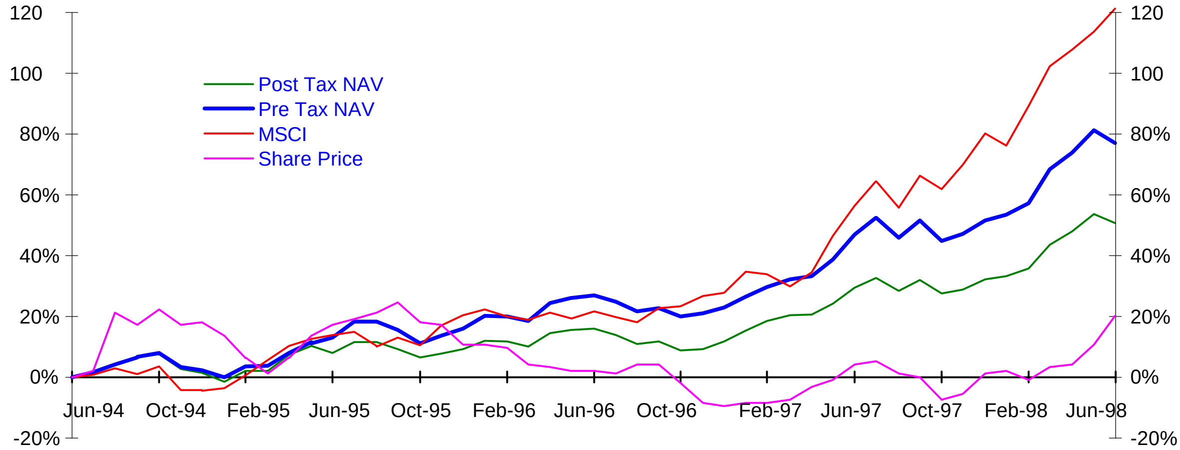
PLATINUM ASSET MANAGEMENT

Platinum Capital Limited

Quarterly Investment Report
30 June 1998

Performance

Net Asset Values (Pre & Post Tax) **and Share Price v's MSCI** (Cumulative Return)



The company has made good headway in raising its Net Asset Value, and through the tax levied at source, has created large franking credits. After a disappointing first half of the year, when some of our holdings became entangled in the Asian contagion ie. investments in Korea and Brazil, the portfolio has risen significantly in the second half. Leading the surge has been our European shares, notably those in France and Italy, which we had accumulated at a time when those markets were considered doubtful contributors to Monetary Union. It may surprise some readers but the holdings in Japan (with that country's sullied image) have given us good returns. As we have conceded in the past, this is a dysfunctional economy and therefore it would be surprising if the financial markets were good at pricing financial assets, hence our ability to earn opportunity rents. The small proportion of holdings in America failed to fully capture that market's advance and the over-hedged position dragged on our performance.

As valuations in the Western hemisphere are mostly at unprecedented high levels, we have continued to maintain an over-hedged position against the US market as a form of insurance against that market and western markets in general.

Top Ten Holdings (as at 30 June 1998)

Stock	Country	Industry	Holding
Rinascente	Italy	Retail	5.2%
Swiss Industrial Group	Switzerland	Packaging/Engineering	3.2%
Mikuni Coca-Cola	Japan	Bottler	2.9%
Douglas	Germany	Retail	2.8%
Acuson	US	Medical Equipment	2.8%
Sony Corporation	Japan	Electrical Equipment	2.7%
Hornbach	Germany	Retail	2.7%
Lagardere	France	Media/Defence	2.6%
Wella	Germany	Hair Products	2.5%
San Paolo	Italy	Banking	2.5%
Total			**29.9%**

Disposition of Assets

Region	30 June 1998	30 June 1997
Western Europe	45.7%	31.9%
Japan	25.8%	31.8%
North America	8.3%	2.9%
South America	3.8%	5.6%
Other Asia	2.7%	11.0%
Australia	2.1%	1.1%
Eastern Europe	0.4%	-
Cash	11.2%	15.7%

Commentary

It has been interesting to witness the gradual souring of the view of the Tiger economies. Late last year, the concensus was that a contraction of imports and a surge in exports (induced by a massive fall in their currencies) would ensure that the region would have no more than a temporary setback. As time has passed, the picture has become increasingly grim. Social harmony has been threatened, unemployment has surged and hunger stalks. Far from being a blip, the disruption is now endemic. The IMF's intervention is being seen as a grand failure and in some circles, it is regarded (sadly) in a more sinister light. The consensus forecast is now for a much more gradual recovery with the bottom not quite in sight. Adding to concerns is the poor performance of Japan and the prospect of China falling well short of expectations (see the analysis at the back of this report).

Fear has mutated into perceptions of opportunity in the markets of the West. By late December 1997, the interpretation had started to alter to regard Asia's woes as the West's gain. Cheap imports from Asia and the view that the Federal Reserve Board needs to keep interest rates low (to accommodate Asia, among other things) are seen as favourable stimuli for stock markets. The consensus now is for G7 growth to slip to around 2% with the manufacturing sector in some economies sliding into recession. The so-called Goldilocks environment ("not too hot, not too cold ... just right"), which allows for slow but steady growth and minimal inflation is leading to valuations not seen even in the booming 1960s (some enthusiasts even argue that the economic cycle has disappeared).

At the same time, stock markets have become extraordinarily dichotomous. The weak are being pummelled while the strong are applauded. It is difficult to find any historic precedent where markets have so differentiated between the two. In particular, we find emerging markets being valued as though they will always have high risk premia and presumably low growth. Quality listed companies in South East Asia and Latin America are now found trading on low trailing PEs, typically 6-12x. Such quality companies have very strong business franchises supported by a history of high profitability and growth and in general, modest levels of debt (lesser companies are being valued more harshly still). The explanation for these low valuations may lie in the fact that their host countries have surrendered their independence to the whims of international capital providers, as we warned in September 1997. However, do investors really believe that these companies have gone ex-growth or that risks have risen to such high levels that they warrant differentials in valuations of the order of half to a third of comparable businesses in the developed world?

Turning to the Western markets, we can observe a narrowing of leadership and a preference for large companies with seemingly clear growth prospects. Here one identifies well-known, brand type companies or at an extreme, the likes of internet stocks, mobile telephony and associated businesses. We are being asked to pay high multiples of sales on the basis of prospective customer sign-ups and in some cases dubious assumptions that the present level of gross operating margins will be sustained even when the helter-skelter growth subsides.

For your interest, we show below a valuation table of typical internet stocks. Note the payment for promise. The price to sales ratio highlights the euphoria.

Company	Market Cap US$ billion	Sales US$ million	Price to Sales Ratio x	Price Change Year to Date
Amazon	6.1	226	27	+312%
America Online	23.8	2,464	10	+144%
At Home	6.1	7	827	+106%
Doubleclick	1.2	54	22	+173%
Lycos	1.5	60	24	+91%
Netscape	4.0	534	8	+69%
Onsale	0.5	117	4	+42%
Infoseek	1.2	49	24	+249%
Excite	2.4	87	28	+230%
Yahoo	8.0	90	89	+150%
S&P 500 Index	9,074.0	4,537	2	+18%

The origins of this dichotomy lies, we believe, in the deflationary tendencies that are so evident (these in turn have their origins in massive currency imbalances that contributed to the creation of surplus capacity in manufactured goods). In their attempts to avoid the areas of sloth, investors have charged headlong into the more promising pastures of Europe and the US. Tacit concerns about slowing growth is causing investors to discriminate against smaller sound companies in favour of those with highly visible prospects and predictable growth. In other words, the risk premium attached to smaller companies has risen, even though as a group, they have historically grown the fastest. Given our philosophy to invest in under-priced, neglected stocks, it is evident that we find the oppressed more interesting than the lauded. However, we are unwilling to simply buy the deeper value because of the great uncertainties and weak macro-economic factors which will bear down on many businesses for the time being. Our preference is to mostly occupy the middle ground of companies with strong businesses that are growing and where valuations are attractive in a world where the risk free rate (ie. government bonds) is likely to stay at around 5%. In Europe, this growth is often seen in companies engaging in restructuring and rationalisation and/or consumer sensitive companies. In Japan, our focus is very specific with the emphasis split almost evenly between pharmaceuticals, Coca Cola bottlers and exporters/technology stocks. The few holdings we have in the United States are enterprises where profit margin are likely to rise significantly led by new product introductions. Sprinkled throughout the portfolio there are several deep value plays.

Outlook

It is true neither that the Eastern hemisphere is without interesting opportunities nor that the Western hemisphere has found the elixir of ever increasing profits and low risk. Our sense is that at present valuations, the risk adjusted attraction of specific stocks in Eastern markets is at least as attractive as those in the West.

While we are very conscious of the economic and social disruption caused by the collapse of confidence in Asia, some very interesting opportunities are emerging. Moreover, changes are being instituted and in particular the illiquidity of the Japanese banking system is now being addressed.

Our recent visit to Japan reinforced our view that companies have become much more conscious of globalisation and the need to make respectable returns on funds employed. Although these lessons are being learned reluctantly, the response one now receives in company meetings is more positive and direct. It does not take a lot of imagination to envisage a scenario which is very positive for the better companies within the country and this should translate into higher returns. Further, we note that even in this dull market (up 2% over six months in A$ terms) we have made good returns from Japanese stocks earning 14% in A$ terms.

In the rest of Asia, we are now starting to take more interest but remain wary about profit transparency.

Within Europe, we are likely to continue to see investors rotating to new areas of excitement as has occurred in Wall Street. The focus will remain on restructuring/rationalisation ideas which are now entering their second phase. As the portfolio composition suggests, several of the domestic-focused retailers meet these criteria.

The US market is showing the same tendencies that we have highlighted in the past with the most popular stocks being attributed ever higher valuations. There is a clear tendency for the smaller stocks to underperform the S&P index. Those with capitalisations of $2 billion or less have typically declined by more than 20% from their 52 week highs; indeed by greater amounts for those with caps below $0.5 billion. Conversely, companies with capitalisations above $20 billion are still close to their 52 week highs.

Conclusion

The changes we have made within the portfolio, and the preference for moderately valued companies with growing profits, gives us some comfort in an environment of generally extravagantly priced equities. Further, we will maintain our short against Wall Street and will introduce some hedging of other market indices to periodically provide additional protection.

Stock Stories

§ Diagnostic Products Corporation (USA)

Diagnostic Products is a David fighting against the Goliaths of the medical equipment and pharmaceutical sectors. A small, family-run business, it was started in 1971 in the kitchen of the founder to develop tests ("assays") to detect such things as infertility, folic acid, prostate cancer, and thyroid problems. The company has a strong track record of growth but despite compounding sales at over 20% remains small, with less than US$200 million in sales.

In the seventies and eighties, tests were done by combining a patient's blood sample with a radioactive reagent (the key product supplied by the diagnostic company) and measuring the radiation using a standard geiger counter. However, over time the industry has been shifting away from radioactive tests because of safety concerns and the high labour costs of manual testing. Test volumes have been increasing as physicians, wary of litigation, make sure that all relevant tests are carried out. Furthermore, new diseases such as AIDS, and new viral strains, creates new sources of demand for tests. But the good growth of the industry has forced a shift to high volume test methods.

Automated testing using non-isotopic antibodies has grown rapidly, with as many as two hundred tests being run on the fastest machines every hour. The equipment involves a carousel to incubate the test tubes containing combined blood/reagent samples. These are fed into a device that fires light photons at the mixtures and measures the reaction, achieving high levels of accuracy. The test tubes are barcoded which eliminates human error and allows minimal labour input. Once the samples are loaded in the carousel, a computer controls the process: the appropriate reagents are added, incubation times monitored, test results measured and reported, and on the new machine further tests are ordered and carried out if the results are inconclusive. Once a machine has been leased or bought by a laboratory, supplies of reagents must be ordered frequently to carry out the tests, making this an attractive "razor and blades" business. Indeed, when we visited the company we found them adjacent to Los Angeles airport, a convenient location for shipping reagents with a limited shelf life to laboratories around the world.

The Goliaths of the industry are companies such as Abbott, Roche, Chiron and Johnson & Johnson. With ample resources, these companies were quick to bring automation to the market. Diagnostic Products was late in following the shift in testing and bought an embryonic company, Cirrus Diagnostics, in 1992. This allowed the company to make the transition to automation and over 3,500 "Immulite" machines have now been placed in laboratories around the world. However, although the machine offers one of the widest arrays of tests and superior accuracy, it is less automated than the competition. Equal to the challenge, the company developed a new generation machine which has been introduced ahead of competitor proposed new offerings and appears to exceed their performance. Selling or leasing machines is important because the reagents are specific to each company's machine; the blades cannot be sold if the razor is not sold first. Because the new machine is more automated and suits the major hospitals and laboratories, the demand for reagents will increase significantly.

An exciting development is the scheduled launch next year of the "Immugold" machine which uses a revolutionary diagnostic process for rapid results. Traditional tests normally take more than an hour because the blood has to be incubated with the reagent for a set period. The new technology, patented by Diagnostic Products, detects fluorescence occurring when sample blood molecules bind to the reagent on a thin strip of gold. Initially targeted at emergency rooms and doctors' offices where the rapid results would be in demand, this may also be the accepted testing technology of the future. This very impressive technological advance could have a very significant effect on the value of such a small company.

Although large companies have an advantage in distribution and name recognition, they have no monopoly on major innovations. We would expect to pay handsomely for a company with this record of growth and innovation, and with a predictable, bright future. It seems like a steal on less than 15 times next year's earnings and twice book value (the US market is on 23 times those earnings and almost six times book value).

§ Wella (Germany)

Wella are the largest producer of professional hair care products (salon products) in the world. Their leading position has been built and held through genuine product innovation and technology, as well as maintenance of strong relationships with their clients - hairdressers. The strength of these relationships is witnessed by the fact that each year, over 1.2 million hairdressers pass through Wella training seminars.

The problem for Wella has been to convert their success in the professional hair care market into equal success in the chain store retail arena. To highlight the problem, we can look to L'oreal which has similar sales in the salon market to Wella ($1 billion), but in the retail market they are 2.5 times larger. Also, L'oreal's retail hair care business is highly profitable whereas Wella has historically lost money and is only now near breakeven. With retail sales accounting for 50% of the company's hair care sales, the leverage from rising profitability will be enormous.

Up until the mid-nineties, Wella treated the retail market in the same way as the professional market. This meant high quality innovative technical products but little focus on what the **retail** market would actually buy. In practice, this meant the R&D team would develop a product, the finance team would determine the total costs of the product and add a margin to reach a suitable price, and the marketing/sales teams would have to sell it. The problem with this strategy was that the retail client is not necessarily interested in paying $20 for a bottle of shampoo, even if it is technically very good! The focus was around the technology, at the expense of market analysis and suitable marketing/product development. Distribution was also carried on in the tradition of the salon business, with the sales force recruited internally with no training or experience in mass market consumer products. It didn't appear to be recognised that selling to supermarket chains is an entirely different concept from selling to hairdressing salons. On top of this, Wella was saddled with an inefficient manufacturing base and cost structure. In Europe alone, there were thirteen separate manufacturing plants and 18 major warehousing facilities.

The changes in Wella began in 1991 with a change in senior management. The new management formed a four point strategy:

- Concentration of production and logistics
- Reduction and homogenisation of product range
- Emphasis on hair care business and retail expansion
- Acquisition of well positioned brand-names and companies to support the retail expansion.

Over the following years, an aggressive expansion policy was exercised, largely via acquisitions. At the same time, the production process was shaken-up with the number of plants in Europe being cut from thirteen to four, and most importantly, more focus was put on marketing and the development of the retail hair care business.

Probably the most vital action taken at Wella was in late 1993 when mass consumer retailing knowledge was brought in with the hiring of two ex-Proctor & Gamble managers. These two built a team at Wella largely from Proctor & Gamble people. The changes at Wella resulting from this action have been immense. Products are now developed from the end user perspective back, rather than in reverse, as before. The rate of old product relaunches and new product launches have been sped up with the result that in 1996, 50**%** of sales came from products less than two years old, versus 12% in 1994. New sales teams are being trained on a country by country basis to specialise in selling to retailers. Key account managers have also been set up. Marketing budgets and product development budgets have been increased dramatically (funded by savings from more efficient production and logistics).

Despite the positive changes, the wheels fell off the Wella machine in 1995. The rapid expansion, largely through acquisitions, did not come without cost. A 1995 profit warning showed that management had lost control in a number of areas - Russia, China, the UK, and the USA all lost money for Wella. At the same time, there were large temporary costs associated with the consolidation of the manufacturing base in Europe.

Management changed again. New management stopped the policy of expansion by acquisition, and have in fact taken the strong step of closing their retail hair care operations in a number of countries where they don't have a large enough presence to justify the costs (this includes the US market). Controls in other countries have been tightened. In the two years they have been in control, all the disaster areas have been either turned around or eliminated. At the same time, the cultural changes introduced by the previous regime have been encouraged.

Today, the company is in an envious position. Wella was woken up by one management, then tamed by the current regime. The benefits of the changes, instigated by the Proctor & Gamble team recruited through 1994, only started to come through to the accounts in 1996, and continued in 1997. This was evidenced by organic sales growth in the retail hair care business of 14% in 1996 and 11% in 1997. We expect to see continuing strong sales and profit growth from Wella as the retail hair care business benefits from the last seven years of internal development and change.

PLATINUM ASSET MANAGEMENT

Platinum Capital Limited

Chairman's Report
30 June 1998

Investment Performance

The Net Asset Value of Platinum Capital grew by 16.5% last year, after allowing for all tax liabilities, both realised and unrealised. On a pre-tax basis, the growth figure was 20.5%.

The table below sets out the performance of Platinum Capital in each of the four years of its operation 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.

PLatinum Capital Limited Pre-Tax NAV v's MSCI Index (%)

	1994/95	1995/96	1996/97	1997/98	4-Year Cumulative
PCL	13.0	12.2	15.9	20.5	77.1
MSCI	14.1	6.7	28.5	41.5	121.3

Platinum Capital's performance last year was the best for the last four years. The range of returns, from 12-20% is fairly consistent and, taking a long-term view, is very much the sort of return parameters to be targeted for equity investment.

The MSCI, both in 1997/98 and for the four years, has out-performed Platinum Capital. The simple reason for this is the Index's heavy weighting in the US equity market which has performed very strongly. In contrast, Platinum has been, and remains, largely uninvested in the US market and retains a net short position. Platinum's portfolio weighting is, therefore, radically different from the MSCI, a circumstance which reflects the Investment Manager's value-based criteria for stock selection.

From the point of view of an Australian shareholder, however, Platinum Capital continues to provide the chance for some useful portfolio diversification. The pre-tax return last year of 20.5% compares to the All Ordinaries Accumulation Index increase of 1.6%. Platinum, for most of the year, gave Australian investors foreign currency exposure in a period when the Australian dollar was falling. For some investors, Platinum's radical divergence from the MSCI may also be useful at a time when some nervousness exists about the capacity of the US market to maintain or grow from current levels.

Our goal remains to deliver for investors above average returns over the long-term by following a very disciplined approach to stock selection in markets around the world. At times this might put the company out-of-step with received wisdom, but it is done to give shareholders a better chance to receive the returns they seek.

Share Price

The share price continues, in common with many investment companies, to trade at a discount to the underlying value of the company.

In an effort to address this issue, we obtained shareholder approval last year to buy back up to 20% of the issued capital of the company over a 12-month period, rather than the 10% allowed under the Corporations Law.

Over the past year we purchased 2,331,790 shares in the company, equivalent to 2.3% of the issued capital. The company currently has in operation an on-market buy-back which will terminate on 31 December 1998. It is our intention to renew this buy back to give the company power to continue to buy back its own shares.

Most of the shares were purchased at a price equivalent to a discount of about 20% to NAV.

As part of these arrangements, there is on the agenda for the Annual General Meeting a resolution extending the power to purchase up to 20% of the outstanding shares for a further 12 months.

Shareholders will also be aware that after five years of operations ie. from 31 July 1999, if the market value of shares is at a discount to NAV of greater than 15%, a meeting of shareholders must be called to vote on whether the company should be wound up.

Dividends

The company's dividend policy is to pay regular dividends of a level that can be built up over time. In addition, special dividends will be declared to pass on accumulated franking credits.

The total of these franking credits at 30 June 1998 was equivalent to 23.1 cents per share. In addition, if all unrealised tax were to be paid (and this is the basis on which the NAV figure is calculated), a further 12.8 cents per share in franking credits would result.

In February this year, a special dividend of 4 cents per share was declared. Directors are recommending a final regular dividend of 4 cents per share (up from 3 cents per share last year). A further special dividend of 2 cents per share is also recommended. This would bring the total dividend payment for the year to 10 cents per share, all fully-franked.

The company has in operation a dividend re-investment plan which allows a participating shareholder to take the dividend in the form of new shares at a 5% discount to market. In the past, the operation of this plan has been constrained by the law that shares could not be issued below par value (in Platinum Capital's case, $1.00 per share). The Corporations Law amendments, effective 1 July 1998, dispensed with the par value concept and, therefore, your Directors resolved to amend the plan accordingly. A new plan document has been despatched to all shareholders advising of the changes; namely that shares will be issued to plan participants for all future dividend payments at a 5% discount to market.

The plan will be operational for the proposed final and special dividends.

Changes to the Articles

Under the Corporations Law amendments effective 1 July 1998, a number of changes have been made to the way in which companies must operate. A resolution has been included on the agenda for the Annual General Meeting which incorporates these changes into the Company's Articles of Association.

Outlook for 1998/99

The Investment Manager remains very concerned about valuations in many western markets. The current negative stance on the US market will be maintained and investments will focus on Europe, Japan and, increasingly, under-valuations in the rest of Asia.

It is not an environment in which managers can afford to be complacent - caution is very much required and additional measures will be taken to protect the portfolio from adverse market movements from time to time.

Michael Darling
Chairman