PLATINUM CAPITAL LIMITED

ABN 51 063 975 431

Quarterly Report

31 MARCH 2003

Performance

All major markets suffered reverses over the past twelve months. Australia escaped with a fall of "only" 13% compared to a catastrophic collapse of 49% in Germany. The same pattern persisted in the final quarter, with Brazil the sole exception to the trend and the rise there being only 2% from a very depressed level.

MSCI WORLD INDEX – INDUSTRY BREAKDOWN (A$) Source: MSCI		
SECTORS	3 MONTHS	1 YEAR
Telecommunications	-14.4%	-34.8%
Materials	-14.2%	-30.0%
Financials	-13.7%	-33.8%
Consumer Staples	-13.6%	-26.9%
Consumer Discretionary	-11.6%	-37.0%
Industrials	-11.6%	-36.9%
Energy	-10.3%	-29.4%
Utilities	-9.6%	-30.8%
Information Technology	-8.2%	-43.3%
Health Care	-7.7%	-28.8%

It was not possible to avoid the downturn by fleeing to so-called "defensive" sectors. There was some variability but the outstanding feature was the degree of uniformity. Over 12 months, the best performing sector, consumer staples, fell 27%, the worst, information technology yet again, fell by 43%, while all the rest were in the narrow range -29% to -37%.

In the face of such large and widespread declines it was inevitable that Platinum Capital would be affected. For the year as a whole our performance, although obviously disappointing, was creditable, being a decline of 13.3% as against our benchmark, the Morgan Stanley World Index, which fell by 33%.

Your Company was somewhat less successful in bucking the trend in the most recent quarter, suffering a fall of 8.3%, pre-tax, compared to the decline in the MSCI of 11.5%, all values expressed in Australian dollars. We profited from short sales during the quarter but not by as much as hoped. Our sales were concentrated on consumer staples and financials in the US on account of their extravagant valuations and lax credit procedures, but both sectors were relatively resilient. We also profited from some good individual stock selection but gave back part of this benefit by remaining overweight in the depressed German market.

The following Net Asset Value figures are calculated on a liquidation basis. Investments are at net market value and are after provision for tax on both realised and unrealised income and gains.

NET ASSET VALUE (CPS)	
31 January 2003	152.07
28 February 2003	142.41*
31 March 2003	140.16*

* After provision for the 5 cent interim dividend paid 28 February 2003.

Source: Platinum

Changes to the Portfolio

With share prices moving typically by 30% in a quarter, there were opportunities to either add to positions that had sold off fiercely or to trim holdings when prices rose on very short term considerations. For example, Assicurazioni Generali rose by a third, as a result of a fight for control, while Allianz sold off 50% on solvency concerns. Having satisfied ourselves as to the fundamentals of each, we reduced our position in Generali and progressively added to Allianz. As noted later in this report, we bought this share far too early in

DISPOSITION OF ASSETS		
REGION	MAR 2003	DEC 2002
Western Europe	33.0%	36.7%
Japan	20.9%	20.1%
North America	14.8%	16.4%
Emerging Markets (incl. Korea)	12.4%	13.5%
Australia	1.8%	1.9%
Cash	17.1%	11.4%
Shorts	34.0%	30.0%

Source: Platinum

the cycle but now it is addressing its solvency margin via a rights issue, which is not the time to be conjuring up creative imaginings about the fate of the world's largest insurer! Potential buyers are holding back in anticipation of a stock over-hang from the rights issue which provides excellent buying opportunities on weak days.

BREAKDOWN BY INDUSTRY

CATEGORIES	EXAMPLES OF STOCKS	MAR 2003	DEC 2002
Cyclicals/Manufacturing	Schindler, Siemens, RMC, Bayer, Linde, Océ	21%	24%
Medical	Yamanouchi, Takeda, Draegerwerk, Novartis, Merck KGaA	9%	9%
Financials	Assicurazioni Generali, Allianz, Alleanza	9%	8%
Gold and Other	Barrick Gold, Newmont Mining, Gold Fields	9%	8%
Technology/Hardware	Agere, National Semiconductor, Samsung, AMD	8%	12%
Telecoms	Hellenic Telecom, Ericsson, NTT	8%	8%
Retail/Services/Logistics	Metro, Hornbach, Fraport	8%	8%
Consumer Brands	Citizen Watch, Adidas Salomon, Lotte Confectionery	6%	8%
Software/Media	Sky Perfect Communications, Seoul Broadcasting	4%	4%

Source: Platinum

Currency

The US$ was weak for the quarter, the cost of a Euro rising from around $1.00 to $1.09. Similarly, the A$ gained ground and rose from 56 cents to 60 cents versus the US$. Our hedging strategy is working favourably and even though the US$ could find some vitality in the short term, we are reluctant to fine tune our position. We remain principally hedged into A$ at 70% and own Euros, Swiss Francs and some Korean Won.

Commentary

Armchair Generals may be disappointed at our lack of commentary about the invasion of Iraq but there are plenty more knowledgeable sources than ourselves. We will say only that we believe this war is coincident with the bear market rather than causal. That the war adds to uncertainty via geopolitical risk is indisputable.

We have just celebrated the **third anniversary of the Nasdaq bear market** and arguably approximately the fourth year of the broader US indices decline. In case there is need to emphasise the madness of the crowds, in mid-March of 2000, the Nasdaq index ostensibly represented 4% of US corporate earnings and 40% of total US listed equity values. Today this index represents some 25% of available US market capitalisation.

Other signs of the deflation of the bubble lie in the collapse in merger and acquisition (M&A) activity and the rapid decline in cross-border capital flows. World **M&A activity** amounted to US$12.4 trillion between 1995 and 2002, the peak year being 2000 which accounted for 26% of the total. Characterising the frenetic excitement was the amount devoted to pure "body businesses"; support services, media, and software. These in aggregate accounted for 34% of all activity. Aggressive investment bankers convinced clients of a supposed advantage in acquiring entire blocks of people rather than hiring the individual talents that typify these asset-poor enterprises. Only later has it become clear that the huge "goodwill" purchased is largely illusory and all that has been acquired is other people's problems.

Cross border capital flows are showing a similar pattern. Having peaked in 2000 at around 14% of world GDP they have evaporated. The diminished desire to invest in distant markets is reflected in the de-rating of emerging markets. From the frothy highs of 1994 when emerging markets had price earning ratios higher than the developed markets, they are now valued at just over half (PE relatives are about 55%).

The extravagances of the bubble can start to be measured by the spectacular level of **corporate busts**.

TOP BANKRUPTCIES IN THE US IN 2001/02 BY ASSET SIZE

COMPANY	BANKRUPTCY DATE	PEAK MARKET CAPITALISATIONS (US$ MN)
WorldCom	July 2002	162,980
Enron	December 2001	62,698
Global Crossing	January 2002	39,438
Pacific Gas & Electric	April 2001	15,527
NTL	May 2002	13,328
UAL	December 2002	12,328
Kmart	January 2002	11,198
Conseco	December 2002	10,570
Adelphia Communications	June 2002	7,410
Federal-Mogul	October 2001	4,000
Finova Group	March 2001	3,412
Reliance Group Holdings	June 2001	2,182

Source: BankruptcyData.co, Worldscope, Factset

The magnitude of these is well worth recording and all the more when viewed alongside those company's peak capitalisations (see table above).

Fortunately we have avoided these disasters and, in fact, benefited from some through our shorting activity. This also, incidentally, serves to underline the benefit of following our seemingly perverse disdain for popular stocks.

In the place of ultra-large mergers and corporate hubris there are now spectacularly **large rights issues**. The scramble for liquidity is clear. Led by yesterday's heroes, money is being demanded from unwilling pension funds and insurance companies who are in any case reviewing the wisdom of very large exposure to shares. We have managed to avoid most of these demands except in the case of the world's largest insurer Allianz which we unwisely bought too soon. Our cardinal error was to be influenced by the share's price collapse. This was foolish when set against the backdrop of general under-reserving by the insurance industry, the cavalier behaviour of the finance industry in general and, particularly our anticipation of the bear market and understanding of the effect of falling share prices on solvency ratios.

The big unresolved question now is where we are in this bear market. Investor psychology suggests that Europe and NE Asia are already well into the second phase of the negative appraisal of shares. The general talk is about **geopolitical risk, balance sheet rebuilding and corporate malfeasance.**

We have written before on the valuations found in Japan where the share prices barely match the value of cash in companies' bank accounts, without regard to the business value. In Europe, share values have declined to a level where dividend yields exceed the interest payment on Government guaranteed bonds.

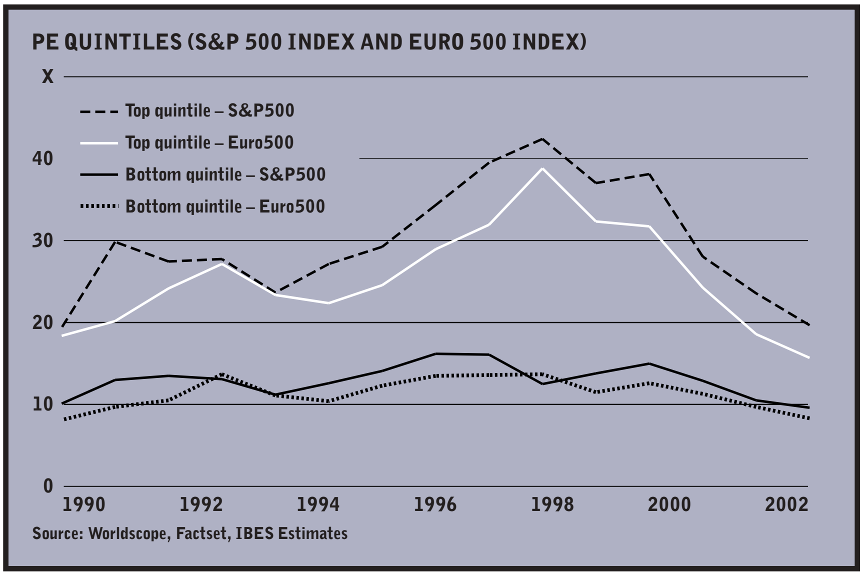
A good indication of the presence or absence of euphoria in markets is the variance of price/earnings ratios between high and low rated companies. As the accompanying table on the following page shows, the absurd excitements of the late 1990s have already given way to far more sober assessments.

Having said all this, shares in the US remain relatively highly valued. PEs are still above their long term average, balance sheets are often weak and no case can be made that the book keeping is superior. US consumers and businesses may show more responsiveness to cheap money than is likely elsewhere. But given the already very high level of debt and the low savings rate we are not convinced that monetary stimuli will lead to a rebound in corporate profitability sufficient to justify current ratings. The US remains our main arena for taking short positions.

FOCUS – ASIA

In the last three months we have visited Asia twice. We strongly subscribe to the view that the Eastern hemisphere will be the **strongest area of world growth** over the next few years.

Agricultural land and commodity prices in Europe collapsed in the latter part of the 19th Century following the opening up of the American west and, to a lesser extent, Australia and Argentina. As we have noted previously, the reduction of trade barriers and the rapid transfer of technology and capital to emerging economies is having similar consequences for labour employment in the developed world now, while at the same time



flooding it with goods at low prices. Russell Napier of brokers CLSA has written an excellent study comparing the emergence of China with that of the US in the latter part of the 1800s and Japan in the 1950s. The parallels he draws suggests that the opening of China will tend to depress labour and land costs in the developed world. Simultaneously the improvement of Chinese living standards will tighten the supply of various raw materials and raise urban land values in China. Russell sees China as being at a similar level of per capita commodity consumption as the US in 1910 and Japan in the 1950s. He argues that in a fiat money system, the emergence of a relatively resource poor nation is likely to produce commodity price inflation.

We have no argument with Russell's view. Interestingly, the economic take-off of Japan in the 1950s coincided with very high levels of mining exploration and development although this is not apparent today. Studies by the auto majors corroborate the view about commodity usage and show how once incomes per head exceed US$2,500 to $3,000, automobile consumption grows at an accelerating rate. Several of China's coastal provinces are now in this position and vehicle production is already past three million per annum. In general, Australia seems well placed on account of the prospects for its commodity exports and, most importantly, the relative weak prices of its imports ie. improving terms of trade. A big surprise may be an explosive rise of mainland Chinese travelling abroad.

Yes, China is the favourite for the moment and we cannot find much that will get in the way of this juggernaut. Our recent visit avoided the normal rounds of Beijing and Shanghai as we sought out multinationals, local officials and emerging entrepreneurs in other locations.

To distil our observations to a few sentences is difficult. The sheer size of China and its population makes the comparison with other emerging markets misleading. We are witnessing **the transformation of over one fifth of the world's population from a totalitarian, command regime to a much more mixed economy.** The desire and ability to leapfrog patterns established by other emerging economies is breathtaking. Increasingly the old brigade are tolerated rather than revered or even feared. Regional governments are vying amongst themselves to attract new foreign investment secure in the knowledge that this will bring them popularity and wealth. This competition is helping to expedite approvals and to reduce opacity.

For good ideas money always seems available, be it from the State banks, State Owned Enterprises, State and municipal governments, and more informal groupings. It is striking that long term funding is available at a floating rate of only 4.5% pa. **Competition is extremely fierce.** As soon as a new idea or product takes off, imitators pop up, showing little regard for trademarks or intellectual property.

It is seldom clear who is the true beneficial owner in many of the recent success stories. The share register does not always tell the full story as various front-men masquerade as owners. Interests seem to be shuffled among the participants in an endless choreography but invariably there are politicians at local or regional level who share in the action.

For this and other reasons one sensed that we were visiting *chaebols* in the making.

We were often surprised at the relatively small labour forces we encountered. Far from relying on low labour costs alone, we found many examples of highly sophisticated industrial solutions that one would normally have expected in the West. Assembly line workers, making say TVs, cars, motorcycles or heavy earthmoving tractors, typically earn around Rmb 1,000 to 1,400 per month (US$120 to $170) - depending on whether housing is supplied. It is standard practice for a free canteen lunch to be given.

The **theft of intellectual property** is a major problem for foreign firms. Lucent is a stark example of this. Having initially come to China to supply telecommunications equipment, they soon encountered local imitators who both undercut prices and responded far faster in developing new applications. In order to compete they have had to go deeper into the lion's den and have established some of their leading R&D labs in three mainland cities. Far from being a market to be sold to, China is now an integral part of Lucent's global research and procurement network. The fact that China is fast developing into the biggest market for some products puts many foreign firms in a similar dilemma: how to participate in one of the few large and growing markets and yet not lose one's know how. Speed of response, low manufacturing costs and market flexibility all contribute to the leapfrogging process noted earlier. The rule of thumb is that capital costs of setting up in China are about 50% of western costs!

For all the positive aspects of change taking place, one should not underestimate the immense problems the country faces. These include a growing income differential between the coastal areas and the interior, problems with education, health, water supply, influence-peddling and so on. Our assessment is that these are all the ingredients for major booms and busts as unbridled optimism takes its toll. The energy the present transformation is unleashing, following on from nearly two decades of strong growth will surely lead to periodic over-estimations of demand. Should over-production, possibly on a massive scale, lead to dumping overseas, the flow-on effects could be spectacular.

Will we be able to make money out of China? The answer is far from clear. However, our work so far has given us some keen insights into what to avoid and who may be well placed. Imports of sophisticated equipment are still clearly on the rise where local sources have not as yet mastered the technology. Commodities and fashion goods should also be fertile areas.

Conclusion

A combination of a weak investment cycle and over-stretched consumers in the Anglo Saxon countries is likely to suppress economic growth. Companies may continue to face pressure on prices even as costs keep rising. However, in Asia and Europe at least equity valuations look to have over-discounted this unpromising background.

It would be surprising if positive news on the Iraq war does not lift some of the gloom in share markets. Rather further ahead we anticipate continued strong volatility. We suspect, though, that the worst of the sell-offs are behind us so expect an upward if jagged trend.

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