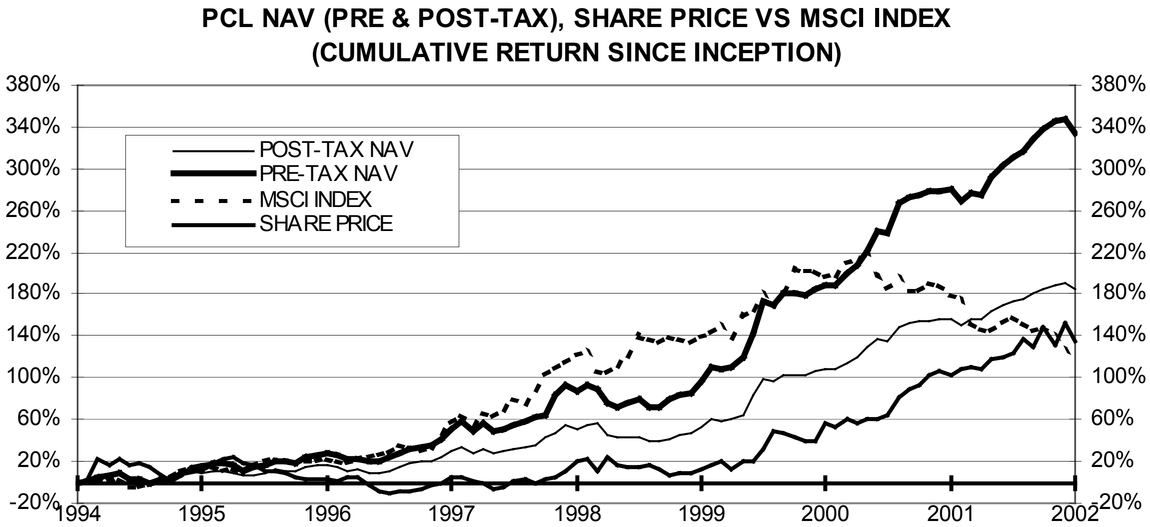
PLATINUM CAPITAL LIMITED
ANNUAL REPORT AS AT 30 JUNE 2002

INVESTMENT MANAGER'S REPORT

Performance



Confidence in the valuation of equities worldwide has been shaken by the revelation of major accounting irregularities primarily but not exclusively in the US. It is now feared that we have been living through a financial mania accompanied by systemic distortions involving very influential individuals and institutions which if not downright illegal have certainly served to mislead.

In terms of stock market sectors, information technology and telecoms were affected worst but there were no hiding places. By geography, the only bright spots producing positive returns were Korea and Peru. The Morgan Stanley World Index fell overall by 13.6% in the quarter to 30 June, by 16.9% over the first half of 2002 and by as much as 23.2% in the latest twelve months.

MSCI WORLD INDEX – INDUSTRY BREAKDOWN

Sectors	3 months	1 year
Information Technology	-29.3%	-43.4%
Telecommunications	-25.1%	-42.6%
Health Care	-17.1%	-21.0%
Consumer Discretionary	-14.8%	-26.3%
Industrials	-13.3%	-25.2%
Utilities	-10.2%	-26.7%
Financials	-9.3%	-20.2%
Energy	-8.3%	-10.0%
Consumer Staples	-4.8%	-1.9%
Materials	-3.6%	-4.1%

Source: MSCI

Platinum's portfolio did well for the year as a whole but lost momentum in the last quarter as the upward re-rating of smaller capitalisation shares came to an end and some of our holdings were marked down. Short sales played an important part in our overall returns. The composition of these has changed through time as we gradually migrated from technology names to financials and consumer dependent names as the year progressed. The quarterly reports hopefully kept you abreast of our activity throughout the year. In summary, the last three months saw the value of the company's portfolio decline by 1.1%, while it rose by 5.5% over six months and increased by 13.9% pre-tax for the last 12 months. Readers may be interested to note that the Micropal survey of 601 managers of International equity funds records that they lost an average 27% over this last 12 months.

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

30 April 2002	31 May 2002	30 June 2002
179.42	179.91	176.65

<u>Disposition of Assets</u>

GEOGRAPHICAL DISPOSITION OF PLATINUM ASSETS

Region	Jun 2002	Mar 2002
Western Europe	40.3%	40.0%
Japan	18.0%	14.9%
Emerging Markets (incl. Korea)	14.3%	15.5%
North America	12.0%	13.4%
Australia	1.5%	1.3%
Cash	14.0%	14.9%
Shorts	28%	28%

At year end the company's portfolio was very underweight in the US, overweight on western Europe and retained a supernormal holding of cash.

BREAKDOWN OF PLATINUM PORTFOLIO BY INDUSTRY

Categories	Examples of Stocks	Jun 2002	Mar 2002
Cyclicals/Manufacturers	RMC, Bayer, Linde, Océ	19%	23%
Retail/Services/Logistics	Hornbach, Jones Lang LaSalle, Fraport, Stinnes	13%	11%
Consumer Brands	Adidas Salomon, Lotte Confectionary	12%	9%
Financials	Deutsche Boerse, Alleanza	9%	9%
Technology/Hardware	Toshiba, Samsung, AMD	7%	11%
Software/Media	Mediaset, Nippon Broadcasting, Seoul Broadcasting	7%	7%
Medical	Draegerwerk, Merck KGaA, Novartis	7%	6%
Telecoms	NTT, Verizon, Ericsson	7%	6%
Gold and Other	Gold Fields, Newmont Mining	5%	3%

Recent selling has reduced our exposure to cyclical and technology stocks whereas our buys have mainly been of companies operating at the consumer end of the market.

Changes to the Portfolio in the fourth quarter

Most of our purchases took the form of additions to existing positions. Our eagerness to start accumulating new positions notably in EDS (IT outsourcing) and Ericsson cost us money as these companies sold off with the techs. Other significant additions were mainly Japanese companies: Takeda, Sky Perfect Communications, Credit Saison, Aiful and Denso.

With the exception of the last named, these are domestic plays largely unaffected by the movement of the yen. This provides balance to the export component of the portfolio and exposes the company to what growth industries exist in the largely moribund Japanese economy. Takeda is the country's principal drug producer, with an interesting portfolio, and sold off in sympathy with its international peers. Trading on around 20 times earnings with 20% of this capitalisation in cash, it is close to its cheapest valuation ever.

Sky Perfect was IPO'd with all the fanfare of the internet boom and has subsequently fallen over 65%. This entity was one of several licence holders to broadcast digital TV via satellite but as time has passed it has merged with JskyB. Another competitor, DirectTV Japan, has terminated its service. Sky is now the sole communications satellite digital platform over Japan, aggregating some 180 channels, with nearly three million subscribers. By the nature of this business, its costs are front-end loaded which means that at the current net sign-on rate of around 40,000 per month, it will break even by year-end. This remains, however, an unattractive proposition to the many institutional investors in Japan who place major emphasis on immediate free cash flow. We believe this is the main suppressant on the share price as subscriber growth has been good, a competing analog station providing two movie channels is losing ground and in the next few months there will be the added attraction of a horse racing channel with on-line betting facilities. Should Sky eventually gain, say, six million subscribers, out of 46 million Japanese households, the shares will prove to be substantially undervalued.

Credit Saison and Aiful are vehicles to participate in the growing credit card market in Japan. Obstructing the acceptance of cards, as well as high merchant fees, are rigid social values, although these are now changing, particularly among those below 30. Both companies have excellent growth records throughout this last 10 years of recession. Credit Saison is aiming to be the leading card processor in the country while Aiful will continue to develop its traditional short term lending business through the offering of credit cards. Both have very low balance sheet gearing, borrowings to equity being around five times, so as credit markets expand in Japan the potential for leverage, as witnessed in Korea, is enormous.

Lastly, Denso is one of the reminders of the distinctive virtues of Japanese companies. Its commitment to product excellence and innovation is partly revealed by its R&D budget of 9% of sales. It is targeting to reduce its costs by 30% by 2003 whilst remaining at the leading edge of auto electronic technology. Sales growth, while partly linked to Toyota's fortunes, is expected to benefit greatly from the adoption of electronics in autos. Denso is the leader in car navigation and will ship close to half a million sets this year. Even more importantly, the company will benefit from the intensifying digitisation of cars, be it in pollution abatement or mobile communication and control. Best of all, its recently spun off competitors such as Visteon (from Ford) and Delphi (General Motors) are showing signs of capitulating to expediency in the face of investor short-termism!

On the sales side, we removed Coke, Kimberly-Clark, Lagardere, Tokyo Broadcasting, Sony and Zhejian Highway. The prices of these shares rose significantly as investors sought the sanctuary of defensive plays so they no longer offer good value.
On the short selling front, we have gradually migrated from the technology sector such as Intel and the chip making companies to financials and consumer sensitives such as Sears, and to the government sponsored enterprises, Freddie Mac and Fannie Mae.

Currency

Almost every currency appreciated against the US$ in this period. The latter is now seen as risky and, notwithstanding their problems, the Euro and even the Yen for a while, look more compelling. The company was relatively well positioned having held to our long term preference for the A$ and the Europeans. At the end of June, 63% of assets were hedged into A$; 28% held in European currencies, with the rest mainly in Korean Won.

Commentary

A particular feature of recent developments in world stock markets has been their synchronisation. From the coverage given in the popular media, particularly in the US, one might think the more intense disturbances were confined to American corporations. In fact the excitement of the new communications mania, the internet, mobile phones, lap top computers etc, was a universal phenomenon. A Panglossian tide swept across America, Europe and Asia alike, submerging reasons with promises of step changes, new paradigms, and everything which went to make a brave new world. Management with large holdings of stock options and investors were affected alike, conservative elder statesman as well as teenage enthusiasts, not to mention the shadier elements, the speculators and creative accountants. The consequence has been stunning losses not just in Enron or Worldcom or “fairyfloss” companies in *neuer markts* or developing countries but in former staid giants such as France Telecom, down 73% in the past six months; Vivendi, down 61%; Marconi, 99%; Ericsson, 73%; Swiss Life, 71%; and Reuter, 62% to name just a few.

It is probably true that US companies deserve recognition as the premier performers in the contest for director self-enrichment and the most creative accounting, but they are not alone. Many great companies are now over-leveraged and operating in markets that are over-supplied. They have lost their operating flexibility and in some instances have surrendered formerly impregnable positions to previously weak adversaries. They are much riskier entities and some will not survive in their present form. Auditor and public scrutiny will reach fever pitch and new legislation will follow. This is leading to a **general de-rating of equities** in all major markets.

The second factor weighing heavily on equities is **currency imbalances.** Like the great empires of the past, the United States now finds itself carrying an imperial burden. Big government is back and the weight on the exchequer is growing. History leads us to believe that the currency is entering a weak phase and the cost of debt, as reflected in long interest rates, will trend higher.

Over the last few years we have held the view that the unlocking of the potential of the vast labour pools of Asia, in particular China, would suppress the price of traded manufactured goods and thereby cap an important element of inflation. Further aiding this tendency is the falling price of communications which has promoted the development of services which can be performed remotely at low cost, for instance call-centres or software development in India. This would be fine in an environment of stable exchange rates but if the US dollar cheapens it may have a **deflationary effect** on world aggregate demand and prices abroad as US producers are able to win back some export markets while at home US consumers feel the bite of less cheap imports.

We nonetheless take a positive view about **Asian growth prospects**, though expecting a lower trajectory than hitherto. The bigger emerging countries of the region have seen their net external indebtedness decline since the '98 crises and bank loan-to-advance ratios have improved markedly. Company balance sheets are much improved and inter-regional trade is flourishing. To be sure, weak currencies have helped spur exports but an important new development is emerging. Extensive use of consumer credit has changed the balance between domestic growth and that generated by external demand. In Korea for example, spending on capital formation has dwindled from over 35% of GDP in the early 1990s to around 28%, and in its place the consumer's share of the economy has been bolstered to over 64%, from 55% formerly. A strong rise in consumer credit and real wages have driven this but because of international competitiveness and improved solvency trade is in surplus and net foreign assets have been rising.

Interesting questions relate to **commodity prices**. Having now retested the lows last seen in the 1930s in real terms do they skid further or will some growth in the West and improving living standards of Asia result in a gradual shift upwards in line with marginal incremental demand? In nominal terms the emerging economies of Asia and India seem too small to have an impact, representing about 9% of world output. However, if one looks at output on the basis of **purchasing power parity** (PPP) to take account of their unduly cheap currencies and to give weight to the physical content of their output, one can draw a different conclusion. Far from being insignificant, a study by Morgan Stanley suggests that China and India on a PPP basis, together account for 17% of world GDP, representing more than twice that of Japan at 7% and just ahead of Euroland's 16%[1]. Should these economies continue to grow at twice or more the rate of developed economies, one could make a case that the real prices of commodities have bottomed. This would partially offset deflationary influences elsewhere. Equally, it has important implications for commodity producing companies and commodity producing nations like Australia.

Latin America is a different story. The main problem stems from weak institutions. Instead of using the period of strong investment flows from abroad to reform its fiscal imbalances, Argentina squandered the opportunity. The strong currency, pegged to the dollar, was the final straw as foreign flows faltered and investors realised they would be seeing very little of their $150 billion back. Argentina's economic future looks very bleak.

1. Sceptics may be surprised to know that China produced 149 million tonnes of steel in 2001 and 595 million tonnes of cement. By way of contrast, the USA produced 90 million tonnes of steel and 91 million tonnes of cement, while India produced 27 million tonnes of steel and 100 million tonnes of cement.

Brazil has been more disciplined and is running government surpluses, before interest payments, of over 3.5% of GDP. However, domestic government debt is very large at 269 billion Reals and interest payments are absorbing around 8.5 % of GNP. Worst still, these government obligations are some 90% inflation or exchange-linked and have a maturity of just 35 months on average. Given the uncertainty of the upcoming election, and with the lead being held by Lula da Silva, a move back to the radical left, a weakening currency and enormous government debt leaves the country's future on a knife edge. This is exacerbated by a small trade component relative to this large economy. The government has little room to manoeuvre.

Japan remains vulnerable to unstable currencies. It was starting to see the benefits of an export surge due to the weak yen but this trend has now halted. We have long held the view that the yen is the safety valve in that dysfunctional economy. On a recent trip we were dismayed at the seeming complacency among large employers. The giant electrical companies are a classic example. The cost of tenaciously standing by their worker obligations is putting their technological standing at risk. This year, for example, the combined spend on IC chip facilities by the big five Japanese semi-conductor companies will be US$2.7 billion which is about the same as last year and is less than that of their nemesis in Korea, Samsung, although their sales are more than three times as large as Samsung's. As pure manufacturers, the Japanese are still very competitive but the overmanning of support staff is a major problem. Even so, there are many facets to this enormous economy which allows stock pickers to find inexpensive investments.

<u>Conclusion</u>

Investors can expect the media to give plenty of attention to whether Wall Street has reached a bottom. We think this will prove premature speculation, an example of the false optimism that can be expected after an 18 year bull market (1982-2000).

Our medium term caution is based on the amount of consumption that has been brought forward, on the excessive use of debt by companies and individuals, on the still stifled criticism directed at key institutions and on the reducing willingness of investors to pay high prices for true earnings (valuations are still too high). Money is still hiding in yesterday's winners, new issuance hovers in the wings and as money is withdrawn from equity mutual funds even wonderful companies will be revalued downwards. **There is simply still too much faith in equities for this to be a fundamental bottom!** The pendulum of investor sentiment has still not yet swung fully from greed to fear.

Such a scenario is no fun for fund managers because of the likely volatility. Particularly with our short positions there are bound to be times when we will close positions too soon on a trading view and thereby forego opportunities. Equally our longs will periodically fail because of growth and competition proving worse than we anticipated or by our misjudging what is priced into expectations. Hopefully by scouring the world and being prepared to avoid the popular shares we can give investors some protection. In the short term there **could be a decent bounce** reflecting a moderation of the present high level of investor pessimism.

“Nasdaq Accounting Definitions”

In truth it is no laughing matter but, following last quarter’s comments on accounting nonsense, we were taken by the following “Nasdaq Accounting Definitions” from the internet:

EBITDA – Earnings Before I Tricked the Dumb Auditor
EBIT – Earnings Before Irregularities and Tampering
CEO – Chief Embezzlement Officer
CFO – Corporate Fraud Officer
EPS – Eventual Prison Sentence

Kerr Neilson
Managing Director