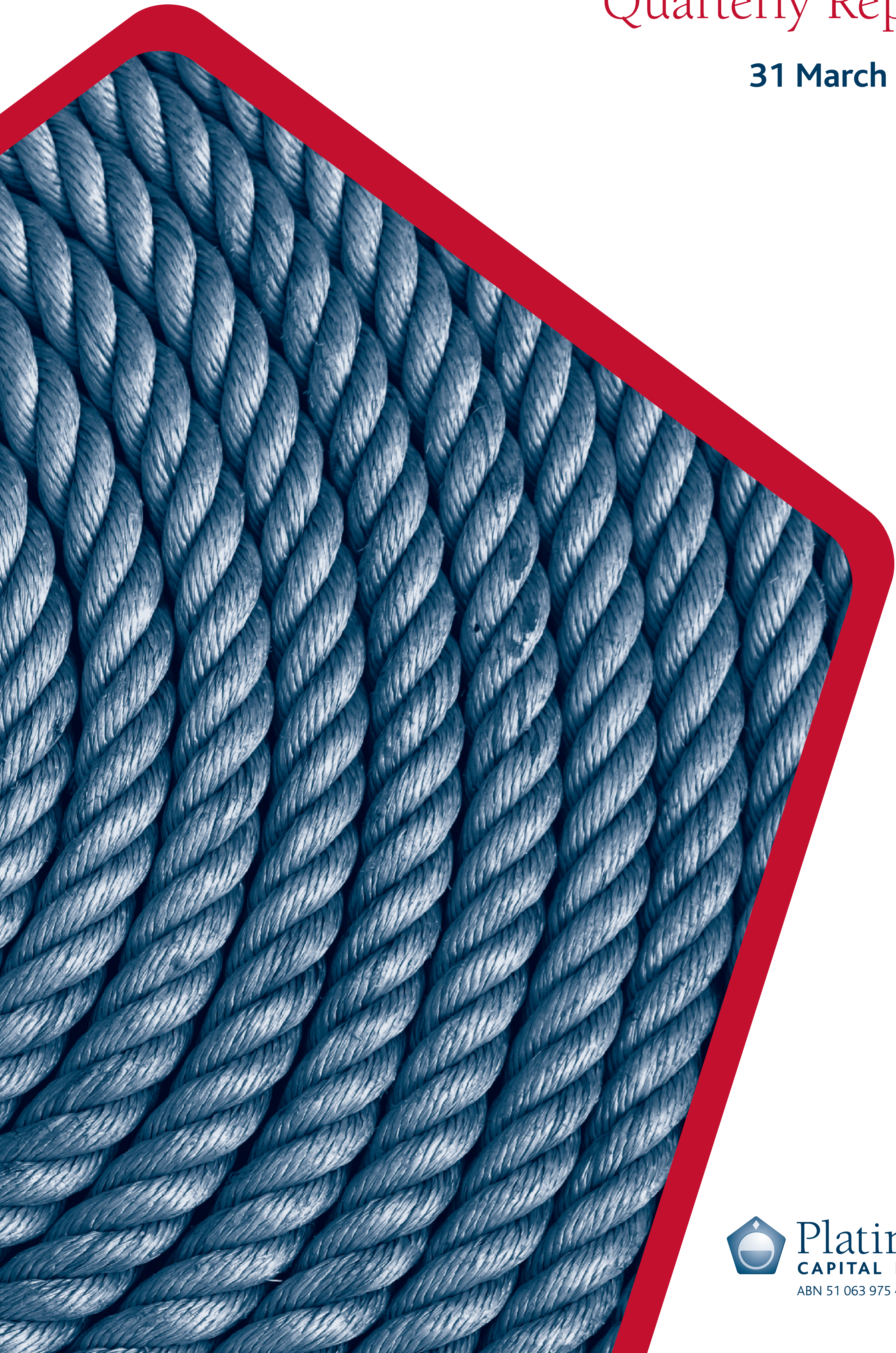
Platinum Capital® Limited Quarterly Report

31 March 2007



Platinum®
CAPITAL LIMITED
ABN 51 063 975 431

PERFORMANCE

The Chinese Government took further steps at the end of February to cool an economy growing at a furious pace. This triggered a sharp reversal in the market for Chinese "A" shares which, in turn, caused some of the more active international fund managers to review their overall risk profiles. The rising level of defaults in the U.S sub-prime residential mortgage markets gave everyone something substantial to worry about.

A notable knock-on effect of this flurry of de-risking was an abrupt change of direction of the value of the Japanese yen on foreign exchange markets as international borrowers of this cheap form of funding reduced their positions. At the same time domestic Japanese portfolio outflows dropped significantly to the point where they were exceeded by net foreign buying of Japanese assets. More recently, however, the yen has been depreciating again, largely due to a re-expansion of the "carry-trade" as foreign exchange speculators exploit large interest rate differentials.

For most of March markets were listless as investors tried to assess the risk of renewed selling in Asia, the effect of tighter conditions in the derivatives market, and the impact of a flatter housing market on the US consumer. On balance, the attraction of earning yields being above borrowing costs convinced participants that the global leveraged buy-out game was still intact.

Looking at market returns, for Australian investors the dollar's rise over the last 12 months from 71.5 cents to above 80.9 cents, up 13% versus the US dollar, has made positive returns hard to achieve. Over the last year the MSCI is almost unchanged. For the quarter the Index has been flat. Shorting assisted Platinum this quarter and our asset value rose by 0.8% (pre-tax) although it still lagged the MSCI for the year as a whole by -3.7%

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

MSCI* WORLD INDEX COUNTRY PERFORMANCE (AUD)

SECTOR	QUARTER	1 YEAR
AUSTRALIA	7%	19%
GERMANY	4%	13%
BRAZIL	4%	12%
FRANCE	0%	8%
KOREA	0%	-3%
JAPAN	1%	-9%
UK	1%	10%
US	-2%	-2%
HONG KONG	-2%	8%
INDIA	-6%	6%

Source: MSCI
* Morgan Stanley Capital International

NET ASSET VALUE (CPS)

31 JANUARY 2007	162.05
28 FEBRUARY 2007	162.53
31 MARCH 2007	161.97

Source: Platinum

CURRENCY

As mentioned earlier, the Australian dollar has been one of the best currencies to own as it, together with other commodity-related currencies, has been climbing systematically.

The Japanese yen may now have had the worst of its weak spell, having been a costly currency to hold. It has no yield support but we suspect there is an underlying shift in sentiment taking place so we believe it will gradually strengthen as the Asian block steadily appreciates.

We have added to our hedging back into the Australian dollar, eliminating exposure to the US dollar.

SHORTING

Our short positions provided positive returns over the quarter although we were disappointed at the meagreness of the rewards from the shorts of US mortgage insurers and US financials. We closed our housing shorts several months back which was just as well as the freefall in housing sales clearances and weaker prices had remarkably little impact on share prices.

DISPOSITION OF ASSETS

REGION	MAR 07	DEC 06
JAPAN *	26%	26%
NORTH AMERICA	25%	25%
WESTERN EUROPE	22%	25%
EMERGING MARKETS	16%	16%
CASH	11%	8%
SHORTS	34%	40%

Source: Platinum
* The company also has a 4% short position in Japanese Government Bonds

CHANGES TO THE PORTFOLIO

As the quarter progressed we continued to consolidate our holdings in favoured stocks. We sold out of El Paso, Agco and Union Pacific, each having made a contribution and in the case of the last two a substantial return. We cut back on the long held position in Carrefour as it ran strongly on speculation of "monetising" its 20 billion euro property portfolio and finally exited Alcatel which has failed to meet our expectations. Sadly, the company faces a prolonged integration effort as it merges with Lucent and in the meantime its fierce competitors such as Cisco can forge ahead. The loss on Alcatel was some 15% on purchase cost and more in terms of foregone opportunity.

The mid-quarter sell-off gave us the opportunity to introduce Microsoft and Aeon to the portfolio. They both fit the theme of quality at barely more than market valuation. Microsoft is presently being characterised as mature, as having a blurred vision of the internet and as being potentially vulnerable to depredations by Google. That the company will grow more slowly than in the past we do not doubt but appraisal of each separate income stream reveals a unique buying opportunity of one of the world's more interesting companies.

The revenues from Microsoft's founding operating system division, now called "Vista", are rock solid. Sales will gradually grow as it finds its way onto most new PCs and laptops. On discounted cash flow models this monopoly alone accounts for much of the company's capitalisation. The real gem, though, is the strength of the company's distribution network and the demand generated for the so-called Server and Tools division. This business supports applications and is finding ever wider demand from smaller businesses seeking packaged solutions for their IT needs. There are other areas that are sleepers, such as the loss-making games and entertainment division and the software behind mobility. All this, together with the attempt by Ray Ozzie to reorientate the business away from its monopolistic mentality, suggests that the market is doubting the ability of this champion of bundling to succeed.

Aeon is Japan's largest supermarket operator and also the country's leading owner and developer of large scale shopping malls. Despite a very difficult consumer market over the past 15 years, Aeon has a strong record of expansion and has increased earnings per share by 11% p.a. Our interest stems from the recent acquisition of a stake in Daiei which will raise its share of the Japanese grocery market to 10% and allow it to exercise superior buying power through the use of its centralised distribution network. In a world that dreams of REITs we are intrigued that the company is given so little credit for its property portfolio.

COMMENTARY

Some of the concerns we have raised in recent reports regarding easy money and the hunger for risk took substantial form in late February with failures in the US residential mortgage market. The subsequent sell-off of shares globally was relatively mild, though sharp, but nonetheless acted as a reminder to market participants that linear extrapolation has its dangers. As there has been thorough coverage of the subject[1], it is enough to say that securitisation funding does not remove credit risk but simply reallocates it, often to people who have little control of the underlying assets. The market volatility associated with these failures presumably reflected the general call by financial institutions to tighten portfolio specifications and credit controls. Concerns about credit losses and the detrimental effect of adjustable rate mortgage (ARM) resets, and foreclosures on lower-end properties probably have some way to unfurl. The main popular focus, however, remains on globalisation and the recycling of surplus savings.

Adherents to this new paradigm believe that we have achieved that highly desirable state where the developing world's surpluses neatly accommodate the developed world's insatiable consumers and, at the same time, new producers can supply an abundance of tradeable goods, facilitated by the free movement of capital and know-how, plus seamless logistics, to remove the traditional inflationary bottleneck of labour that so stunted economic growth in the 1970s and later. The changing composition of developed economies truly seems to have flattened the economic cycle. For the moment these observations are evident, though highly dependent on the willingness of those nations with savings to place them where needed. A less plausible notion of the new paradigm is that Central banks have developed such a clear understanding of all the moving parts of a modern economy as to be able to direct them with intricate precision.

The current disregard for risk and the belief that easy funding will persist has virtually eliminated the distinction in valuations between quality and junk. This careless view will not persist forever which offers us the opportunity to accumulate great companies that are on valuations almost in line with the market in general[2]. Here we define quality as those businesses with an achievement record that sets them apart, often enjoying dominance of their industries globally, and with the ability to grow in any but the worst circumstances. Their balance sheets are typically free of debt, on account of their superior profitability, and incremental growth can be achieved and still cast off free cash flow. The paradox is that one can acquire these companies on such relatively attractive terms[3] even though they remain below peak profitability and may benefit from home currency weakness. One explanation is that they tend to be too large to be "privatised" and another is that some of them are being sold by American-based funds who are choosing instead to increase their foreign holdings. Interestingly these shares are in most cases on free cash flow yields for 2007 that exceed those of US long treasuries. Does their progressive de-rating portend a deflationary future or, alternatively, is our analysis plain wrong?

Four excellent companies that fit this mould are Cisco, Microsoft, Ericsson and Samsung. Each has clear dominance of its place in today's electronic highway and market place, the mobile Internet, and while one can take issue with aspects of each of their businesses, in

1 Of the entire US residential mortgage market of $9.7 trillion, sub-prime constitutes approximately $1.2 trillion. By value, about 5% of US mortgages are delinquent while some 14% (and rising) of sub-prime mortgages are delinquent. Reasonable estimates are that cumulative defaults on the 2006 sub-prime mortgages are around 20%. Suppose 20% of 2006 sub-prime mortgages default and the severity of those defaults is say, 30% then the total credit losses would be about 6% of the pool – $35-40 billion. This compares with the US financial industries' annual pre-tax profits of around US$430 billion.

2 An important observation is that the PE of the US market itself, say 15.5 times, understates the broader level of valuations on account of the heavy weighting of the financial sector that is typically trading on 10 or 11 times forward earnings.

3 By measures such as cost to sales or PEs, they are towards the lower end of their 15 year range.

general they are hard to fault. One exercise we do is to project the likely free cash flow for the next three years and net this off, together with current net cash holdings, against the current capitalisation to arrive at an adjusted 2009 price earnings ratio (PE). On this basis three of them are on forward PEs of less than 10 times.

Apart from the information technology sector where we have deployed about 15% of the Company's assets, we have similar over-exposure to industrials and materials. In the case of industrials we like Siemens, Bombardier, Mitsubishi Heavy Industries, Yokogawa Electric and JGC each of which is trading at well-below peak profitability and yet serves markets that face a growing backlog of under-investment, either public sector transport or neglected services such as power generation or new endeavours such as alternative energy. Exposure to materials reflects our expectations of tightening agricultural commodity supplies and growing capacity constraints in pulp and paper. Mosaic is the world's second largest potash producer and a major supplier of general fertilisers. Apart from the near-term pressures exerted by the bio fuel subsidies, there are good reasons to expect steady long term expansion of demand for the output of Ajinomoto, the world's leading producer of lycine, an amino acid feed supplement. Our strongly held view that the market is underestimating the impact of China and India on the demand for pulp is gaining factual support with spot pulp prices having risen by 30% in US dollars in the last year. The other component in our materials portfolio is the 3% holding in major gold producers. These have been hibernating as the mines have failed to meet production forecasts and costs are running much higher than anticipated. We believe these to be transitory problems.

As the table below reveals, the areas where we are under represented against the world's top 5,000 companies are financials, energy and utilities. It should be emphasised here that our 'weightings' are a consequence of individual stock-picking combined with themes rather than a macro overview. The fact is that we are not able to find many financials that interest us relative to other opportunities. Those that do are mostly in Japan which is on the cusp of a reflationary pulse with the increase of land and property prices now migrating to the provinces and into residential accommodation. After 14 years of deflation some find it difficult to view observable trends in a positive light.

In energy our main exposures are to Royal Dutch Shell and Areva, the world's leading integrated nuclear producer, from mining yellowcake through to plant building and fuel recycling. Shell is a gift we believe on a PE of less than 9 times, a 4.5% dividend yield

PLATINUM AND MSCI WORLD INDEX INDUSTRY WEIGHTINGS

INDUSTRY	PLATINUM	MSCI
INDUSTRIALS	15%	9%
MATERIALS	15%	9%
INFORMATION TECHNOLOGY	15%	7%
FINANCIALS	15%	25%
CONSUMER DISCRETIONARY	10%	8%
CONSUMER STAPLES	9%	8%
HEALTH CARE	6%	7%
TELECOMMUNICATIONS	5%	6%
SERVICES AND MEDIA	5%	6%
ENERGY	3%	10%
UTILITIES	3%	6%

Source: Platinum and MSCI

and showing all the signs of re-establishing its credibility after its fleeting dalliance with corporate pretence.

There is clearly a risk in our relatively high commitment to those areas which can peter out in the latter stages of an economic boom. We are relying on the strength of each individual holding and the fact that this cycle has been characterised by surprisingly weak investment in basic infrastructure, particularly in the West. We are also reassured by the growth prospects and modest valuations of our more defensive holdings.

OUTLOOK

The recent de-risking episode following the mortgage problems in the States will have left a scar on perceptions of derivatives, of the reliability of some funding sources, of the prospect of further house price inflation and of leverage buyout (LBO) financing. Global growth remains solid with Asia continuing to grow the fastest and despite the gilt coming off some Western economies. Most forecasts expect company earnings to slow into single digits in the developed markets but the systematic de-rating of the larger companies suggests this is well anticipated.

Our portfolio is positioned in companies that are generally operating well below their peak earnings capacity, that face an environment that should favour sales growth and that are on conservative valuations. We believe that this, plus the shorts we are running on highly valued small stock indices, REITs and emerging markets, will protect investors in what we believe to be the later stages of the economic cycle.

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