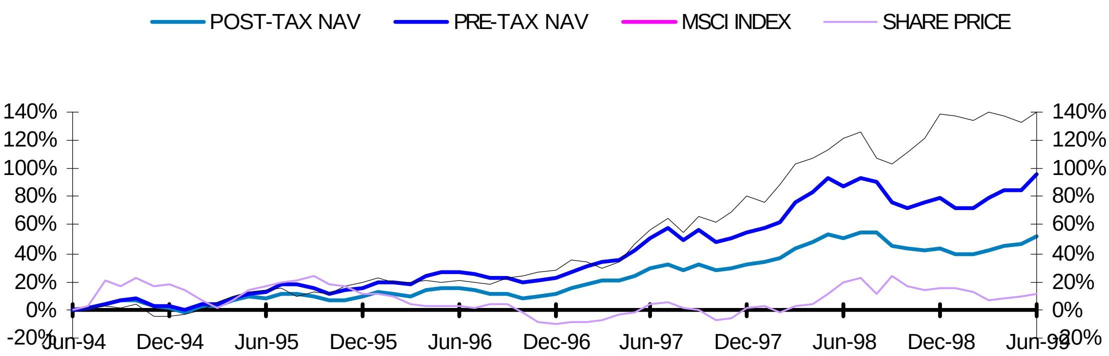
PLATINUM ASSET MANAGEMENT

Platinum Capital Limited

Quarterly Report

30 June 1999

Performance



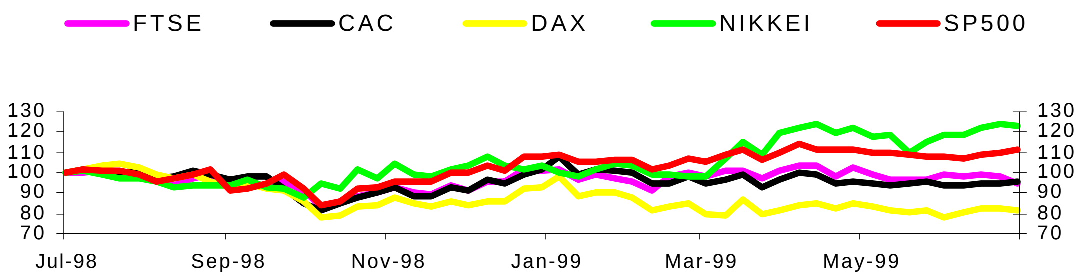
PCL NAV (pre & post-tax), share price v's MSCI index (cumulative return)

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

30 April 1999	31 May 1999	30 June 1999
114.09 cps	115.18 cps	120.28 cps**

** After providing for a 6 cps proposed fully franked Final dividend, payable 2 November 1999.

Retrospective



Comparison of Global Market Indices (A$) (1 July 1998 - 30 June 1999)

The chart above highlights the roller-coaster year that was 1998/99. As we remember well, just as investors had come to understand that Asia could cope with its debt problems, under the auspices of the International Monetary Fund (IMF), Russia effectively defaulted on its debts. The resulting chaos, which included the virtual paralysis of the debt markets and the near demise of one particularly large hedge fund (Long Term Capital Management), with attendant losses to those involved, caused renewed investor nervousness. Fortunately, the US Federal Reserve Board acted with alacrity, dropping the cost of money and arranging a lifeboat operation of leading banks for LTCM in a manner similar to earlier episodes such as those involving the Bank of England in the early seventies.

As far as Platinum Capital was concerned, having long been concerned about the levels of debt in the US economy, the misfortunes of LTCM reinforced our view that the system was very highly leveraged. Further, the need for a bail-out added to our concerns, particularly in the light of earlier stern lectures about *crony capitalism* that had been directed at the leaders of the troubled economy's of Asia. Lastly we believed that the strengthening of the Japanese Yen was highly damaging to that country's prospects of recovery and, by extension, unhelpful for Asia.

None of this will deepen your regard for our market-timing skills which were, perhaps, blunted by a predilection for value and our stubborn refusal to run an unhedged portfolio. Even so, we offer you cause for optimism. At a time when events looked bleak, our stock-picking skills came to the fore and we added to our holdings of Japanese and Korean shares while maintaining the protection we had in place before the markets' dislocation. These purchases have served well and against a position where your fund could have lost value during the year, we achieved a small increase of approximately 5%, against an 8.2% rise in A$ terms, of the Morgan Stanley Capital International Index.

To make room for these new holdings in Asian markets, we gradually reduced the proportion of assets employed in Euroland, selling holdings completely or whittling down the amount held in individual investments. In view of our reservations about the prospects of a general recovery in the north eastern Asian economies, our investments were highly selective, concentrating on companies engaged in the information technology (IT) and telecommunications industries with the likes of NTT, Sony, Samsung Electronics and Softbank - which we believe will grow almost regardless of prevailing general economic conditions.

Our market-timing actions with currencies were on balance, profitable. We started adding to the Australian dollar hedge as the currency moved past 60 cents to the US$, and traded the Yen with some success. The weakening of the Euro largely eluded us however and we have been only partially hedged against the decline of this currency as we had shared the view that it was likely to be strong versus the US$.

Disposition of Assets

Region	30 June 1999	30 June 1998
Japan	40.6%	25.8%
Western Europe	32.7%	45.7%
Other Asia	8.0%	2.7%
North America	6.8%	8.3%
Australia	1.9%	2.1%
South America	0.9%	3.8%
Russia and Eastern Europe	0.3%	0.4%
Cash	8.7%	11.2%

Top Ten Holdings (as at 30 June 1999)

Stock	Country	Industry	Holding
DDI Corporation	Japan	Mobile Telephony	3.6%
Lotte Confectionery	Korea	Food	2.9%
Sony	Japan	Electronics/Entertainment	2.9%
NTT Mobile	Japan	Mobile Telephony	2.7%
Alcatel Alsthom	France	Telecoms equipment	2.6%
Siemens	Germany	Electrical Engineering	2.5%
Mikuni Coca Cola	Japan	Bottler	2.5%
Korea Telecom	Korea	Telecoms	2.5%
Suzuken	Japan	Pharmaceutical wholesaling	2.5%
NTT	Japan	Telecoms	2.3%
Total			**27.0%**

Commentary

Japan

The economic figures coming out of Japan are mixed and the information gathered from our recent visits to a broad range of Japanese companies suggests that the consumer is still very cautious. We take comfort, however, from the improved trade figures with the rest of Asia and from recent optimistic reports by US technology companies trading in Japan. The official figures, the Tankan survey, showed an improvement in business confidence although the intention to cut capital spending remains in place. The explanation for our large position in Japan remains unchanged. The country has in the past been afflicted by too little respect for the cost of capital. With its banks in disarray and globalisation requiring the adoption of more open and less interventionist policies, companies are now having to change the employment practices that have prevailed since 1940. For more on this subject we refer you to the article in the company's 1997 annual report. This is important as it will lead to capital winning a larger share of National Product at the expense of labour. We therefore anticipate a situation where profits lift even in the face of a dull economy. In addition, with an economy this size, (US$5 trillion), there will be some highly vibrant areas as Japan catches up on IT, deregulation and outsourcing. Further, the technical aspects of the stock market are most compelling: the population has an unfavourable age profile and yet pension funds are underfunded and invested principally in bonds and cash. There is a clear need for these funds to reweight their portfolios towards riskier assets if they are going to have any hope of meeting their long-term obligations. Additionally, private investors have a mere 11% of their financial assets invested in equities and in the recent run-up of the Nikkei, they, like the institutions, have been selling to foreigners.

Other Asia

The renewed economic expansion that became evident at the beginning of this calendar year has broadened in some areas, particularly exports. In Korea, Singapore and Taiwan, industrial production is up over 10% on a year ago with Korea leading the field with an advance in excess of 20% in May. Inter-Asian trade is tending to bolster the laggards and it is likely that Thailand and Malaysia will be growing in the second half of 1999 which could lead to production across Asia, excluding Japan, rising by around 10% in the latter half of this year. Helping these economies has been the inward flood of foreign capital which has had the twofold benefit of replacing debt with equity and also causing their currencies to appreciate. This, in turn, has allowed their governments to intervene in the foreign exchanges thereby adding to liquidity and causing further falls in interest rates. Ironically, the absence of western style insolvency laws or, in other cases, the reluctance by banks to call-in the assets behind non-performing loans, has allowed many entrepreneurs to leapfrog their way back into solvency. Under normal circumstances these businesses would have closed but the informal structure allowed them to continue trading even though technically insolvent. As interest rates came down and with the benefit of highly competitive exchange rates they are now flourishing though owing the banks many favours. The last piece of the puzzle has fallen into place with some stock markets rising to levels above those before the crisis which reinforces balance sheets.

Latin America

Just as Asia has surprised professional forecasters with its resilience, even in the face of a bankrupt banking system, so Latin America has surprised with its remarkably low inflation in the face of currency devaluations. However, without the strong savings culture that pervades Asia and in light of their exposure to commodities, these countries have not responded with the same *elan*. Argentina in particular has been hobbled by having a currency linked to the US dollar.

Europe

An element of patchiness remains in the economies of Europe which are sensitive to capital spending such as Germany and Italy. However, with the strength of the small European economies and the prospect for improving exports, it is likely that Europe will finish the year strongly. Evidence of a more friendly attitude towards business was shown in Germany with the passing by the Centre-left coalition of a tax reform bill which will reduce corporate taxes to 35% in 2001. However, legislators continue to drag their feet on important but sensitive reforms such as pensions.

USA

It is important to recognise the role that debt has played in bolstering activity in the strongest economy of all, the US. In the 18 months since Mr Greenspan's celebrated enunciation on market exuberance, debt has risen by US$3.3 trillion or 40% of GNP. House owners, who constitute 66% of households, have taken full advantage of falling interest rates to do two things. They have rolled-down their mortgages into lower rates, mostly on fixed terms, and they have added to their indebtedness; they have drawn out an average of US$15,000 per household for use elsewhere. This is a significant sum in relation to median household pre-tax income of US$37,000 per annum. Personal debt now stands at US$5.6 trillion of which US$4.2 trillion is mortgage debt. The non-mortgage obligations will be sensitive to further rises in interest rates while existing mortgagors will only typically face rising rates when they wish to buy a new home - normal occupancy is for 7 years.

The long duration and steadiness of the present phase of economic expansion has done wonders to inject assurance across all strata of consumers such that the index of consumer confidence is now at a thirty year high. This goes a long way to explain retail sales growing at close to 6% versus income growth of 3.5%, pushing the official measure of the savings rate to minus 1%. With this in mind, we were puzzled by the Fed's meek measure of restraint of only one quarter of a percent rate hike in the Federal Funds rate in June and believe it is going to be a game of catch-up through the rest of the year. The Fed is evidently looking for more concrete evidence of price inflation and perhaps it still has an eye on the precarious situation of some overseas economies. We believe there are very strong reinforcing elements within the US economy such that the interest rate medicine that is eventually administered will need to be a lot stronger than many presently contend. Hence the risk is that bond yields will peak at much higher levels than investors presently envisage. This will help support the US$ but the sheer size of the trade deficit makes the dollar vulnerable to any adverse change in sentiment towards US financial assets.

Outlook

In the short term and with an eye closed to valuations, one can see very little standing in the way of stock markets continuing to rise. The central banks, led by Japan's, continue to feed liquidity into the system. Corporate activity continues to absorb outstanding shares at a faster rate than new stock is being issued. While economic expansion will broaden in Europe and Asia it seems unlikely to grow at a pace that will threaten relative price stability or, indeed, fully absorb the pool of cheap funds. Equity markets will respond with enthusiasm to an environment of positive earnings surprises though rising interest rates should detract from the valuations of high growth companies. In most markets, there is an absence of attractive alternative investments and only in the US and UK, among the major markets, are we seeing much leakage of funds into property. While the Japanese market has run hard in anticipation of better things, we do not believe any retracement will be particularly harsh in the context of a continuing flow of positive news and the need for domestic savings to seek higher rewards.

Despite all the above, we nonetheless intend to maintain our short position against the US market. Exact timing is immensely difficult but it is virtually certain that at some stage, investment principles will assert themselves. It is clear that at current levels, valuations on Wall Street are highly stretched. It is also the case that the US economy is in a much more advanced phase of its economic cycle than virtually any other, which supports our belief that some time relatively soon, Wall Street will come under pressure from rising interest rates. It may be true that any sharp sell-off will temporarily be seen as a buying opportunity by the now well-trained public. Following each recent setback, the market has been characterised by a new emerging component, be it information technology or the internet, that has taken the index to yet higher levels. Obviously we cannot know that there will not be other large engines to drive the index higher, but as other economies improve there will be growing competition in terms of opportunities and certainly a significant absorption of the liquidity, which has been such an important driver of all markets.

Stock Stories

With all the excitement about the internet and e-commerce our shareholders must wonder what we're doing about "getting a share of the action". The problem is to identify which are truly durable businesses versus ones that start well only to fizzle out on account of the e–road taking an unexpected turn. Having looked at a wide range of offerings we have concluded that the most attractive way to pursue the inevitable growth of e-commerce is to invest in companies that are not directly in the spotlight but yet will play a significant role in this emergent industry.

Ericsson (Sweden)

A company we have long followed found itself unusually friendless a few months ago. The shares of the giant telecoms equipment manufacturer Ericsson experienced two years of virtual hibernation as investors expressed concern about its relatively poor showing in mobile hand-set model releases (mobile phones) and continuing losses in its traditional business of telephone switches (exchanges). As is usually the case, the market was right in having reservations, particularly as newcomers such as Cisco were completely changing the rules by offering "routers" which in the internet protocol (IP) world all but obviate the need for traditional exchange equipment. Further, the street's blue-eyed boy, Nokia, had gained a lead over Ericsson in the highly profitable and fast-growing arena of mobile handsets. Adding to the discomfort was concern about the company's exposure to big markets that were caught up in a credit crunch, in particular China and Brazil.

Our assessment is that these were purely transient matters and did not detract from Ericsson's core position in the emerging scene of mobile internet access. There is a lot written about the diffusion of personal computers (PCs) and availability of bandwidth but already in the advanced markets for mobile telephony, such as Finland and Sweden, the volume of data is exceeding that of voice. Before entering that domain, let's examine what Ericsson has to offer. Firstly it is by far the world's largest provider of wireless infrastructure, the base stations and network management software which are the heart and soul of the network, with more sales than its three top competitors, Lucent, Motorola and Nortel combined. Even more importantly, unlike these competitors it can offer the full range of standards, GSM, TDMA and CDMA. Secondly, it is number two to Nokia in the supply of mobile phones and is likely to ship about 33 million units this year, some 14% of the world market. The profitability of the handset division should benefit from the release of several new high performance models in the second half of 1999. The business that has been causing problems is that of the traditional wireline exchanges. Here, too, the company is a global leader with an installed base of 105 million lines and is presently downsizing the business, a task made necessary by the fact that as these facilities become more sophisticated they rely on more embedded software to the extent that Ericsson's latest AXE switch occupies one tenth of the space of its predecessor.

The growth in mobile telephony is truly colossal: from a base of about 300 million users at the beginning of 1999 the market is likely to expand to 1200 million users by 2003 with the peak in *growth rate* of new subscribers only expected to be reached in 2002 at 200 million pa. For those having concerns about our optimism, spend a moment on a street corner observing passers-by. Australian usage is now 30 % of the population while in Finland it is 60%. Crucially, the US market is just coming alive with penetration at 28% and climbing fast. The spend on infrastructure is, therefore, likely to grow at over 20% pa over the next four years.

The mobile phone market is equally interesting as users upgrade to take advantage of smaller phones or new features and standard changes from analogue to digital etc. Half of this year's sales, perhaps 120 million phones are expected to come from replacement demand. The problem one can envisage is that the very evident scale of demand will encourage the entrance of new suppliers. This will be exacerbated by the convergence of standards which sees the Asian suppliers, Panasonic and Samsung, joining the fray significantly this year. Hand-set prices have been falling by around 20% pa and are expected to average US$196 in 1999. Ericsson's strength in infrastructure rather than phones, compared to its principal rival Nokia, sits well with us on this account. Nokia, though, has stayed at the top end of the market and, by adding new features and by clever manufacturing and marketing, has continued to earn high margins even as prices have fallen.

All this points to Ericsson achieving sales growth of around 20% pa for several years. Profits could even do better as the traditional wireline switching business returns to profit and the US based CDMA business expands. The most exciting part of all though, is the build-up in the use of mobile data transmission. In a digital age all information, speech and images can be converted into ones and zeros. Hence data can mean sending a "movie" to a phone or laptop PC or, alternatively, a salesman can interrogate the company's databank remotely, using a hand held device, while in the field. Kyocera has already released a mobile phone with a built-in video camera plus display for those who like to chat and gaze!. The world of fully mobile multi-media is right upon us. Ericsson is at the forefront of this aspect of e-commerce and, just as the use of mobile phones has astounded some of us, so too will mobile commerce. The Japanese mobile operator NTT DoCoMo will be the first to roll-out the new wide band CDMA standard in 2001 which will allow full video transmission to a mobile terminal at 2 megabytes per second. In the meantime operators everywhere are beginning to introduce equipment upgrades which will allow mobile users to receive and transmit data at high speed.

Unlike some areas of the internet, this road map is fairly clear and Ericsson's place in the market reasonably well defined. Once the present restructuring problems are out of the way, the company is likely to resume its trend growth rate of the last 15 years of about 15% pa.

Japanese Telecom Industry

It is no secret that the global telecommunication industry is experiencing boom times driven by the twin phenomena of rising mobile phone usage and surging data transmission. In a world of patchy growth, this industry is growing at four times that of GDP and this has caught the imagination of investors who have clambered to buy telecom carriers. Rather like the railways in the nineteenth century, there seems no end to the potential of these companies as widening band-width facilitates video conferencing and as local access lines change to fibre optic cable or clever electronics allow traditional copper wire to carry sufficient pulses to deliver a full feature video to one's home. (Normal voice requires transmission speeds of only 6,000-8,000 bits per second (bps) whereas a video would need up to 300 times that speed).

When one looks at the Japanese telecoms market, the same trends are apparent but we think it is potentially a much more interesting story.

NTT has its genesis as a government department, that of the Ministry of Post and Telegraphs in much the same mould as Telstra, British Telecom and Deutsche Telecom. Though the market is being deregulated and competition is showing some signs of increasing, it finds itself in an even more privileged position than the incumbent in any other country. It is a truly enormous network with 62.5 million local access lines of which 4.6 million are high capacity ISDN lines. Also, through its mobile subsidiary, DoCoMo, there are 26 million mobile phone subscribers, a 57% market share, which places it in an unusually privileged position with suppliers. Like its European peer group, which are engineering-led, it maintains a strong commitment to R&D and employs no fewer than 9,000 people researching leading edge technologies such as wide-band CDMA. This commitment will result in Japan implementing this new mobile world standard, perhaps two years ahead of the Europeans. The same technical bias and low priority on profitability has led to a history of massive capital spending that has put it in a very strong position in the so-called local loop (the wiring from the exchange to the home) and unlike any other telecom carrier, it is now laying optic fibre from the main exchange to the local exchange. This could add to its strong position as an internet service provider because of all the attendant bandwidth advantages.

None of the above is a mystery to those who are familiar with NTT. However, rather like its major overseas peer group (which for well-understood companies have achieved extraordinary returns), it is the massive power of this incumbent that is perhaps being under-estimated. In particular, NTT is at the centre of the communications industry of the world's second largest economy and because of Japan's pacific based trade, it has a natural advantage over foreign carriers or newcomers.

As a one time monopoly, it has been careless with its costs and capital expenditure. This is changing following its break-up into three divisions in July 1999; accountability will improve and like Japan Railway before it, profit improvements will surprise even the optimists. Most analysts are looking for profits to nearly double over the next five years – we think it will be higher. Consider; fixed costs such as depreciation alone accounts for 25% of sales, with capital spending diminishing this will massively boost profits. Further, the use of sub-contractors is being reviewed and new arrangements entered into. For example, the yellow and white pages divisions that have proved so successful for Telco's the world over, are loss making in Japan.

Most appealing of all is NTT's valuation. It earns a higher proportion of its revenues from mobile phones on account of DoCoMo's 57% share of that market, yet it is valued, in terms of cash flow to enterprise value, at one fifth lower than its western peer group. This is explained by its history of gold–plating everything. The valuation however does not take account for its prospects as a leader in Japan's transformation to the multi-media age nor the fact that the lower cost of capital in Japan should allow a much higher valuation once the earnings growth pattern is reappraised.