



Platinum International Technology Fund

Quarterly Report

September 2000

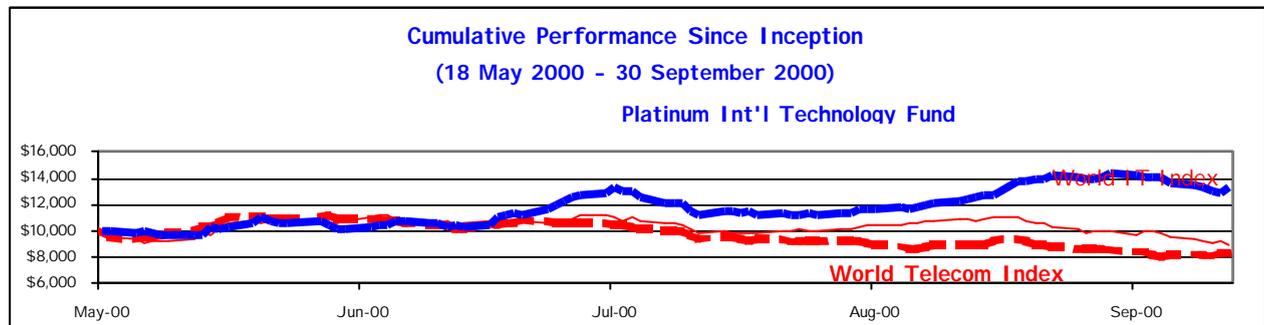
Redemption Price: \$1.3416

Fund Size: \$8 million

Performance

Technology and telecommunications stocks had a very weak quarter with the MSCI Information Technology Index and the MSCI Telecommunication Services Index both declining 15%. The fall in the Australian dollar helped offset these declines somewhat, with these indices falling 8% and 10% respectively in Australian dollar terms. Despite the weakness in the market, the Platinum International Technology Fund rose 28%.

The market has continued to place extraordinary valuations on technology where the growth opportunity appears endless and the position of the business is dominant while other “less perfect companies”, which nevertheless have good products, an existing customer base, and reasonable growth prospects, have been severely punished. The Fund's performance has been achieved by a two pronged strategy of investing in the latter group with holdings such as Peoplesoft, Silicon Valley Group, Alcatel, and Anritsu contributing strongly, while shorting a number of companies in the former group of “perfect” stocks, with positions in Nokia, Intel, and JDS Uniphase having added nicely to returns.



Commentary

The movements in technology and telecom stocks over the last quarter have been more about the dynamics and psychology of a stock market bubble than about fundamental deterioration in the core themes of the IT revolution. **If stocks become overvalued then knowledgeable owners will sell.** This was the driving force behind the vast number of technology companies listing in 1999 and the first quarter of 2000, the legacy of which remains today as “insider” lockup periods expire and allow more supply onto the market.

Supply of paper can be created in a number of ways other than listing of new companies. A common occurrence is the spin-off where an already listed company partially lists a division, often achieving a valuation much higher than implied in its own share price. The other method is simply to make acquisitions using stock, which some cynics would point out has the benefit of bringing forward the expiration of lockup periods. The bull market in technology and telecom came to an end in March primarily because the global investment banking community was creating new paper with such efficiency that it more than met the rush of money from retail and institutional investors.

Having been badly burnt by the sell-off in “lower quality” technology companies during April and May, investors still committed to the concept of “technology investing” crowded into names where there was

great certainty of outcomes. By August leading blue chip technology stocks such as Intel, Sun Microsystems, EMC, Nortel, Broadcom, Siebel Systems and many others, had made significant new highs. Not surprisingly the investment banking community is working hard to create supply of new paper in the remaining hot areas such as “communication IC’s”, “optronics”, and “computer storage”.

As is the usual pattern, analysis and commentary follows rather than leads share price movements. A number of concerns have preoccupied the market through the quarter but in nearly every case there is little change from six or 12 months ago. The case for investing in different areas is being reassessed and in the more sober stock market environment that we now face, the focus is on how basic business principles apply rather than on the blue sky of the never ending growth opportunity. Questions being examined today are about capital requirements, the need to ultimately earn a return on that capital, and the competitive responses.

The key area of concern through the quarter has been telecommunications capital expenditure. Deregulation of telecom markets around the world in recent years has seen a raft of new entrants attempting to take a slice of this very large, growing and profitable market. This created demand for telecom equipment, not only by the new entrants, but also by the incumbent operators who were forced to lift quality of service to protect their business. To date, the new entrants have been highly successful in driving down prices but few have managed to build a profitable sustainable business. The business is highly capital intensive and as these new entrants run down their cash balances, they are finding it near impossible to raise new funds. The incumbents have also been spending heavily and balance sheets are in poor shape. Looking at the major US operators only, capital expenditure this year is expected to hit US\$105 billion versus available cash flow of approx US\$73 billion. In Europe, the invested capital base of the major players by the end of 2000, will have more than doubled in two years, with the returns on invested capital shrinking from over 16% to around 12.5%.

It is clear that aggregate telecom capital expenditure is well above sustainable levels, although certain segments will continue to be strong. Adding to concerns have been the huge prices paid in recent auctions for third generation cellular licences in the UK (US\$33 billion) and Germany (US\$45 billion) which significantly reduces the future returns that will be made from providing wireless data services and raises the question of how these investments will be funded. Even worse perhaps is the US situation where the spectrum required for third generation services is already in use by the television industry and auctions have had to be postponed until the issue is resolved. Following on from here concerns have been that if the introduction of wireless data services are either delayed or alternatively more expensive, then the demand for leading edge handsets will be dull. Unfortunately for the handset manufacturers, this is the area where their profits are greatest.

From here the concerns cascade through to the semiconductor companies. Besides PC’s, where demand has generally been sluggish throughout the year, the next biggest demand for semiconductors comes from the telecom sector. And a slowdown in expectations for semiconductors flows through to slower demand for semiconductor capital equipment. As investors have retreated from the telecom and semiconductor related areas, they have in turn piled into areas benefiting from corporate IT budgets such as enterprise software, computing and storage. However, as this is being written we are starting to see concerns about the rate of growth in corporate IT expenditure. Projects to web-enable businesses are turning out to be more complex both in regard to the technology and business strategies, and for many the downfall of their internet competitors has meant the urgency of investment has been reduced a notch.

Our comments here are about the stock market and the psychology of investors. Real investment in business to business e-commerce, building of internet and wireless infrastructure will continue. The issue is the way in which the market values these opportunities. Significant damage has been inflicted on individual stocks and whole sectors, and one would expect better performance from these sectors going forward. Elsewhere, large parts of the markets remain on high valuations providing opportunities to make money by “shorting” these companies.

Portfolio

Interesting opportunities are arising among less than perfect companies where despite having good products or technology, an existing customer base, and a profitable and sustainable business model, have in some respect disappointed the market, earning these companies a bargain basement valuation. Often these companies despite already showing reasonable growth rates, are trading at significant discounts to their “perfect” competitors.

National Semiconductor is a manufacturer of analog semiconductors found in products such as cellular phones, lap top computers, and flat screens displays, with their top customers including Nokia, Ericsson, Motorola and Siemens. Once the leader in its field, through the nineties the company lost significant share to competitors. New management has revamped development methodologies and focused the company on system-on-a-chip where digital and analog elements are integrated onto the one chip. While

progressing along this path the company made an apparently disastrous acquisition of Cyrix who were competing with Intel in the microprocessor market. Although costly, the acquisition brought to the company valuable intellectual property in the form of an x86 processor which the company has now integrated into their Geode chip, a single chip designed to run "information appliances". The company is not reliant on the success of this chip but rather it is illustrative of the pipeline of new products that has helped reignite growth in National Semiconductor's revenue. The stock can be purchase on 13x earnings with profits growing at 20% plus for the next three years.

Peoplesoft is a software company wrong footed by the move in corporate IT spending away from internal applications to focusing on the internet. Management took the hard decision to re-write their entire application suite for the web and with these new applications now launched, sales growth is re-accelerating. The stock has doubled since the Funds initial purchase but still trades at a fraction of the valuation of competitors such as Oracle or Siebel Systems. Similar stories can be told about good businesses that have stumbled and that are now priced attractively such as Motorola (wireless infrastructure and handsets, cable television equipment), Lucent (telecom equipment), Synopsys (software for designing semiconductors), and Novell (software).

The portfolio also continues to carry significant down side protection in the form of shorts on both individual stocks and the Nasdaq index which we believe makes sense given still high valuations in much of the market. Cash balances remain high at 20%, which is valuable strategic asset in a market where stocks are moving 20% to 30% in a very short space of time with incredible frequency.

Breakdown by Industry

Categories	Examples of Stocks	Sep 2000
Semi-Conductor	AMD, National Semi	27%
Semi Capex	Silicon Valley Group, DuPont Photomask	16%
Telecom Equipment	Lucent, Motorola	14%
Software	Peoplesoft, Novell	12%
Telecom Operator	Verizon Communications	4%
Consumer Electronics	TiVo	2%
Electronic Components	Citizen Electronics	1%
Other		3%

Invested Position

	Long Position	Net Position
US	67.9%	34.9%
Japan	6.3%	6.3%
Korea	4.8%	4.8%
Europe	<u>1.6%</u>	<u>1.6%</u>
Exposure	80.6%	47.6%
Cash and Other	19.4%	52.4%
Total	100.0%	100.0%