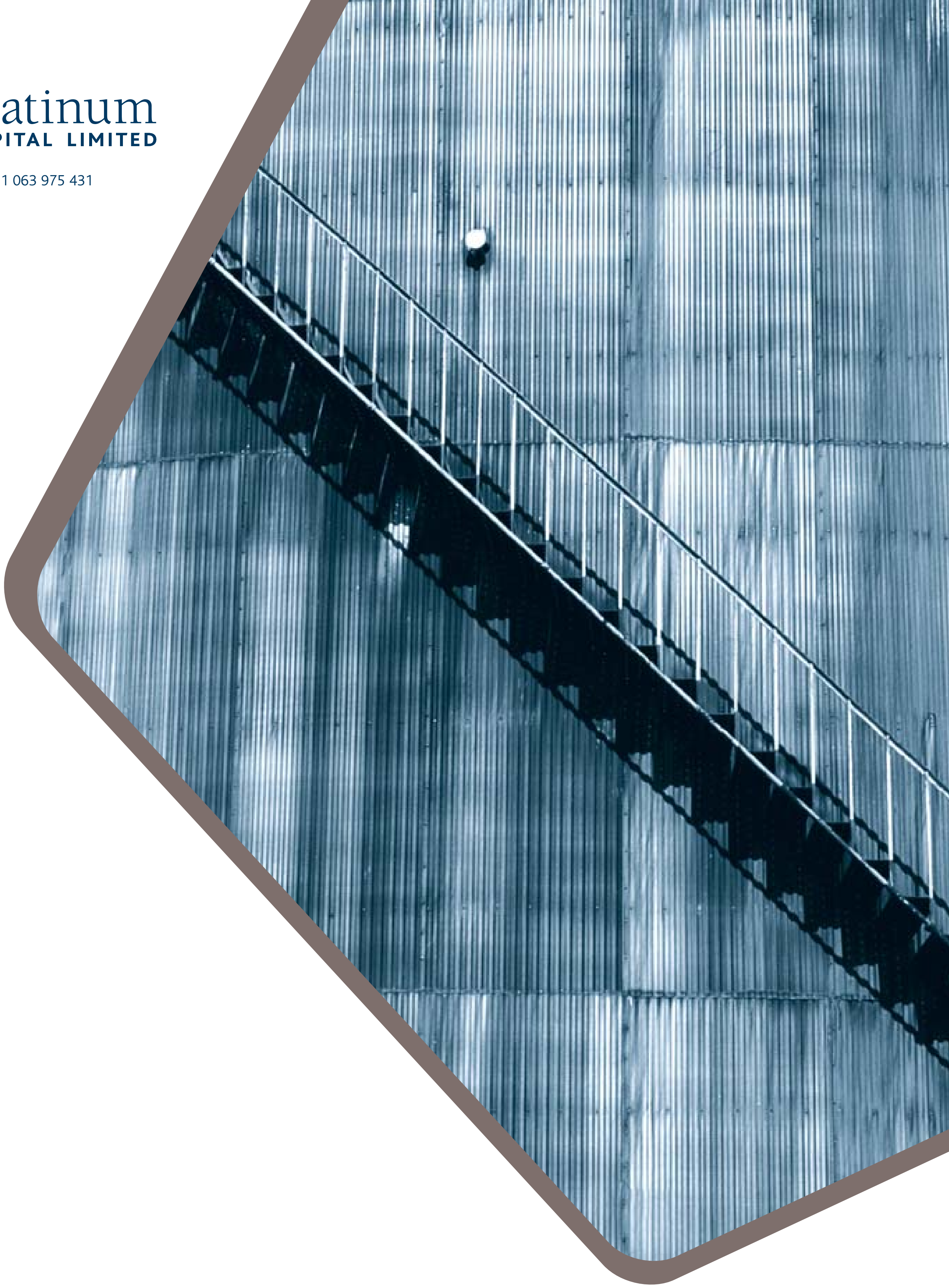
Platinum
CAPITAL LIMITED

ABN 51 063 975 431



Platinum Capital Limited Quarterly Report

30 September 2004

PERFORMANCE

There was a strange divergence in the behaviour of markets in the face of concerns about faltering growth over the quarter. Some countries one would imagine would be adversely affected, like Hong Kong and Australia, made gains of around 5% in Australian dollars. By contrast Japan fell a full 11%. Perhaps it was consideration of the adverse impact of higher oil import bills, but why then did India, Indonesia and Brazil, each of whom is in oil deficit, rise by 10% or more? Valuations, liquidity, and an acceptance of the growth prospects of these smaller economies are the best explanations we can offer. The other large traditional markets were flat or slightly lower. This resulted in the MSCI being weak for the quarter at -4.4%.

Movements within industry sectors seem easier to explain. Energy was the star performer, up over 5%, while IT trailed at minus 13%. IT suffered in particular from concerns of stock accumulation on weak sell-through of flat TV screens and mobile handsets. As has become a feature of the present environment, some sectors that would normally have been protected by their defensiveness, such as health care and consumer staples, were adversely affected by special circumstances. For example, there were profit warnings from Coke, Colgate, Unilever and Nestlé as they battled for shelf space against own-label brands in a fast changing environment, a problem we have identified in several earlier reports. The major drug companies also had a variety of product disappointments and recalls, driving big names like Merck and Pfizer down to between 60% and 40% of their peak levels.

There has also been a strange phenomenon of PE compression. CSFB has found that the dispersion of PEs for 19 of the 26 sectors globally are at historically narrow levels which implies that investors are unwilling or unable to differentiate between the companies in these industries with good prospects and those facing a more problematic outlook.

Within this rather unpredictable environment, the Company's performance has been acceptable, beating the MSCI marginally over the quarter although still declining by 3.7%. For the year, the Company is up 9.4%.

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

NET ASSET VALUE (CPS)	
31 JULY 2004	168.27
31 AUGUST 2004	167.94
30 SEPTEMBER 2004	167.96

Source: Platinum

SHORTING

With our large exposure to growth sensitive Asia, we believe it prudent to maintain downside protection in a highly uncertain commercial environment. Year to date, however, shorting has done us little good. We have periodic wins such as the sell-off of Fannie Mae in response to accounting issues, but our positions against the other financials have as yet failed to be profitable.

MSCI ALL COUNTRY WORLD INDEX INDUSTRY BREAKDOWN (A$)

SECTORS	QUARTER	1 YEAR
ENERGY	5.2%	29.2%
MATERIALS	2.8%	19.6%
UTILITIES	0.9%	14.1%
TELECOMMUNICATIONS	-1.6%	9.1%
FINANCIALS	-3.3%	9.2%
INDUSTRIALS	-4.1%	13.3%
CONSUMER DISCRETIONARY	-6.4%	7.4%
HEALTH CARE	-6.9%	1.5%
CONSUMER STAPLES	-9.6%	2.0%
INFORMATION TECHNOLOGY	-13.5%	-5.2%

Source: Bloomberg

CURRENCY

We are finding it difficult to read the markets at present. The Japanese yen has been remarkably sluggish for the currency of a country that is generating a current account surplus of 4% of GDP pa. If the lull in growth has passed, as we believe, the yen should appreciate unless we are under-estimating the market's worries about the deterioration of Japan's terms of trade ie. strong energy and commodity prices relative to manufactured goods. Our currency disposition has barely changed.

CHANGES TO THE PORTFOLIO

The resource sector has been particularly volatile. In our usual search for undervalued companies we were tempted into **Yukos**, the privatised Russian oil giant, after a 30% decline in its share price following the arrest and imprisonment of its principal shareholder. Fortunately we took only a small stake and as soon as it became clear that the attack on the company was due more to political than commercial consideration, we cut our losses and slunk away with relatively minor wounds.

On the contrary, our response to dull news from **Shell** has been to use moments of price weakness to add to our holding. The issue of classification of its hydrocarbon reserves, while disappointing, will have limited impact on the longer term value of this company, though it reveals a certain muddling of priorities. We remain attracted to its natural gas deposits, at the current level of oil and gas extraction of 1.5 billion boe pa it has extractible resources to last 40 years.

Brascan, the Canadian listed parent of another of our resource holdings Noranda, has chosen a suitor for its subsidiary as it continues its course of vacating the sector. **Noranda** has been given a Chinese government sponsored mining trading company as its preferred negotiating partner. We are a little apprehensive that in its eagerness to reshuffle its portfolio, Brascan will settle on a MIM-style cheap sale but to date it has been a good investment benefiting from strong nickel and copper prices.

We used a run-up in share prices to restructure our gold share holdings in favour of lower cost producers. We sold Harmony and reduced our commitment to Gold Fields in favour of **Anglogold, Newmont and Barrick**.

Among new additions are IMC Global, Carrefour and Fuji Electric. **IMC Global** found itself at the bottom of the fertilizer cycle after a hectic debt funded expansion programme and in its weakened state was forced to accept a merger proposal with Cargill. The latter is one of the world's great private agricultural companies and has injected its fertilizer production and distribution business into the new entity. The positional strength of the merged entity, together with Cargill's proven management, should ensure that these excellent underlying assets are optimised in the present up-cycle.

Carrefour is a fallen angel. Its rating has deteriorated dramatically since the late 1990s after it experienced its first earnings setback following years of successful expansion at home

BREAKDOWN OF COMPANY'S LONG INVESTMENTS BY INDUSTRY (% OF ASSETS)

CATEGORIES	EXAMPLES OF STOCKS	SEP 2004	JUN 2004
CYCLICALS/MANUFACTURING	TOYOTA MOTOR, SCHINDLER, SIEMENS, LINDE, OCÉ	24%	21%
FINANCIALS	CREDIT AGRICOLE, MITSUBISHI TOKYO FINANCIAL, MITSUI SUMITOMO INSURANCE, NORDEA	16%	16%
CONSUMER BRANDS	HENKEL, ADIDAS SALOMON, LOTTE	9%	8%
MEDICAL	TAKEDA, SCHERING, NOVARTIS, MERCK KGaA, GLAXOSMITHKLINE	8%	8%
TECHNOLOGY/HARDWARE	AGERE, INFINEON TECH, SAMSUNG, AMD, SUN MICROSYSTEMS	8%	9%
RETAIL/SERVICES/LOGISTICS	VEOLIA ENVIRON., DEUTSCHE POST, HORNBACH, MITSUBISHI CORP	8%	8%
GOLD AND OTHER RESOURCES	SHELL, BARRICK GOLD, NEWMONT MINING, GOLD FIELDS, NORANDA	7%	7%
SOFTWARE/MEDIA	SKY PERFECT COMMUNICATIONS, SEOUL BROADCASTING, NEWSCORP	6%	7%
TELECOMS	ALCATEL, NTT DOCOMO	4%	5%

Source: Platinum

DISPOSITION OF ASSETS

REGION	SEP 2004	JUN 2004
WESTERN EUROPE	31%	31%
JAPAN	29%	30%
EMERGING MARKETS (INCLUDING KOREA)	15%	13%
NORTH AMERICA	14%	13%
AUSTRALIA	1%	2%
CASH	10%	11%
SHORTS	35%	34%

Source: Platinum

and abroad. The worry at the moment is the loss of market share in France which still accounts for half of the group's sales and more of its profits. However, by devolving a greater share of influence back to the hypermarket and supermarket managers and by fundamentally changing the emphasis of the buying department, we believe this home market base will stabilise, albeit on slightly lower profit margins. As a useful offset we can expect continuing good growth from expansion in Latin America and Asia, including China. This is still a wonderfully profitable company and earnings per share have grown each year, barring 1999, to yield a trend rate of 15%.

COMMENTARY

As the quarter progressed, it became evident that markets were seeking confirmation that economic growth was not about to peter out. Valuable signals were given by world bond markets where yields drifted down, signalling a world where inflation risks were remote and growth scarce or fleeting. Commodity prices, excluding oil which has its own peculiarities, were mixed with grains being weak in response to strong North American harvests, while metals were generally firm. The two leading engines, the US and China, gave off conflicting signals. By the close of September the view had formed that there was an easing in credit conditions for large Chinese corporations who through the kerb market were then able to ameliorate the funding shortages of smaller private companies. Bonds corroborated the positive growth interpretation by weakening in price.

We spent some time in Japan during September. Prior to any of these visits, where we meet with senior representatives of twenty or more companies, there are several weeks of intense activity. This is directed at identifying key variables to help us understand whether or not there is a gap in the market's assessment of a company's position and prospects. Brokers' analysts can assist to some extent but invariably it is the meeting with the company that seals our opinion. On this occasion we were focusing on new technologies, in particular hybrid drive systems, photovoltaic (PV) cells, energy storage systems, light sources and fullerines. **In each of these areas Japan is the undisputed world leader in terms of development and mass production.**

While there are endless references to the frailties of the Japanese economy, remarkably little attention has been given to the unremitting commitment to greater R&D spending throughout this post-bubble period. So much so that the country ranks second only to Sweden in terms of the proportion of its economy so engaged. The accompanying two graphs are quite illuminating in terms of trends and sources of funding. Thus of global expenditure on R&D totalling some US$760 billion, the US accounts for 38%, the EU 26% and Japan 14%, with a notable preponderance of funding by industry in Japan versus some other major industrial countries.

We explored with some enthusiasm the progress Toyota has made with its petrol/electric hybrid drive system found in the *Prius* model. As noted in our March review, this led us to examine tangential opportunities regarding drive systems and energy storage. For example, one of the problems Toyota has faced in giving an eight year guarantee for the battery of the *Prius* is the need to over-specify size to ensure it stands up to a large number of recharge cycles. A recent discovery, together with clever current control software, may soon obviate the need for such over-engineering. A Japanese development team has discovered a way to **produce a power storage device that combines the storage capacity of a battery yet can accept and dispense power in the manner of a capacitor**. As it is a non-chemical reaction the cycle life is exceptionally high and because of its high

COMMENTARY continued

power-taking characteristics it could allow the capture of as much as 80% of regenerative power created when the vehicle (or other moving conveyance) brakes. As always there are some trade-offs, one being cost and the other being the 30% greater size over a traditional lead-acid battery. Should this development live up to its promise and achieve cost reductions from the application of mass production techniques its use could displace present battery technology – to the considerable benefit of its two listed backers.

Another area that has fired our imagination is the use of solar power. At present it is a hostage to subsidies. In green conscious countries, such as Japan and Germany, consumers are guaranteed a payback via receipt of high rebates when they feed domestically generated photovoltaic power into their local grids. These subsidies are gradually dropping but there is no sign of interest flagging.

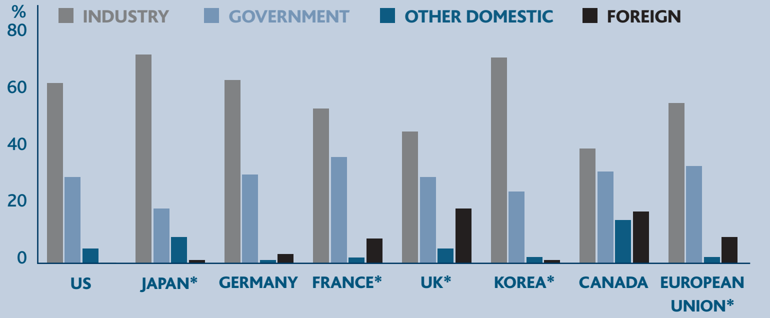
For a sense of scale, current world production of solar cell modules, in terms of nominal electrical producing capacity, is 744 MW, which is equivalent to three quarters of the capacity of a medium sized power station. The latter would typically operate for 350 days at say 16 hours a day, to produce 5,600MWh of electricity per year. By contrast a typical 3 kW unit sold to householders in Japan, costing about US$20,000, weighing 300kgs and covering an area of 5 by 6 metres, is expected to *function for an average of 3 hours per day* to produce 3000 kWh a year or about *70% of average annual householder consumption* in that country. With an electricity fee of Yen 23 the payback is about 20 years while the installation's life is as much as 100 years.

The two important variables are sunshine and conversion efficiency. The latter is normally around 15 to 18% with Sharp, the world's biggest producer, projecting gradual improvements in efficiency and manufacturing costs. Even with these handicaps, PV demand is growing very strongly at perhaps 30% pa. The polysilicon crystal, which acts as the photon-absorbing substrate of these electron generators, is presently in short supply with the PV industry currently accounting for nearly as much demand as the semiconductor industry.

We can't know that Sharp will hold its lead in this race but it is generally acknowledged that *manufacturability* is the key to reducing the cost of this energy source. Giving comfort is the fact that Sharp is nearly three times the size of each of the next three largest players, Kyocera, Shell solar and BP solar and has achieved improving margins in its PV division over the last few years.

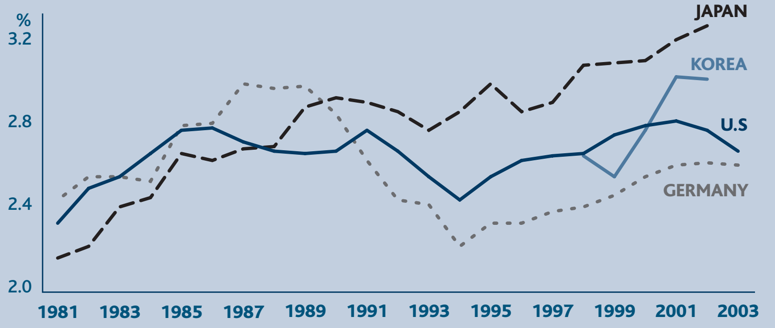
To lead us back to where we started, Japan has a wealth of these technologies. Investors are often critical about the apparent low economic pay-back but our view is that with so many industries becoming commoditised by emerging market competition, holders of such differentiating technology should be more favourably rated. Simple PEs do not describe the depth of a company's resources and often mask the creation of longer term competitive advantages. How, for example should we evaluate Toyota? In terms of PEs it is more expensive than GM, its larger rival, but Toyota outspends GM on R&D by 1.6 to 1 and has demonstrable technical superiority. Leading Japanese companies remind us of the

R&D EXPENDITURES BY COUNTRY AND FUNDING SOURCE, 2002
(% OF TOTAL R&D)



Source: OECD Main Science and Technology Indicators, 2003, *2001 data

TOTAL NATIONAL R&D AS A PERCENTAGE OF GDP, 1981-2003



Source: National Science Foundation, National Patterns of R&D Resources and OECD, Main Science and Technology Indicators building period of the US multi-nationals of the 1960s and 70s: far from being profligate, we see these companies laying some good foundations for future growth.

We have noted before the transformation of the balance sheets of large Japanese companies as profits return to previous peaks and as capex has been reined in. At the same time there has been a great deal of corporate activity as companies have eliminated their minorities in subsidiaries and have swapped divisions to consolidate activities among fewer players. We have identified US$67 billion of these transactions among industrial companies since 1998 on top of US$175 billion of financial sector transactions.

The short term risk for Japan, and for that matter our portfolio, is the behaviour of the Chinese economy. By resisting an upward movement of its currency and recycling funds into US$ assets, principally bonds, the Chinese authorities are limiting their options.The easing of credit controls should remove the danger of the slow-down turning into a rout. The **remaining concerns will be exchange rates and energy prices**. All we can add on the former is that although it is becoming popular to regard Asia as some sort of US$ block, these things often only seem so until the subtleties expose themselves. Our currency position reveals our skepticism.

The other worries weighing on markets are oil and gas prices. The loss of tax breaks this quarter in the US and the extra cost of winter heating will impair discretionary spending power. Continental Europe continues to plod, though there have been some surprisingly positive developments in France. We see growth remaining subdued, inflation very mild and the cost of money likely to stay low enough to bolster spluttering activity.

CONCLUSION

China is likely to be foremost in investors' appraisal of the investment scene. Our reading is that concerns about growth are receding which is highly beneficial for Asia and commodities. The hope is this will allow for more balanced growth globally although there may be risks on the currency front There has been a clear de-rating of equities in general which we consider quite appropriate in view of the uncertain background.

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