PLATINUM CAPITAL LIMITED

ACN 063 975 431

Quarterly Report

31 MARCH 1999

Performance

NET ASSET VALUE	
31 January 1999	110.08 cps*
28 February 1999	110.29 cps
31 March 1999	111.77 cps

* This is after making provision for the 4 cent special dividend paid 26.2.99.

The smaller markets have tended to do better than their larger brethren this quarter. Among the latter, Japan stood out with a gain of 9% while the US rose 2.5% and the UK 1.3%. Europe succumbed to soggy economic numbers, with Germany declining nearly 12%, France 5% and Italy 6%. Our performance has benefited significantly from the large position we hold in various Japanese companies. In Europe, several of our holdings have been bid for, notably Telecom Italia, Banca Di Roma and Albright & Wilson which have given a fillip to these holdings and compensated for the neglect of the smaller companies in the portfolio which continue to be overlooked in virtually all western markets.

Notwithstanding the strong components of the portfolio, the drain on our performance remains our short positions on Wall Street. As a consequence the portfolio made little headway this quarter.

The Net Asset Value figures above are after provision for tax on both realised and unrealised income and gains.

Changes to the portfolio

In changing the portfolio we face an unusual dilemma in the present environment. There are a large number of smaller companies which have sound growth prospects and balance sheets and yet are being treated as pariahs in a world that favours large corporations. Our problem is in deciding what proportion of the portfolio should be exposed to these companies versus those larger enterprises with no greater prospects but a higher likelihood of participating in this liquidity-led bull market. The dilemma is accentuated by periodic takeovers and the observation that the value gap has so widened that there is bound to be more emphasis on smaller company acquisitions.

On balance, we are inclined to stay with our quality small companies provided that their good prospects compensate for their lower liquidity.

Early in the quarter we aggressively added to our holdings in Japan. Here we bought companies like Softbank, Trans Cosmos, Moshi Moshi, NTT Data, NTT Mobile and DDI - all of which are involved with software, systems integration, mobile telecommunication and outsourcing. (This has proved most timely and each of these companies has subsequently soared as they have been anointed as internet-related stocks). At the same time we sold down the coke bottlers, Kita Kyushu, Mikuni and Sanyo Coca Cola which have risen strongly on news that Coke Atlanta has designated the merged entity of Kita and Sanyo as an anchor bottler. We also added to old favourites like Nippon Broadcasting, Sony Corporation, NTT and Citizen Watch while reducing Yamanouchi Pharmaceutical and Daiichi Pharmaceutical.

Funding for these acquisitions came primarily from cash and reduced positions in several European and US stocks. In particular we reduced our large exposure to Rinascente, San Paolo/IMI, sold the entire position in Valora and Albright & Wilson was taken over. In the US, King World Productions was also bid for and we reduced our position in Great Lakes Chemical.

The portfolio is 22% short of the S&P 500 index which together with two specific stock shorts leaves us with a net short position of 23%.

DISPOSITION OF ASSETS (%)

	31 MAR 99	31 DEC 98
Japan	40.2	27.5
Western Europe	36.4	47.3
North America	6.7	7.4
Other Asia	4.7	5.9
South America	2.8	3.1
Australia	2.6	2.8
Russia & Eastern Europe	0.3	0.3
CASH	6.3	5.7

TOP TEN HOLDINGS AS AT 31 MARCH 1999

STOCK	COUNTRY	INDUSTRY	% HOLDING
Suzuken	Japan	Pharmaceuticals	3.6
Sony	Japan	Electronics/Entertainment	3.4
Rinascente	Italy	Retail	3.3
WPP	UK	Advertising	3.1
Softbank	Japan	Software/Internet	3.0
Sanyo Coca Cola	Japan	Bottler	2.8
DDI Corporation	Japan	Mobile Telephony	2.7
Siemens	Germany	Electrical Engineering	2.7
Samsung Electronics	Korea	Electronics	2.7
SIG	Switzerland	Packaging/Engineering	2.4
TOTAL			**29.7**

Commentary

The underlying drivers of this bull market remain intact. In some respects, recent developments have improved prospects. Notably the resignation of the German Finance Minister, Mr Lafontaine, removes concerns about the left-ward drift that was evident in Germany. At the same time, French economic policy seems to be more pragmatic. However, the most important development is the decision by the European Central Bank to cut short-term interest rates by 0.5% which leaves them at 2.5%. This strong medicine was administered in the face of a noticeable slowing in the export sensitive countries such as Germany and Italy in the fourth quarter. We therefore believe the outlook for Europe has improved markedly with the only blemish being the ghastly mishandling of the crisis in Kosovo.

Strong growth, full employment and low inflation remain the hallmark of the US economy. Poor pricing power acts as a counter force for the stock market as profit downgrades damage transgressors. (Commerce Department figures show corporate profits fell 2.2% in 1998 despite economic growth of almost 4.0%). This is fuelling the "urge to merge" as many companies face the hard edge of deflation/globalisation and seek the benefits they hope to extract from economies of scale and greater reach. The excitement this adds to an already heady atmosphere generated by the internet, has the bulls rushing onwards, now playing the gatekeepers such as America Online, which now constitutes 1.5% of the S&P index, from only 0.9% at the beginning of the year, and then switching back to the facilitators such as Sun Microsystems, Microsoft, Cisco and IBM. We made reference to these in our last report and forecast a pause to refresh followed by further excitement. References are no longer made to valuations, instead it is fashionable to relate to "eyeballs", customer acquisition and retention costs, and so forth. Positive cash flows are rare but the potential of a cyberlinked world is all.

These comments are not meant to be taken cynically. Seldom does one witness such significant change, made all the more attractive by the ability of companies to reel out successful domestic formulas that can be almost instantly replicated across the entire globe - with all the attendant attractions of scale, blocking power and so forth epitomised by the Microsoft business model. The weight of these ultra-large capitalisation stocks is resulting in an ever narrowing band of companies driving the S&P higher while the "dull" majority of companies languish.

In the quarter, the top 20 US stocks rose 13.7% on average. By contrast more than half of the top 500 declined. If one analyses the S&P500 by size the differences in performance are very stark.

% US$ RETURNS	WEIGHT	1ST QUARTER RETURN	1998 RETURN
Top 100 coys	72.5	7.0	47.3
101-200	14.6	2.3	18.9
201-300	7.4	-2.7	6.6
301-400	4.0	-6.3	-4.7
401-500	1.5	-11.8	-25.0

The Japanese market has been the recent wild card. Happily many of our views are now being more widely accepted. Barely a day goes by without an announcement of further restructuring and capacity closure. Merger and acquisition activity is accelerating, unemployment is mounting and foreigners are crowding hotels in their efforts to fulfil their long held desires to have a more meaningful presence in the world's second largest economy. Apart from the evident acceptance for the need for change, perhaps the two most important drivers of the stock market have been the infusion of public funds into the leading banks, and secondly, the action of the Bank of Japan to liquify the system.

After much discussion, an agreement was reached between the Financial Reconstruction Commission (FRC) and the banks for the infusion of ¥7.45 trillion. This took effect from the first day of the new financial year, in exchange for equity in the banks. During the process each bank participating in the scheme had to firstly reappraise its loan books according to much more stringent regulation and was required to submit detailed plans with quantified targets. The outcome was that only one city bank, Bank of Tokyo-Mitsubishi has not accepted government funds with 15 others having issued convertibles of varying duration and varying yields. These have differed according to the inherent viability of the institution involved.

Having met with a member of the FRC, it is evident that they favour further staff cuts and mergers and foresee the likelihood of another tranche of public money being injected as the next group of economic sensitive companies face difficulties. In the meantime, the FRC will have its hands full taking over the bad loans from failed banks and also acting as an administrator of bad loans acquired from viable banks.

The second factor bolstering the Japanese stock market has been the activity of the Bank of Japan in the short end of the money market. This has effectively made credit almost free (would you believe that 3 month CDs yield 0.09% per annum). Simultaneously, the government extended its loans guarantee program to small companies to ¥30 trillion. Finding themselves underweight in a seemingly improving environment, foreign investors responded aggressively and poured ¥2.2trn into Japanese shares this quarter.

Elsewhere in the world there are signs of improving confidence. The new governor of the Central Bank of Brazil has been able to begin to cut interest rates against a backdrop of surprisingly moderate inflation in the face of a weak *real*. The political environment in that country remains turbulent with a power struggle among the coalition partners. The smaller economies of Latin America are still feeling the noose of tight liquidity with credit lines having been cut.

Parts of South East Asia are benefiting from an improvement in their net exports which is helping to fund their recovery in the absence of foreign credit. Korea has enjoyed a particularly strong turnaround and is now the net beneficiary of foreign direct investment. As you will be aware our principal interests in South East Asia have been in Korea.

Currency

Continuing weak commodity prices and poor current account numbers are tending to depress the Australian dollar. As we mentioned previously there is a risk that Australia may grow somewhat faster than its principal trading partners which will have adverse consequences for our trade account. However, the abundance of liquidity generally should start being felt with somewhat improved industrial production worldwide and this should at least underpin the Australian dollar. For this reason we are gradually raising our hedged position which is currently at 48%. The portfolio has exposure to the Yen of 10%, the Euro and Swiss Franc of 30% and the remaining being to US dollars and their proxies.

Outlook

Repeated interest rate cuts by central banks have unleashed liquidity that acts as a lubricant to the market. The recent behaviour of sub-indices of the US market such as the Russell 2000 index, may suggest that there is a broadening of the general market on the basis of continuing economic growth and the sheer differential in valuations between the leaders and the laggards. This may prove more of a warning signal than a prelude to yet another phase of Wall Street's bull market. It remains vulnerable to bad news such as rising interest rates or external shocks. Variances in performance among quality companies in Europe offer pockets of value and we remain excited about prospects for our Japanese holdings.

Stock Story

HOECHST (GERMANY)

For the last decade Hoechst has been making the transformation from conglomerate to focused life sciences business. The recently announced merger with French group Rhone-Poulenc will create Aventis, the world's second largest pharmaceutical business, after Merck Inc of the USA.

There are two crucial areas to consider when assessing Hoechst as an investment. The first is the practical problems of becoming a very large pharmaceutical business through acquisitions and mergers; indeed the managerial and financial difficulties of this process specifically created the investment opportunity. The second issue is the heritage of Hoechst and the context of its decision to transform itself from conglomerate to pharmaceutical specialist - this issue in a broad sense balances (and in time should outweigh) the practical difficulties referred to above.

THE TRANSFORMATION

Aventis is effectively the merger of Hoechst Marion Roussel (HMR, the Hoechst pharmaceutical business created when Hoechst brought together Marion Merrel Dow and Roussel Uclaf with its own existing drug business in 1995) and of RP (the life science business of Rhone-Poulenc). The creation of Aventis is scheduled for completion this year and requires that both groups have sold (or "spun-off" to shareholders) their remaining industrial chemicals operations.

The received wisdom in the pharmaceutical industry is that scale is important because of (a) the costs of research and of the "basic tools" required (enormous computing power for high throughput screening and combinatorial chemistry, access to gene technology etc); (b) distribution clout on a worldwide basis needed to justify the research once a product is commercial (literally thousands of sales specialists in the US market alone for example); and (c) the need to have scale in order to be a "partner of choice" for in-licensed products in what is becoming ever more a late-stage development and distribution business. With this logic in mind there is little mystery as to why Hoechst is merging with RP, however the stock market has reservations.

The practicalities of a merger mean it is tricky to arrive at the blissful state of an integrated, smoothly-functioning company on a grand scale. Consider the difficulties of managing multiple research sites all over the world, and of allocating funds to the most promising areas. The new group will have over fifty drug production sites - an over-endowment which illustrates the problem of which thirty-plus to close and which staff to shed in the process. The fact that these processes are complex is illustrated by the dull earnings that HMR has achieved in its own four years of existence.

Thus the opportunity. Despite the scale of the new company, the market has priced the business at a very large (40-50%) discount to its peers on the basis that such a merger will take a long time to consummate. We have confidence in the business because of the late-stage product pipeline (ie. the pharmaceutical products scheduled to come to market in the next 2-4 years). Indeed the HMR "pipeline" is one of the most interesting in the industry. In addition, the R&D processes, and the "science" of the company is highly regarded. The missing link has been speed of commercialisation and aggression in distribution. Hoechst has worked hard on these areas in recent years and we have evidence of much more successful product launches in the last few quarters than was previously the case.

HOECHST'S HERITAGE

The other reason we have confidence in the company successfully transforming itself is the context of the decision to do so. Hoechst is one of the three (roughly equally sized) parts of the traditional German chemical industry. Its competitors are Bayer and BASF, and by the mid 1980s all three had become vast chemical conglomerates. Bayer has decided to remain as a conglomerate, while BASF has focused more on its integrated chemical business. All three are big employers and a crucial part of the German industrial fabric.

The point is that for Hoechst to decide to dispose of these cyclical industrial operations in favour of the potential profits of a big drug company is a very radical and high-profile decision. The German press has been full of commentary on the story for some years already; when some industrial businesses were closed or staff fired, the criticism was vicious. The company's head office has been besieged by protesters, and head office and management have felt the heat from unions, government and shareholders alike. This is not a plan that has been hatched without due consideration to precise execution.

As an investment Hoechst offers some uncertainty over the timing of profit growth, offset by great potential from its R&D efforts and a very modest starting valuation. The stock market does not contain great expectations for the company and we are confident that management will respond to the various pressures to succeed.

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