.

Unlisted investments', including monetary items', net fair value is determined from alternative pricing sources in 'over the counter' markets or by Directors' valuation, less an estimate for realisation costs.

Certain investments with a carrying value of \$56,278,238 (1999: \$42,804,769) have a net fair value of \$46,139,498 (1999: \$33,446,390).

Investment markets are in a continuous state of flux, changing the net fair value of the Company's investments, sometimes to below original cost. The Company is a long term value investor and short term fluctuations in the net fair value of investments are not taken to account, other than if they represent a permanent diminution in value. (Refer to note 1(c)(ii)).

## 15. RISK MANAGEMENT

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It is the Company's investment objective to seek long term capital growth through value investing internationally in businesses and companies. The Investment Manager may also invest in fixed interest investments, although this is not the primary investment objective. The Company's investments are subject to price (which includes currency, interest rate and market risk) credit and liquidity risks.

The Company's primary risks are related to the investment activities undertaken on its behalf by the Investment Manager. The Company has a policy of not borrowing moneys, other than on a short term basis for settlement, trading and like purposes. The Company's investment restrictions prohibit it from taking positions in futures, options, other derivative products or short sales of securities if the aggregate exposure to those products exceeds 50% of the net asset value of the Company.

The Board monitors the level of risk in the Investment Portfolio regularly through formal Directors' meetings with the Investment Manager. The Investment Manager monitors the risks daily and implements risk management strategies consistent with the invested position as it believes necessary. The effective exposure to currencies and markets is continuously monitored by the Investment Manager and the Company.

The Company is exposed to credit related losses in the event of non-performance by counterparties to financial instruments, but it does not expect any counterparties to fail to meet their obligations given their high credit ratings. Where appropriate the Company utilises master netting agreements.

The Company is exposed to liquidity risks – the possibility of being unable to obtain the fair market value of an asset or derivative owing to prevailing market conditions – and manages this risk by using derivatives in liquid markets and managing exposure to assets in illiquid markets; although it should be noted that even the most liquid markets can become illiquid in times of severe downward price corrections.

The international investment activities of the Company expose it to currency risk – the possibility of losing money owing to changes in foreign currency exchange rates – and manages this risk through forward currency hedging contracts.

The investment activities of the Company expose it to market risk – the possibility of losing money owing to changes in the market prices of its investments – and manages this risk through derivative hedging contracts.

The Company is exposed to interest rate risks – the possibility of losing money owing to changes in interest rates and, more particularly for the Company, the effect that changes in interest rates have on currency and stock market prices – and manages these as noted above for currency and market risks.

**15. RISK MANAGEMENT CONTINUED**

Refer to note 1 for the Accounting Policies adopted with respect to Derivatives and Currencies.

**(a) INVESTMENTS AT NET FAIR VALUE AND DERIVATIVES EXPOSURE**

	PHYSICAL \$'000	FUTURES AND OPTIONS \$'000	UPSIDE (i) \$'000	FUTURES AND OPTIONS \$'000	DOWNSIDE (ii) \$'000
Japan	57,229	(3,479)	53,750	(3,479)	53,750
Other Asia	13,009		13,009		13,009
Europe ~ Euro	33,225		33,225		33,225
Europe ~ Other	15,062	(1,949)	13,113	(1,949)	13,113
North America	34,942	(61,142)	(26,200)	(61,142)	(26,200)
South America	733		733		733
	154,200	(66,570)	87,630	(66,570)	87,630
Liquids	28,435	66,570	95,005	66,570	95,005
<b>TOTAL NET FAIR VALUE OF PORTFOLIO</b>	<b>182,635</b>	<b>-</b>	<b>182,635</b>	<b>-</b>	<b>182,635</b>

The above table categorises the Investment Portfolio in the same way that the Investment Manager does for day-to-day management. The 'physical' column simply shows the location of the Company's investments.

(i) The 'upside' column is an approximation of the Portfolio's exposure to upward movements in markets. This is calculated by making two adjustments to the 'physical' position. The first is to subtract, from the physical position, any short (sold) and add any long (bought) positions in shares or share index futures. For example, if 5% of the Portfolio was invested in Japan but there was a 2% short position in Nikkei futures, then the upside column would show 3%. Conceivably the figure could show a negative exposure which would indicate the Portfolio was net short the Japanese market. The second adjustment is for options held to buy shares (bought calls). A call option with the premium representing 0.5% of the Portfolio to buy shares in Toyota worth, say 3% of the Portfolio would require an additional 2.5% to be added to the Japanese exposure (thus determining underlying exposure).

(ii) The 'downside' column is an approximation of the Portfolio's exposure to downward moves in the market. It is calculated by adjusting the 'physical' position for any short or long positions in shares or share index futures and bought put options. It is not necessary to adjust for call options as only the option premium (already included in 'physical') is at risk, not the underlying holding callable by the option.

The Company uses futures contracts in liquid markets and generally utilises short dated contracts; those with 90 day maturities. The existing derivative positions' maturity dates range from 77 days to 80 days. Initial margin requirements and daily variation margin requirements on futures contracts are met in cash. Futures contracts have little credit risk as they are traded on recognised exchanges.

**15. RISK MANAGEMENT CONTINUED**

The Company uses Exchange Traded and Over The Counter Options where the maximum potential loss is paid up-front by way of a premium. There is little credit risk attached to these instruments as they are traded on recognised exchanges or with high credit rating counterparties.

<b>(b) CURRENCY EXPOSURE AT NET FAIR VALUE</b>				
	<b>PHYSICAL \$'000</b>	<b>BOUGHT \$'000</b>	<b>SOLD \$'000</b>	<b>NET EXPOSURE \$'000</b>
Japan	69,646		(51,572)	18,074
Other Asia	16,530			16,530
Australia	976	73,190		74,166
Europe – Euro	33,514	13,882		47,396
Europe – Other	12,551			12,551
North America	48,685	13,274	(48,774)	13,185
South America	733			733
<b>TOTAL NET FAIR VALUE OF PORTFOLIO</b>	<b>182,635</b>	<b>100,346</b>	<b>(100,346)</b>	<b>182,635</b>

The above table categorises the investments in the Portfolio into the currencies that the securities are issued in. For example a security issued by a Japanese company in US\$ will be categorised as a US\$ exposure.

Forward foreign currency contracts and options on forward currency contracts are adjusted against the 'physical' column to arrive at a net exposure to each currency grouping.

The Company generally utilises short dated (90 day maturities) currency agreements with high credit rated counterparties.

The existing currency hedging positions' maturity dates range from 14 days to 76 days.

**(c) INTEREST RATE EXPOSURE**

The Company had no fixed interest investments or derivatives thereon at balance date. Refer to note 12(a) for information on short-term interest rates.

<b>16. FRANKING ACCOUNT</b>	<b>2000 \$'000</b>	<b>1999 \$'000</b>
Opening Balance – Class C	<b>22,067</b>	16,781
On dividends received: fully franked	<b>41</b>	56
On tax paid and payable: 1998/1999	–	15,322
1999/2000	<b>27,335</b>	–
Prior year tax provision – franking adjustment	<b>(5,634)</b>	9
Prior years' tax paid adjustment – tax refund	<b>(3,408)</b>	
Prior year final dividend adjustment on shares cancelled (on market buyback)	–	13
Special dividend paid – fully franked	–	(4,006)
Interim dividend paid – fully franked	<b>(4,163)</b>	–
Proposed dividends – fully franked	<b>(8,409)</b>	(6,108)
	<b>27,829</b>	22,067

Amount of retained earnings that could be distributed as dividends and be franked out of existing credits or out of franking credits arising from the payment of income tax in the period subsequent to 30 June 2000, after deducting franking credits applicable to any proposed dividends:

Accumulated profits	<b>26,382</b>	5,523
	<b>26,382</b>	5,523

The balances of the franking account disclosed above is based on a tax rate of 36%. Legislation was introduced into Parliament in December 1999 which deals with the implications for franking accounts of the company tax rate change from 36% to 34% for the 2000-2001 income tax year. The legislation requires companies to convert their existing Class C franking account balances from an underlying tax rate of 36% to an underlying tax rate of 34% on 1 July 2000.

<b>17. DIVIDENDS (FULLY FRANKED)</b>	<b>2000 CPS</b>	<b>2000 \$'000</b>	<b>1999 cps</b>	<b>1999 \$'000</b>
Paid – Special fully franked	–	–	4.00	4,006
Paid – Interim fully franked	<b>4.00</b>	<b>4,163</b>		
Prior year final dividend adjustment on shares cancelled (on market buyback)	–	–	–	(13)
Proposed – fully franked				
– Final	<b>8.00</b>	<b>8,409</b>	6.00	6,108
	<b>12.00</b>	<b>12,572</b>	10.00	10,101

## 18. INVESTMENT MANAGER

The Investment Manager is Platinum Asset Management. It receives a monthly management fee for investment services provided in accordance with the Investment Management Agreement. This agreement provides for a management fee payable monthly and calculated at 1.5% per annum of the Portfolio Value.

Additionally a Bonus (Performance) fee is payable at 10% of the amount by which the Portfolio's annual performance exceeds the return achieved by the MSCI plus 5% (MSCI is the Morgan Stanley Capital International World Accumulation Net Return Index in A\$). Where the Portfolio's annual performance is less than the MSCI the amount of the underperformance is aggregated and carried forward and deducted from the annual performance in the subsequent year before calculating any Bonus fee for that year. The aggregate of underperformance is carried forward until a Bonus fee becomes payable.

The pre-tax performance of the portfolio for the year to June 2000 was 45.18% against the MSCI's 23.69%. Even though there is an outperformance of 21.49% there is a bought forward underperformance amount of 34.66%. Accordingly, a performance fee has not been accrued.

The Investment Manager is to be paid a lump sum termination fee of 1.5% calculated on the value of the Portfolio on the first day of the month in which termination is effective. The fee is not payable if the termination results from the default or insolvency of the Investment Manager. Additionally a Bonus fee is payable for the period from the last calculation of the Bonus fee (as described above) to the date of termination.

	2000 \$'000	1999 \$'000
Amounts paid and payable to the Investment Manager for the year	2,500	1,917

## 19. CONTINGENT LIABILITIES AND COMMITMENTS FOR EXPENDITURE

No contingent liabilities exist at balance date.

The Company has commitments for uncalled share capital on investments of \$407,000 (1999: \$347,000).

## 20. SEGMENT INFORMATION

The Company was predominantly engaged in investment activities on world markets and derived revenue from sale of investments, interest and dividends. The Investment Manager does not invest with any pre-determined asset allocation ranges as it uses a stock selection methodology. Accordingly the results of the Company are a function of the investment portfolio and its make up is a function of the stock selection process. As the investment portfolio's composition varies dependent on stock selection decisions it is not considered appropriate to allocate revenues to some pre-determined contrived segment, which would be contradictory to the investment objective of the Company.

**21. SUBSEQUENT EVENTS**

No significant events have occurred since balance date which would impact the financial position of the Company as at 30 June 2000 and the results for the year ended on that date.

**22. RELATED PARTY INFORMATION****(a) DIRECTORS**

The names of persons who were Directors of Platinum Capital Limited at any time during the financial year are as follows: MG Darling, PW Clarke, WKS Neilson, AM Clifford and RM Halstead. All of these persons were also Directors during the year ended 30 June 2000.

**(b) DIRECTORS' REMUNERATION**

Remuneration received or receivable by the Directors of the Company, including aggregate amounts paid to superannuation plans is disclosed in note 4 to the Accounts. The number of Directors of the Company included in the figures disclosed in note 4 to the Accounts are shown below in their relevant income bands:

	2000	1999
\$20,000 – \$29,999	2	1
\$9,999 – \$19,999	–	1
\$0 – \$9,999	–	1

The three Executive Directors, Messrs Neilson, Clifford and Halstead, are employees of and have a relevant interest in the Investment Manager and accordingly will receive some portion of the management fee; they do not receive any Directors' remuneration from the Company. Refer to note 18.

The aggregate number of shares held by Directors of the Company and their director-related entities at balance date:

	2000 ORDINARY SHARES	1999 ORDINARY SHARES
MG Darling	–	3,560,420
WK Neilson	<b>1,384,356</b>	1,267,829
AM Clifford	<b>1,204,164</b>	1,102,804
RM Halstead	<b>1,192,152</b>	1,091,802

The Directors declare that the financial statements and notes set out on pages 20 to 42:

- (a) comply with Accounting Standards, the Corporations Regulations and other mandatory professional reporting requirements; and
- (b) give a true and fair view of the Company's financial position as at 30 June 2000 and their performance as represented by the results of its operations and its cash flows for the financial year ended on that date.

In the Directors' opinion:

- (a) the financial statements and notes are in accordance with the Corporations Law; and
- (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the Directors.



**MG Darling** Director



**WK Neilson** Director

Sydney 4 August 2000

**SCOPE**

We have audited the financial report of Platinum Capital Limited (the Company) for the year ended 30 June 2000 as set out on pages 20 to 43. The Company's Directors are responsible for the preparation and presentation of the financial report and information contained therein. We have conducted an independent audit of the financial report in order to express an opinion on them to the members of the Company.

Our audit has been conducted in accordance with the Australian Auditing Standards to provide reasonable assurance as to whether the financial report is free of material misstatement. Our procedures included examination, on a test basis, of evidence supporting the amounts and other disclosures in the financial report, and the evaluation of accounting policies and significant accounting estimates. These procedures have been undertaken to form an opinion as to whether, in all material respects, the financial report is presented fairly in accordance with Accounting Standards, other mandatory professional reporting requirements, being Urgent Issues Group Consensus Views, and the Corporations Law so as to present a view which is consistent with our understanding of the Company's state of affairs, the results of its operations and their cash flows.

The audit opinion expressed in this report has been formed on the above basis.

**AUDIT OPINION**

In our opinion the financial report of the Company is in accordance with:

- (a) the Corporations Law, including:
  - (i) giving a true and fair view of the Company's financial position as at 30 June 2000 and of its performance for the financial year ended on that date; and
  - (ii) complying with Accounting Standards and the Corporations Regulations; and
- (b) other mandatory professional reporting requirements.

**PricewaterhouseCoopers**

Chartered Accountants



**PK Merrett** Partner

Sydney 4 August 2000

**SUBSTANTIAL SHAREHOLDERS**

The Company's Register of Substantial Shareholders, prepared in accordance with section 715 of the Corporation Law, recorded the following information as at 31 July 2000.

NAME	NUMBER OF SHARES	CLASS OF SHARE
Questor Financial Services Limited	8,679,544	ordinary
National Australia Bank Limited Group	7,106,261	ordinary

**DISTRIBUTION OF SECURITIES**

	CLASS OF EQUITY SECURITY ORDINARY
(i) Distribution schedule of holdings	
1 – 1,000	223
1,001 – 5,000	1,710
5,001 – 10,000	1,461
10,001 – 100,000	1,870
100,001 and over	77
<b>TOTAL NUMBER OF HOLDERS</b>	<b>5,341</b>
(ii) Number of holders of less than a marketable parcel	349
(iii) Percentage held by the 20 largest holders	32.06%

## SHAREHOLDER INFORMATION

### TWENTY LARGEST SHAREHOLDERS

The names of the 20 largest holders of each class of equity securities as at 31 July 2000 are listed below:

	NUMBER OF SHARES	%
Questor Financial Services Limited	10,969,953	10.44
Perpetual Trustee Company Ltd	7,047,866	6.70
National Nominees Limited	4,977,627	4.74
Questor Financial Services Limited	1,706,770	1.62
Platinum Asset Management Limited	1,144,100	1.09
RPG Management Pty Limited	1,136,228	1.08
Groote Eylandt Aboriginal Trust Inc	1,061,096	1.01
Cox Bros Coffs Harbour Pty Limited	1,000,000	0.95
Merrill Lynch (Australia) Nominees Pty Limited	764,947	0.73
Tower Trust Limited	575,707	0.55
Nizin Holdings Pty Limited	458,638	0.44
Feboco Investments Pty Limited	361,098	0.34
Nizin Holdings Pty Limited	360,384	0.34
Mr Gregory Mitchell Maughan	352,448	0.34
Abtourk Pty Ltd	331,292	0.32
Veredi Pty Limited	325,231	0.31
Gallium Pty Ltd	300,320	0.29
Dr Russell Kay Hancock	300,000	0.29
Mr Matthew Curzon Allen	266,031	0.25
Transport Accident Commission	243,102	0.23

### VOTING RIGHTS

#### Ordinary Shares:

On a show of hands, every member present in person or represented by a proxy or representative shall have one vote and on a poll every member who is present in person or represented by a proxy or representative shall have one vote for every share held by them.

**ADDITIONAL INFORMATION IN ACCORDANCE WITH THE ASX LISTING REQUIREMENTS FOR THE COMPANY**

1. The total number of securities transactions entered into during the reporting period, together with total brokerage paid during the reporting period:  
Number of transactions – 948  
Total brokerage paid – \$748,000
2. Shareholders may review a list of investments acquired or disposed of by the Company in the reporting period at the Registered Office.
3. A listing of the Investment Portfolio may be found in note 14 to the Accounts.
4. A summary of the fees paid or payable to the Investment Manager may be found in note 18 to the Accounts.
5. A summary of the salient provisions of the Investment Management Contract are as follows:
  - (a) the Investment Manager will invest the Portfolio in accordance with the investment objectives and restrictions of the Company and subject to the Constitution, the Management Agreement, the ASX Listing Rules, the Corporations Law and investment restrictions and directions from the Company;
  - (b) confer with the Company at regular intervals;
  - (c) administer the borrowings of the Company;
  - (d) the Investment Manager may appoint the Managing Director of the Company;
  - (e) the Investment Manager is required to publish the Net Asset Value of the Company monthly at the ASX and in an Australian national daily newspaper;
  - (f) the Agreement will continue for a term of five years, the Investment Manager may retire after giving six months notice;
  - (g) the Agreement may be terminated or renewed by the Members of the Company in General Meeting at the end of each five year term; and
  - (h) the Agreement may be immediately terminated by the Company in the event of:
    - (i) a breach of a material obligation by the Investment Manager;
    - (ii) the Investment Manager going into liquidation or having an administrator or receiver appointed.

## FINANCIAL CALENDAR

Annual General Meeting	26 October 2000
Ordinary Shares trade Ex-Dividend	27 October 2000
Record (books close) date for Final dividend	2 November 2000
Final dividend paid	14 November 2000

*These dates are indicative and may be changed.*

## **DIRECTORS**

**Michael Darling**  
**Peter Clarke**  
**Kerr Neilson**  
**Andrew Clifford**  
**Malcolm Halstead**

## **SECRETARY**

**Malcolm Halstead**

## **INVESTMENT MANAGER**

**Platinum Asset Management**

## **REGISTERED OFFICE**

**Level 21, Gold Fields House**  
**1 Alfred Street**  
**Sydney NSW 2000**  
**Phone (61 2) 9255 7500**

## **SHARE REGISTRARS**

**Computershare Registry Services Pty Ltd**  
**Level 3, 60 Carrington Street**  
**Sydney NSW 2000**  
**Phone (61 2) 8234 5222**

## **AUDITORS AND TAXATION ADVISORS**

**PricewaterhouseCoopers**  
**201 Sussex Street**  
**Sydney NSW 2000**

## **SOLICITORS**

**Allen Allen & Hemsley**  
**2 Chifley Square**  
**Sydney NSW 2000**

## **STOCK EXCHANGE LISTING**

**Official list of the Australian Stock Exchange Limited**  
**Ordinary Shares ASX Code: PMC**

## **INVESTMENT MANAGER**

**Platinum Asset Management – Investment team**

**Kerr Neilson ~ Global**  
**Andrew Clifford ~ North America, IT Services, Software**  
**Jim Simpson ~ Japan, Korea, Semi Conductors**  
**Charles Evans ~ Japan, Korea**  
**Doug Huey ~ S.E. Asia, Semi Conductors & Capital Equipment**  
**Toby Harrop ~ Europe, Currencies, Healthcare**  
**Alex Barbi ~ Europe, Telecom Equipment & Operators**  
**John Hempton ~ Global Banking, Financials, Insurance**  
**Ross Curran ~ Global Consumer Goods**  
**Steven Glass ~ Quant Methods, Risk**  
**Jacob Mitchell ~ Global Engineering & Technical Services**  
**Liz Norman ~ Shareholder Liaison**