PLATINUM CAPITAL LIMITED
HALF YEARLY REPORT AS AT 31 DECEMBER 2002

Performance

Investment management in 2002 was not a pleasant experience. The aggregate capitalisations of all the big markets fell by between 25% and 35%, while smaller markets were typically down by 15%. Only the relatively tiny emerging markets of Eastern Europe produced positive returns, of around 15%, led by Russia which benefited especially from a large weighting of oil producers.

Looking at performance by economic sector, we see the defensives and commodity producers out-performing other areas although still ending down, by around 15% for the year. Over the last three months, the pariahs, telcos and IT leapt from their heavily oversold position, up 24% and 15% respectively, but they nevertheless dropped by 36% and 44% for the full 12 months.

The value of Platinum's portfolio was up 6.6% for the quarter, down 4.4% for the six months and up 0.9% for the year (pre-tax). In comparison, the MSCI World index returned 3.9% for the quarter, declined 12.4% for the six months and was down 27.2% for the year.

This substantial outperformance was a function of several factors: stocks we owned have typically outperformed their markets, though many are down over the year; the migration of our shorts from tech to financials, predictables and earnings manipulators has generally worked well; thirdly, our high exposure to the Euro in preference to the US dollar has paid off handsomely.

MSCI WORLD INDEX – INDUSTRY BREAKDOWN

Sectors	3 months	1 year
Consumer Staples	-2.9%	-13.2%
Consumer Discretionary	-0.3%	-29.9%
Utilities	0.0%	-25.8%
Health Care	0.7%	-26.0%
Industrials	0.7%	-30.2%
Energy	3.5%	-16.4%
Financials	4.3%	-25.2%
Materials	6.1%	-14.5%
Information Technology	15.8%	-44.2%
Telecommunications	24.9%	-36.5%

Source: MSCI

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

31 October 2002	30 November 2002	31 December 2002
157.47	165.17	161.94

Changes to the Portfolio

DISPOSITION OF ASSETS		
Region	**Dec 2002**	**Jun 2002**
Western Europe	36.7%	40.3%
Japan	20.1%	18.0%
North America	16.4%	12.0%
Emerging Markets (incl. Korea)	13.5%	14.2%
Australia	1.9%	1.5%
Cash	11.4%	14.0%
Shorts	30%	28%

Market weakness early in the quarter allowed us to add to existing positions at attractive prices. At the same time it threw up the opportunity to start to put together a mini portfolio of biotech shares. We have built a basket of seven companies which, although at the forefront of medical science, have seen their share prices fall 80-90% since their valuation peaks in the biotech bubble of 2000. Currently, even though many have programs testing new drugs in the advanced stages of clinical trials, they are valued at little more than their cash holdings (1-2 times). The biotechnology arena provides almost daily excitement as new discoveries are made ranging from genetic identifiers of predisposition to disease to potent new treatments for notoriously hard-to-treat diseases, but it is still very risky. Any individual biotechnology company tends to be dependent on a key technology, or core element of science, which is then developed into a few drug development programs limited necessarily by the smaller size and resources of these companies. Many of them have partnerships with the large pharmaceutical companies who despite having their own in-house biotech departments need outside help to replenish their drug pipelines. They face constantly the threat of generic competition and political interference on drug pricing for their current, ageing product portfolios. As the era of more focused treatments and the dream of personalised medicine develop, we believe it is the smaller, more focused companies that will reward the investor. Having a portfolio of seven shares compensates for the risks of individual failures.

The weakness of the Nikkei index saw some of Japan's leading companies fall to attractive buying levels. In particular we started acquiring Canon, Fanuc and Sony, which are all leading global entities with long histories of growth, high profitability and, now, relatively low ratings. In the short term, Canon will benefit from very strong and profitable digital camera sales while as chip-making capex recovers it is highly probable that it will gain share in the stepper market from Nikon. At the same time, sales of colour printers, copiers and, of course toner and inks, which are wonderfully profitable, keep providing good cash flow. Sony is benefiting from the slipstream of the digital revolution and its Playstation and movie business. Fanuc is the world's largest manufacturer of industrial robots. Apart from its scale advantages, which include the bizarre reality of robots making other robots, the company is unrivalled in profitability, making a 26% return on capital employed. Some important users, such as automobile assemblers, are cutting back their new investment but Fanuc is finding a growing market in other applications, such as hazardous industries (foundries), picking and packing.

In Europe, we introduced the Danish company Great Nordic to our portfolio. Once a market darling because of its telco testing division, the shares have fallen a long way. The testing business has recently been sold so will no longer be a drain while the two other divisions will be powerful profit drivers. The company is ranked as number three in the global hearing-aid market and the second in the world headset business. Both these businesses are growing and will benefit from the consolidation of production at a company-owned facility in China. An exciting twist for the company is the recent launch of ''blue tooth'' technology which allows headsets for fixed and mobile phones to be wireless and, indeed, for all aural devices to be untethered from the transmitter. We also took a small position in ThuyssenKrupp, the steel and engineering giant, which is now priced at a fraction of its steel-making replacement cost even though it is now perhaps the lowest cost strip maker in Europe and has a portfolio of very interesting traditional and advanced engineering businesses.

On the selling front, we took good profits on reducing our holding in Gold Fields of South Africa in favour of the politically less risky Barrick Gold Corp. The latter partially hedges its production but if the gold price remains strong for an extended period the effect of hedging on performance may prove immaterial. We also sold Rinascenti, which was bid for, and eliminated Mediaset after a good price appreciation.

We continue to see opportunities for short positions, particularly in the United States. We perceive great vulnerability in three areas:

- Companies with opaque or incomprehensible accounting (Tyco recently disclosed years of "aggressive accounting").
- High valuation consumer product companies, which have been bid to very high levels as investors seek shelter in perceived stability. These companies have often leveraged-up, buying back stock at high prices. We believe that those seeking shelter might find there is more risk than they previously expected.
- Financial institutions more generally, which we see as leveraged to their own weak balance sheets and to highly indebted consumers throughout the US.

BREAKDOWN BY INDUSTRY

Categories	Examples of Stocks	Dec 2002	Jun 2002
Cyclicals/Manufacturing	Schindler, Siemens, RMC, Bayer, Linde, Océ	24%	19%
Technology/Hardware	Agere Systems, National Semiconductor, Samsung, AMD	12%	7%
Medical	Yamanounchi, Takeda, Draegerwerk, Novartis, Merck KGaA	9%	7%
Telecoms	Hellenic Telecom, Ericsson, NTT	8%	7%
Gold and Other	Barrick Gold, Newmont Mining, Gold Fields	8%	5%
Financials	Assicurazioni Generali, Allianz, Alleanza	8%	9%
Retail/Services/Logistics	Hornbach, Jones Lang LaSalle, Fraport	8%	13%
Consumer Brands	Citizen Watch, Adidas Salomon, Lotte Confectionary	8%	12%
Software/Media	Sky Perfect Communications, Seoul Broadcasting	4%	7%

Source: Platinum

Currency

There have been no changes in Platinum's currency weightings. The rise in the Euro relative to the US$ is working in our favour. We are positioned for the A$ to continue to rise relative to the US$ in 2003 with a hedged position of 69%.

Commentary

Late in 2002 we visited a broad cross section of high quality companies in Japan and came back with a general impression of quiet yet growing confidence. One could sense a rise in their self-belief as the merits of pursuing their traditional patient and systematic planning and execution has begun to bear fruit.

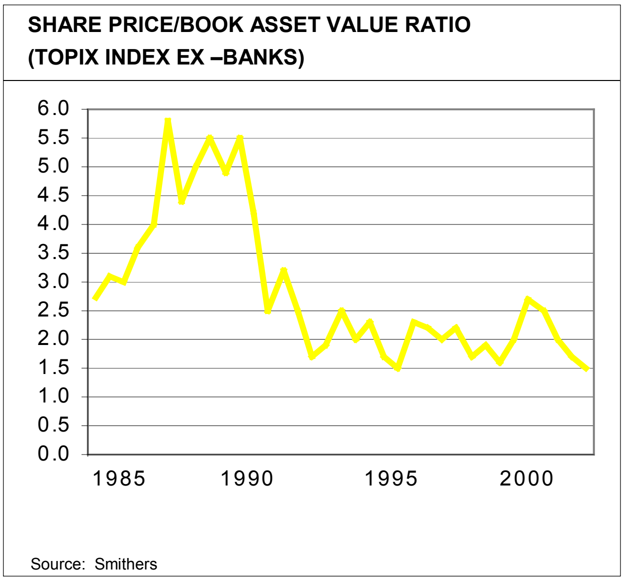
Constant themes were the raising of productivity and the reduction of costs. This in Japan means finding ways to harness technology to reduce weight and size and to improve manufacturability. We were constantly reminded of the depth of know-how and the tremendous specialisation by individuals and companies which through gradual incremental embellishments has been building extraordinary competence. Most of the companies visited have been increasing their R&D spend, capex was typically below depreciation and where serious money was being spent overseas it was in low cost countries. One of the benefits of specialisation and a loyalty to staff is clearly seen by the mutual trust and cohesion found in most Japanese companies. There are inevitably costs to this approach in the short term but there are also great advantages in avoiding over-aggressive hiring and firing which tend to show up mainly in the longer term.

The big idea in Japan at present is the emergence of China as the next great market. To some extent, company management is using the threat of Chinese low production costs to drive through reforms on the home front. There was not a single company visited that was not expanding or enlarging its presence in China. Some of the figures quoted for the difference in costs were astonishing with products being landed in Japan at the value of their raw material at local prices. Chinese made bicycles, for instance, admittedly of poor quality, were selling at prices one tenth that of Japanese made units. Most companies have already been operating in China for several years and have very largely mastered the problems of local sourcing and distribution. Competition from Korean and some Western European and US companies is strong but the Japanese are in the forefront in many areas.

The areas which on previous visits we found to be concerning management, mainly incentive systems, forced lay-offs and board restructuring, were largely dismissed this trip as having been tackled. The main concern now is exogenous, the persistence of price deflation. On the financial side the management of the better companies have done what they can, eliminating debt from the balance sheet and hoarding cash. At the operating level, however, the short term problem of the automatic deflation of reported profits continues. On the other hand, it can very plausibly be argued that large long term benefits are accruing as a forced emphasis on manufacturing efficiency and cost control does wonders for international competitiveness.

After a decade of price decay, influenced by weak demand, new supply channels and easier access to imports, domestic prices in Japan no longer seem out of alignment with those of other developed countries. At the current exchange rate this competitiveness is evident with the country being able to run a trade surplus of around US$100 billion per year. This attests to its producing what its trading partners want and gives Japan an ability to project considerable economic power abroad.

From our perspective, this last decade has not been entirely lost by Japan and so long as savings are generated at home and locals own the Government bonds, the country may be able to extricate itself from the mire without resorting to excessive use of the printing press. After all, interest rates are perhaps below the economy's medium term growth rate. The outstanding stock of debt is unquestionably large so it is likely to be a tight race. However, valuations in Japan reveal a total lack of belief in the ability of firms to earn a sensible return on assets employed (see chart below). For those who question the absence of commentary about the Japanese banking system and the rising bankruptcies, the answer lies in our ability to be highly selective with the shares we hold and to take appropriate positions regarding the currency.



One of the benefits of studying the fall-out from the collapse of the Japanese bubble is to learn lessons for the US market. We often hear that the US will prove much more responsive than Japan in getting to grips with its problems. This may be so though we believe there are obstructions to market-clearing such as Chapter 11 bankruptcy protection, litigation hurdles, state subsidies and so on. Either way, we would expect the US market to continue gradually to de-rate just as we saw in Japan. New share leadership will emerge and it is almost certain not to be in the information technology sector. Companies heavily burdened by debt are likely to be ill-treated (the slogan being debt and deflation don't mix). So-called, “quality of earnings” is paramount in an environment of weak pricing power and a mere sniff of accounts fiddling will set off a fury of selling. Investors will pay above the odds for growth and certainty of earnings.

Several of these factors can already be seen at work in Wall Street, in the case of defensive stocks the trend has perhaps been taken too far. This has given Platinum some useful short selling opportunities, in particular as regards consumer non-durable companies like Anheuser Busch, Procter & Gamble and Colgate. The market also seems to be over optimistic in its expectations for the profit growth of several financials. This false optimism is all part of what we describe as using the “retrospectascope”. By the time the bear market has woven its web, investors will have given up on any fantasy about the Fed or tax cuts as panaceas for the natural deflating of a massive financial bubble. Quite the contrary, it is probable that questions will be asked about the efficacy of the various forms of intervention.

Will Europe share the same fate? There are some factors that suggest Europe could have a similar outcome but debt is much lower on the Continent and valuations are also considerably lower. The worst performing market, and indeed the one with the worst outlook, Germany, is now capitalised at Euro 380 billion, putting it in line with Australia!! Even making adjustments for what is not listed in Germany, this is truly astonishing. Further we feel the accounting on the Continent is less promotional although far less conservative than say, ten years back. There is one serious cloud that needs to be watched. Should the US dollar weaken further, one of the European drivers, namely exports, would suffer.

A weak dollar would have other serious implications particularly on US fixed interest securities and shares. Foreign ownership of US assets is now over 70% of US GDP, having more than doubled since 1990, and of the US treasuries in issue, over one third are held by foreigners, who also own some 23% of the corporate bond market and over 12% of US equities. With a relatively poor choice of alternatives, the mired Yen and the politically incohesive Euro, some speculators seem to be seeking refuge in gold. Writing in a book just released, “Tomorrow’s Gold – Asia’s Age of Discovery” (published by CLSA Books), Mark Faber, a seasoned campaigner with good historic insight, suggests that the international liquidity which has been created will find itself expressed in higher prices of many commodities including gold and silver. We share many of his views and see the Company's 5% position in gold producers as protection against likely currency instability.

We think currencies will be a major topic as 2003 unfolds. As noted in our annual report of June 2002, on the basis of purchasing power parity the Chinese economy is massively larger than the current renminbi exchange rate would suggest. The growing trade surplus and foreign direct investment, running at around US$120 billion per year, would normally ensure a strong appreciation of the Chinese currency. However, currency restrictions and other devices such as internal US$ accounts and now the opening up of an internal gold market all conspire to keep the currency fixed to the US$.

Conclusion

Terrorism, war and high oil prices are all damaging to consumer confidence and business investment in the short term. Longer term there is reason for optimism. Valuations have come back to sensible levels in Asian and European markets and quality companies will be able to achieve modest earnings growth. The level of debt and general uncertainty will promote volatility as short term events are periodically given too much emphasis.

Kerr Neilson
Managing Director