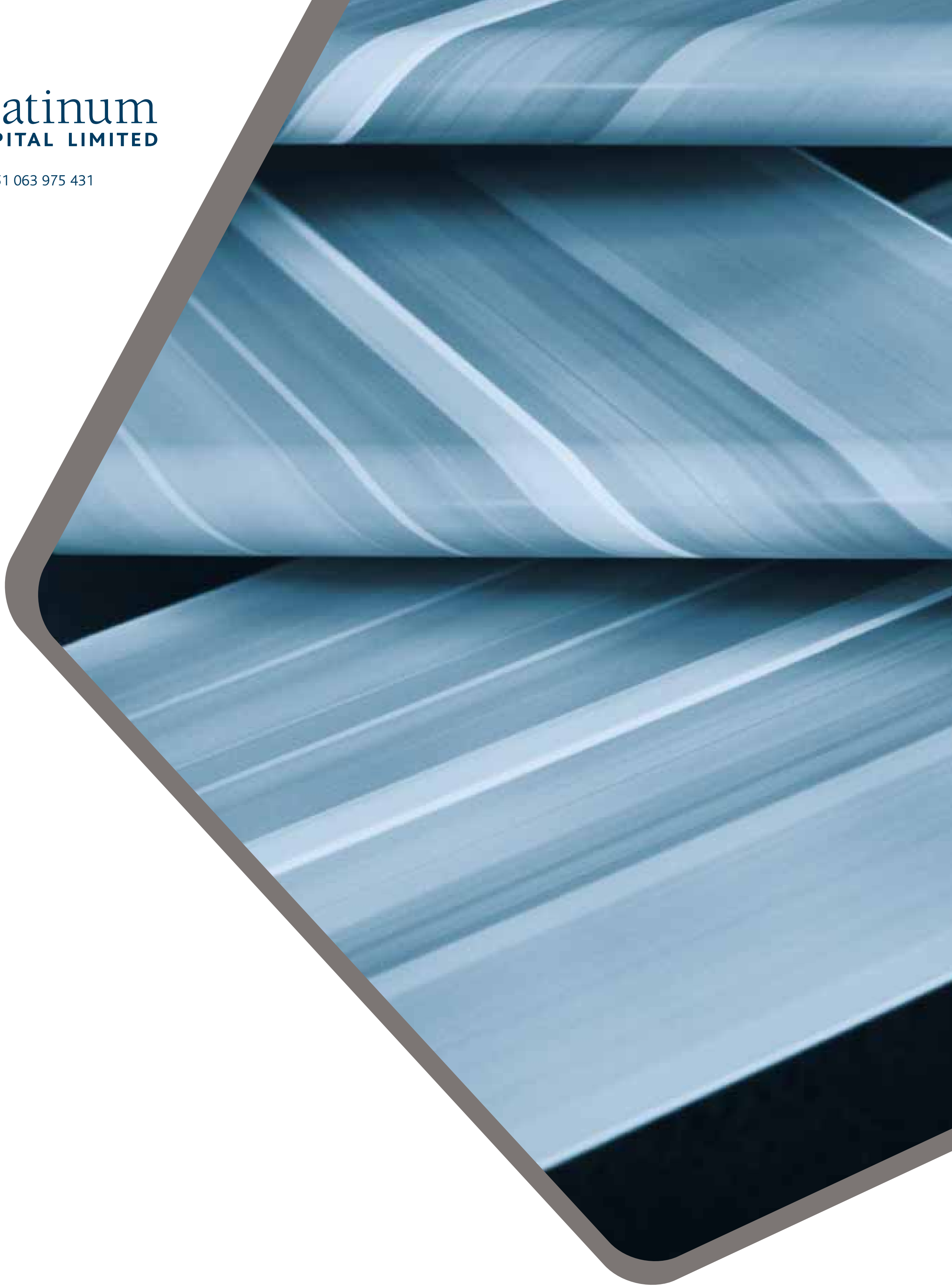
Platinum
CAPITAL LIMITED

ABN 51 063 975 431



# Platinum Capital™ Limited Quarterly Report

## 31 March 2005

## PERFORMANCE

This was a very dull quarter for the major markets. There was little movement over the period as a whole and low volatility from one week to the next. Energy was the only sector to achieve any worthwhile gains. There were better returns to be had in emerging markets but the best gains were in the smallest centres such as Cairo and Karachi. Overall, the MSCI in native currency terms rose by only 0.2%, translating to a gain of 0.4% in Australian dollars.

On a twelve month view, those parts of the market that benefit most from strong growth, such as energy, materials and industrials, outperformed by a big margin with the rest of the field well behind. The conspicuous exception was utilities, which developed strength from an oversold base. Information technology was the one sector to record a decline year on year.

It is not too surprising, with this background, that Platinum has been going through a sluggish phase. Some of the shares we have bought during the last six to nine months are still priced close to our entry levels. Good profits in some emerging markets, such as India and Korea, have been offset by negative returns from sectors such as technology and biotechnology.

Platinum's investment philosophy is to seek quality, price-setting companies with unique positions, good brands or technological leadership. The market has recently been derating companies of this sort and, in the process of seeking outperformance through risk, has been favouring smaller, less well-established and more volatile counters. We believe this is driven by short-termism which will be punished eventually, particularly as interest rates rise to more "normal" levels. We remain focused on quality and, so long as the companies' underlying business continues to perform as anticipated, we have been using relative price weakness to add to positions.

**MSCI WORLD INDEX** INDUSTRY RETURNS (A$)

| SECTORS | QUARTER | 1 YEAR |
|---|---|---|
| ENERGY | 12.7% | 34.4% |
| MATERIALS | 2.8% | 17.7% |
| UTILITIES | 2.3% | 18.5% |
| CONSUMER STAPLES | 1.7% | 5.8% |
| INDUSTRIALS | 1.2% | 14.7% |
| HEALTH CARE | -0.2% | 3.6% |
| CONSUMER DISCRETIONARY | -2.8% | 5.6% |
| FINANCIALS | -3.2% | 5.5% |
| TELECOMMUNICATIONS | -4.7% | 7.4% |
| INFORMATION TECHNOLOGY | -4.9% | -6.3% |

Source: Bloomberg

Even so we are disappointed with the Company's performance. We gained 1% pre-tax for the quarter, slightly more than the MSCI Index, but trailed the MSCI over the last 12 months by 4.3%.

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

**NET ASSET VALUE** (CPS)

| | |
|---|---|
| 31 JANUARY 2005 | 160.96 |
| 28 FEBRUARY 2005 | * 158.46 |
| 31 MARCH 2005 | * 159.28 |

* After provision for a 5 cent interim dividend paid 4.3.05.

Source: Platinum

## SHORTING

The various financial stocks that we have sold short are at last responding to bad news. Most of our positions are in companies that will suffer as short term funding costs rise. Superficially they look cheap but on account of their vulnerability to a steepening yield curve, many will fail to meet the market's earnings expectations. In addition, revelations about phoney insurance underwriting is starting to work for our insurance company shorts.

## CURRENCY

We may be entering another period of turbulence. The reversal of carry trades ie. borrowing low interest cost and devaluing US dollars to fund leveraged investments, seems to be buoying the US dollar. On fundamental grounds we have difficulty in shifting our negative stance on the US dollar and thus remain principally hedged into yen and euros. This position will be kept under close surveillance.

## CHANGES TO THE PORTFOLIO

Clients will know that we have been keen protagonists of both India and Korea but, as excitement built to a crescendo in March, we reduced and consolidated our positions in those markets. Out went highly successful holdings like Korea Electric Power, Jaiprakash (Indian civil engineering and hydro power) and some banks, while positions in ITC (consumer products) and NTPC (power generation) were increased.

In Japan we sold Ajinomoto on account of a disappointing follow through to Lycine price increases and Nippon Sheet Glass after a very strong share price advance. We also added to our existing holdings in financials and introduced Mitsubishi Heavy Industries and IHI who should both see a further improvement in their operations and benefits from greater investment spending.

In North America we added to Noranda, Mosaic, Newscorp, Foundry Networks, and Pfizer and Merck, as the price of each had dipped throughout the quarter. There was very good news from Noranda in that the planned trade sale by its holding company Brascan was shelved and Noranda is now acquiring the outstanding shares in Falconbridge Nickel that it does not own. This is a transformational deal that substantially increases the company's worth, and in an environment where the large cap miners are no longer cheap, offers investors a large cap alternative which is about to benefit from the tightening supply in zinc and aluminium.

In Europe, many existing holdings were increased, while Merck KGaA was reduced after considerable price strength on the back of its liquid crystals leadership and success with Erbitux (anti-cancer drug). Ericsson was re-introduced after price weakness as we remain enthusiastic about telco capital spending and the company's insufficiently recognised strength in Internet Protocol (IP) Ethernet multiplexing.

**DISPOSITION OF ASSETS**

| REGION | MAR 2005 | DEC 2004 |
|---|---|---|
| WESTERN EUROPE | 31% | 31% |
| JAPAN | 28% | 28% |
| NORTH AMERICA | 18% | 18% |
| EMERGING MARKETS (INCLUDING KOREA) | 13% | 16% |
| CASH | 10% | 7% |
| SHORTS | 32% | 31% |

Source: Platinum

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

| CATEGORIES | EXAMPLES OF STOCKS | MAR 2005 | DEC 2004 |
|---|---|---|---|
| CYCLICALS/MANUFACTURING | TOYOTA MOTOR, SCHINDLER, SIEMENS, LINDE, OCÉ | 27% | 27% |
| FINANCIALS | CREDIT AGRICOLE, MITSUBISHI TOKYO FINANCIAL, MITSUI SUMITOMO INSURANCE | 15% | 17% |
| RETAIL/SERVICES/LOGISTICS | CARREFOUR, DEUTSCHE POST, HORNBACH, MITSUBISHI CORP | 9% | 7% |
| CONSUMER BRANDS | HENKEL, ADIDAS SALOMON, LOTTE | 8% | 10% |
| MEDICAL | TAKEDA, SCHERING, MERCK KGaA, GLAXOSMITHKLINE | 7% | 8% |
| TECHNOLOGY/HARDWARE | AGERE, INFINEON TECH, SAMSUNG, AMD, SUN MICROSYSTEMS | 7% | 8% |
| GOLD AND OTHER RESOURCES | SHELL, BARRICK GOLD, NEWMONT MINING, NORANDA | 6% | 6% |
| SOFTWARE/MEDIA | SEOUL BROADCASTING, NEWSCORP | 6% | 6% |
| TELECOMS | ALCATEL, NTT DOCOMO | 5% | 4% |

Source: Platinum

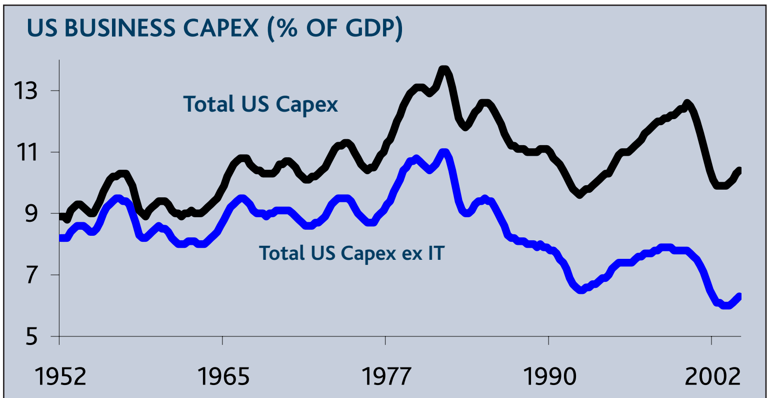
# COMMENTARY

"Reflexivity" as a financial concept, popularised by Mr George Soros, considers the relationship between an idea dreamt up by the market and the influence that idea has, reciprocally, on the market. One moment it may be technology or information, the next inflation or deflation, at present it is China. Someone says how important a thing is, then we all tell each other how important it is, then we move on to the next thing. How far each idea will shift absolute and relative prices before it is superseded by the next idea is unknown and unknowable.

Here at Platinum we recognise at present three themes. Understanding as we do the unreliability of "reflexivity" we will not bet the farm on any of them but they are certainly contributing to our directional bias. These themes are that the high level of debt in the Anglo-Saxon countries will be ultimately deflationary; that we are in the early stages of a prolonged capital spending cycle world-wide; and that Asian markets are more interesting than western markets.

The infusion of liquidity by the Federal Reserve Board, and the reciprocal currency intervention by many central banks in Asia, have worked relatively well to rejuvenate activity but at the cost of global imbalances. US consumer spending has responded to tax breaks and to the lower cost of debt. As these and other influences have washed into property values there have been further rounds of leverage that have spurred on spending and built consumer confidence. At the same time, in their search for yield, those with savings are increasingly placing their hopes in the miraculous activities of some 8,000 hedge managers who will somehow each provide them with superior returns at no extra risk. (For this unusual offer, an estimated US$25 billion of fees were extracted in 2004!) Hence too, the excited chatter in the art world about a new breed of moneyed art aficionados. Hedge fund activity in turn is influencing the relative pricing of bonds and equities, both in terms of developing versus developed markets and within markets: for example, there has been a clear narrowing in valuations between fast-growing businesses and dull price-takers. We believe that this debt frenzy entrains a circular motion that ultimately will be buried under its own weight. Higher interest rates will gradually reveal the full extent of leverage and of carry trades and this will result in credit impairment and loss. The deflationary force alluded to comes from the ultimate need to retard consumption, which is usually forced rather than chosen, and arises from debt and asset liquidation. If you have difficulty in envisaging this consider that Japanese property prices have been declining for 14 years and are only now stabilising. The low rating of many financial shares in the US and UK suggests that this view is shared by at least some market operators but we suspect the damage will be more severe than is presently priced into capitalisations.

The second long-term theme, the prospect of a strong, long capital spending cycle, stems from the influence of supply-side economics. With concepts like privatisation, user-pay and so-called "shareholder value", there has been a marked tendency towards short-termism and under-investment. Throughout the 1990s, management faced a constant barrage of advice or rebuke from the fund management industry to sweat their assets and balance sheets. Even the redoubtable Japanese and continental Europeans, who failed to participate in the self-enrichment programme of lazily priced options, nearly succumbed to the siren call of this new paradigm. The bursting of the dot com bubble was their salvation. Today there are innumerable industries suffering from under-investment, ranging from infrastructure to public services to heavy manufacturing. The newspapers here and abroad are crammed with reports of public services short-comings but perhaps the more surprising data relates to the private sector. As you can see from the accompanying chart, expenditure by US businesses on fixed assets, excluding information technology, is at a fifty year low. Some of this is probably structural, determined by the changing mix of activity in the economy, but, nevertheless, we draw the conclusion that it is below trend. This same pattern applies to Europe and Japan although the figures there are less dramatic.



Source: BEA

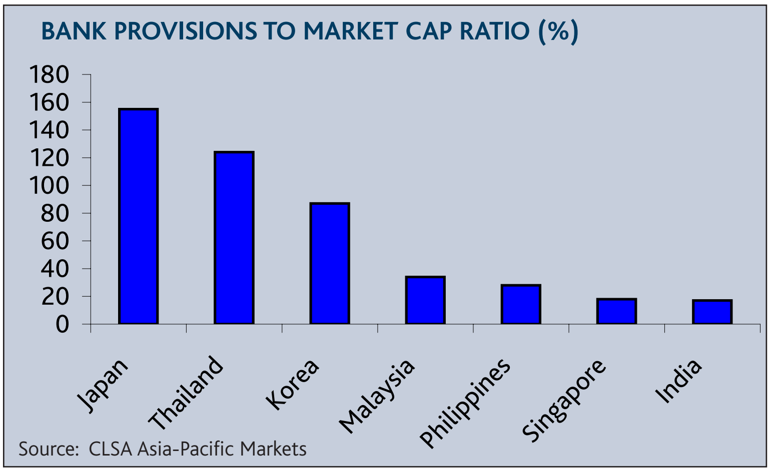
This raises the prospect that growth in many economies will be significantly skewed towards capital works and away from the consumer. We have already seen the spectacular boom in shipbuilding, with tonnages completed in 2003 at record levels and expectations of more to come. Order books in mid-2004 for tankers were at a 30 year high of 1,261 vessels, equivalent to 88 million dwt (dead weight tonnes), while container vessel orders stood at 723 vessels, equal to 39 million dwt. Ports including Liquefied Natural Gas compressing and receiving terminals and rail are likely to be the next big thing, together with the resuscitation of power grids. This is before core industries, which have been spending less than their depreciation, find reason to modernise.

Many economies in Asia will follow the opposite pattern. It is now eight years since foreign lenders pulled the rug from under them, causing devaluations and reduced consumption. Total external debt for "developing Asia[1]" has remained pretty flat at around US$700 billion, while the growth of exports has allowed external debt servicing to nearly halve to 8.9% of total exports and external financial reserves to more than triple to US$850 billion. With their banks in sound order, local credit is expanding to assist domestic demand, and contrary to the belief of some, we suggest a slowing in the west will not cause a recession in developing Asia. Our view is based on the strong growth of inter-regional trade, highlighted last quarter, and the fact that exports of many of the low cost items to the west will barely slow given the removal of textile quotas and the like.

Of particular interest is the heavy-weight of the region, Japan. Virtually on the day that General Motors announced further market share loss and a profit down-grade, which caused the market to ponder its debt rating, Toyota released new SUV models powered by 3.3 litre petrol engines and twin rear-wheel electric motor drives. These all-wheel drive vehicles achieve fuel economy twice as good as that of a standard vehicle in this category. This is attractive in itself but of far more significance is the revelation of the technical lead the world's number two auto producer now has over all-comers, including the German producers. One can cite similar technical leads by a host of other Japanese companies. Two quarters ago we noted that Japan has increased its research and development spending steadily since the bubble burst and now allocates 3.3% of GDP in this way. We remind clients again that this commitment to the long term has a value that is ignored by crude measures such as return on equity or price earnings ratios.

Furthermore, the lingering fear about the Japanese banks may be overdone. Work done by Credit Lyonnaise Securities Asia (CLSA) suggests that the accumulated loss provisions taken since 1993, together with prior provisions, represent 155% of the current market capitalisations of Japanese banks. The boom was crazy but with property prices now recovering in core locations, the scale of provisions gives a hint of the potential write-backs that may in due course be experienced. Note the accompanying chart and the scale of the Japanese provisions compared to Thailand and Korea following the 1997/98 bust.

[1] Asia accepting Japan, Korea, Singapore and Taiwan.




## CONCLUSION

More attention is now being paid to the prospect of further rises of interest rates. This seems to be causing an unwinding of US dollar funded asset plays, the repayment of which is giving support to the US currency. This may be the beginning of a bottoming of that currency although a lot will depend on the relative economic growth of the principal trading blocks. Once risk is given more emphasis there will be an adverse affect on recent investor favourites, namely emerging markets, smaller capitalisation companies and sub-prime debt. Conversely, it should presage a greater emphasis on high quality, larger, global companies.

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