Platinum European Fund

Clay Smolinski Portfolio Manager

Disposition of Assets

REGION	JUN 2012	MAR 2012
Germany	40%	43%
France	17%	16%
UK	15%	16%
Netherlands	3%	4%
Italy	3%	4%
Spain	3%	2%
US*	2%	2%
Sweden	2%	2%
Finland	1%	1%
Belgium	1%	1%
Switzerland	0%	1%
Cash	13%	8%
Shorts	1%	6%

* Pulp stock listed in the US but predominant business is conducted in Europe

Source: Platinum

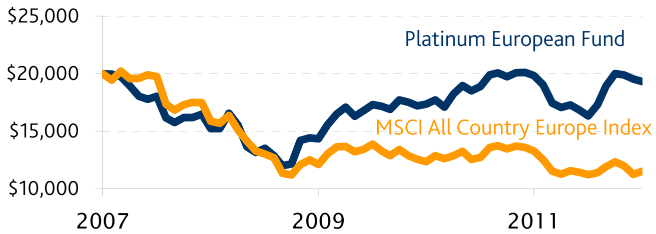
Performance

European markets consistently sold down over the quarter as investors increasingly questioned the political will of European bureaucrats to both agree upon and implement a long-term funding plan for Spain and Italy. The major European indices fell in unison with the Italian and Spanish markets down -6% over the quarter, while the German and French markets fell -5% and -4% respectively. The UK, somewhat insulated from the long-term doubts over the euro currency mechanism fared slightly better, finishing down -3%.

The markets heavy focus on the 'macro outlook' also meant the correlations in stock price movements returned to very high levels. By way of illustration, looking at the price action of Europe's largest 540 stocks over the quarter, only 24 companies posted price gains of over 10% versus the 261 which fell by 10% or more. The performance of specific stocks and sectors largely reflected the fearful market, with the financials (Unicredito -37%, Credit Suisse -35%, Deutsche Bank -27%) and the industrial and mining related cyclicals (Metso -25%, Xstrata -28%, Volvo -22%) suffering heavy falls.

Value of $20,000 Invested Over Five Years

30 June 2007 to 30 June 2012



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

For the quarter, the Platinum European Fund returned -3.4% versus -6.7% for the MSCI Europe Index (A$). Good performance from a number of our French holdings (Eurofins +34%, CFAO +16%) and airline IT leader Amadeus (+12%), helped to offset falls in a number of our German holdings (most notably Deutsche Börse -20% and BMW -18%).

Over the last 12 months, the European Fund has returned -2.6%, outperforming the Index by 10.6%, which returned -13.2% over the same period.

Commentary

Europe

Given the sovereign crisis has now been underway for two and half years, many readers are probably wondering if we are any closer to a resolution. When thinking about Europe's situation, it is worth remembering the central problem; that governments are spending more than they are earning and have accumulated large debts, is not unique to Europe. In fact Japan, the US, and UK all face the same situation.

The aspect which of course is unique to Europe, in contrast to the US where there is one Central Bank and one government, is we have one Central Bank and *seventeen* (or at least six with significant power) governments trying to make consensus decisions on highly charged topics such as funding and national budgets, all while juggling their respective four year election cycles and political ideologies. Viewed in this light, it is hardly surprising that it feels like we are making progress at a snail's pace.

The crisis poses two risks. The first is the general risk of widespread economic slowdown and the effect this will have on companies earnings caused by the adjustments to fiscal spending and the dampening of 'animal spirits'[1]. This risk can be reduced by stock selection and seeking companies where the fear of this is more than reflected in their low valuations. The second is the tail risk of a major event like a break-up of the euro. Even in this extreme situation, it is clear the underlying business of most companies will continue on; people will still want to wear Adidas sportswear and drink Pernod Ricard's spirits, but the panic and uncertainty of such an event would likely lead to a large market sell-off.

In analysing the risk of a break-up, on the downside we need to consider that in the mid-term, it will be hard for the southern economies to grow and under the conditions of high unemployment and toil, the political views of nations can swing wildly (as we have most recently seen in Greece with the rise of the radical left wing party Syriza). On the positive side, there is evidence the southern economies are slowly healing; absolute levels of exports are now running at €229 billion for Spain and €402 billion for Italy, **15% and 4% above their respective peak levels reached in 2008**. Also, we must remember that policy makers understand the overall funding problems the government's face and will react. Given that they can resort to the printing presses of the European Central Bank (ECB), policy makers still have huge resources to hold the euro together.

It is clear the ECB and the European governments understand the design flaws of the European Union (EU) and are currently putting in long-term plans to correct them. But given the need to manage election cycles and public opinion there will continue to be an enormous amount of conflicting rhetoric around every decision. Because of this we need to remain focused on the **actions of policy makers, not the words**. The European summit at the end of June gave us the next evolution of steps being taken, which included:

1. That the ECB would become the central supervisor for the EU banking system.
2. Future recapitalisations of EU banks would be done via the European Stability Mechanism (ESM). The ESM is essentially a central bailout fund and this is a move towards a 'banking union'. This means the liability for funds required to restore the viability of Spain's banking system would not sit with the Spanish government alone, but would be shared amongst euro members.
3. The commitment to a €120 billion 'growth fund'. This is another mutualisation tool administered via the European Investment Bank (EIB). Again, this money can be used to fund stimulus programs in Spain, without the ultimate liability resting on the Spanish government.

[1] A term used by John Maynard Keynes to describe emotions that drive consumer confidence. A current example in Europe might be those employed in the government sector. While still employed today, they may have less confidence in their long-term job security and therefore choose to save more rather than spend on say a holiday or new clothes.

None of these measures are the quick fix the market so desperately desires but do show a continued move to lay the groundwork for a fiscal union to back the monetary union.

So yes, progress is being made and the actions so far back our base case that a euro exit is still a remote likelihood on a mid-term timeframe. That said, we would be the first to profess our expertise is not in the prediction of geo-political macro events and you can be assured we are constantly testing our base case to see the other side.

Solar Industry

April marked the bankruptcy of the once iconic German solar panel manufacturer, Q-Cells, another signal that the solar industry has changed dramatically from the wild boom times experienced in 2007. Back then, the European panel manufacturers were seen to have the first-mover advantage. They had secured supplies of polysilicon (a key input that was in wide shortage at the time) and had scale in manufacturing, and research and development, which was expected to allow them to remain cost leaders.

The first step-change in the industry was the shift of leadership towards the Chinese solar competitors. The Chinese quickly gained production scale and technological knowhow in solar, which combined with their lower costs allowed them to undercut the western producers and make huge profits. The second phase is the more recent story of overcapacity and falling demand. The Chinese manufacturers with their newfound leadership massively expanded their production capacity, only to see the peak of their build-out coincide with falling demand for panels out of Europe (a legacy of cash strapped governments pulling back their subsidy schemes). We are now left with a solar industry which has excess panel manufacturing capacity, record low panel prices and even the cost-leading Chinese players posting large losses.

We have kept a close eye on the solar industry over the last five years for the simple fact that it is a revolutionary technology. If we can **cost effectively** harness the sun to produce electricity, solar has the potential to change the energy industry as we know it. Despite this potential, whether it was the early boom time valuations, the reliance on government subsidies or the cut-throat nature of the industry, we have always struggled to find attractive investments in the space. The question is, now with the industry going through a major bust (and the stock prices of most listed solar companies down >75% from their highs) is it the time to be investing?

The major factor fueling our interest is how far the cost of solar has fallen – we have reached the point that in many markets electricity can now be generated via unsubsidised rooftop solar at the same price as the retail grid. To illustrate, a two Kilowatt (KW) rooftop system fully installed in NSW in 2007 would have cost roughly $24,000, producing a generation cost of 80 cents per KwH. That same system today costs $6,400, producing a generation cost of 23 cents per KwH – a 75% reduction in price!

The importance of this price fall is that with solar having reached retail grid parity in Australia, Italy, Spain and Germany we are:

1. At a stage where the size of the government subsidies needed to encourage solar demand can be drastically reduced.
2. Nearing a realistic scenario where a reasonably significant portion of the solar market will become viable *without government subsidies*.

The exact timing of this tipping point for each market is difficult to predict, but the evidence of unsubsidised utility scale solar plants being built in Spain and the fact that the German feed-in-tariff for household solar is 18 cents, five cents *below* the current retail electricity price, means that this shift is probably closer than most think.

Returning to the immediate problems of demand and overcapacity, demand for solar will be weaker in Europe over the next couple of years, but we would point to Japan, the US and China as the new markets to take the baton. With the interplay of:

1. Falling solar costs which are further helped by low interest rates.
2. The large solar incentive plan just implemented by the Japanese government.
3. The fact that China has just upped its solar installation target to 21GW by 2015 (up from a 15GW target set in May), there seems to be many good reasons why solar demand may actually prove to be higher than expected.

On the subject of overcapacity, again it is clear the manufacturers have over-expanded, however, we feel this capacity is unlikely to be a long-term overhang on the industry. The pace of technology development in the production of solar cells is rapid enough to ensure steady obsolescence of production equipment. For example, **given the rising importance of the balance of system costs[2] to the total installed cost of a solar system**, manufacturers may find lower efficiency panels produced on older equipment difficult to sell at any price.

Overall, we think solar will remain a growth industry over the next decade and see the current shakeout an opportunity to acquire positions in the industry's best companies. Over the quarter we have started gradually building holdings in two names. Both companies operate in niches of the solar supply chain that are far less competitive than the production of cells and panels, hold dominant positions in their respective markets and have almost zero risk of bankruptcy given the large cash reserves on their balance sheet.

Outlook

European markets are at an interesting junction. We are starting to see some of the more cyclical companies issue profit warnings, pointing to weakening European and Chinese demand as explanation. More warnings will undoubtedly come but given the steep falls in the prices of many of these stocks, arguably much of the bad news is being priced in.

Macro headlines will continue to dominate investors' positioning and the volatility in European markets is unlikely to recede in the near term. As usual, we will place greater focus on the individual companies and valuations, using the volatility as an opportunity to upgrade the portfolio with companies with better earnings prospects or where valuations have become exceedingly cheap.

[2] Balance of System (BoS) costs refer to all the costs apart from the panels that are required to install a solar system. For example, the BoS will include the cost of the inverter, labor to install the panels and so on.

Notes

1. The investment returns are calculated using the Fund's unit price and represent the combined income and capital return for the specific period. They are net of fees and costs (excluding the buy-sell spread and any investment performance fee payable), are pre-tax, and assume the reinvestment of distributions. The investment returns shown are historical and no warranty can be given for future performance. You should be aware that historical performance is not a reliable indicator of future performance. Due to the volatility of underlying assets of the Funds and other risk factors associated with investing, investment returns can be negative (particularly in the short-term).

   The inception dates for each Fund are as follows:
   Platinum International Fund: 30 April 1995
   Platinum Unhedged Fund: 31 January 2005
   Platinum Asia Fund: 4 March 2003
   Platinum European Fund: 30 June 1998
   Platinum Japan Fund: 30 June 1998
   Platinum International Brands Fund: 18 May 2000
   Platinum International Health Care Fund: 10 November 2003
   Platinum International Technology Fund: 18 May 2000

2. The investment returns depicted in this graph are cumulative on A$20,000 invested in the relevant Fund over five years from 30 June 2007 to 30 June 2012 relative to their Index (in A$) as per below:
   Platinum International Fund - MSCI All Country World Net Index
   Platinum Unhedged Fund - MSCI All Country World Net Index
   Platinum Asia Fund - MSCI All Country Asia ex Japan Net Index
   Platinum European Fund - MSCI All Country Europe Net Index
   Platinum Japan Fund - MSCI Japan Net Index
   Platinum International Brands Fund - MSCI All Country World Net Index
   Platinum International Health Care Fund - MSCI All Country World Health Care Net Index
   Platinum International Technology Fund - MSCI All Country World Information Technology Net Index
   (nb. the gross MSCI Index was used prior to 31 December 1998 as the net MSCI Index did not exist).

   The investment returns are calculated using the Fund's unit price. They are net of fees and costs (excluding the buy-sell spread and any investment performance fee payable), pre-tax and assume the reinvestment of distributions. It should be noted that Platinum does not invest by reference to the weightings of the Index. Underlying assets are chosen through Platinum's individual stock selection process and as a result holdings will vary considerably to the make-up of the Index. The Index is provided as a reference only.