Platinum Capital® Limited Quarterly Report

30 September 2008

Platinum® CAPITAL LIMITED

ABN 51 063 975 431

PERFORMANCE

We are at last moving in pace with the rhythm of global markets. The reversal of the trend of emerging markets and commodity producing industries was slow to come but eventually proved profitable for us. The related position of minimal exposure to the Australian dollar also worked in our favour after having been a discouraging drag on performance in the previous two quarters. The value of the Company's portfolio rose by 6.1% (pre-tax) for the quarter and overall is down 10.5% (pre-tax) for the last 12 months. This compares with the MSCI World Index up 1.5% for the quarter and down 18% for the year. Another encouraging perspective is the ten year return where this Company has grown by close to 13.5% compound pa and the MSCI World Index by 1.4% pa.

Investors rotated away from cyclicals over the quarter in favour of defensives while financials are now seeing reduced selling pressure. This is shown in the table below.

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

NET ASSET VALUE (CPS)	
31 JULY 2008	125.19
31 AUGUST 2008	133.15
30 SEPTEMBER 2008	133.63

Source: Platinum

CURRENCIES

We have been of the view that the burden of debt in the US is tantamount to a giant short on the US dollar and that as the unwinding occurs the US currency will strengthen against most others. Fortunately we abandoned our earlier view that the Asian currencies would be strong along with the US dollar. We now see them as vulnerable as foreign flows reverse and internal liquidity tightens. The Japanese yen, being a savings-driven currency, is our second choice.

SHORTING

With the destruction of faith in the bull market the pattern has now changed and our shorts of cyclicals and emerging markets gave us excellent rewards. After taking big gains most of these have been closed. We have migrated to those defensives boasting valuations completely out of synchrony with the great value available elsewhere. A notable large and thus far poorly rewarded short, the Russell 2000 (small cap index), now looks extremely prospective.

MSCI* WORLD INDEX SECTOR PERFORMANCE (AUD)

SECTOR	QUARTER	1 YEAR
CONSUMER STAPLES	18%	3%
HEALTH CARE	18%	-2%
CONSUMER DISCRETIONARY	9%	-21%
FINANCIALS	9%	-29%
INFORMATION TECHNOLOGY	2%	-19%
TELECOMMUNICATIONS	1%	-19%
UTILITIES	0%	-7%
INDUSTRIALS	-1%	-24%
ENERGY	-14%	-9%
MATERIALS	-23%	-26%

Source: MSCI
* Morgan Stanley Capital International

CHANGES TO THE PORTFOLIO

There were no significant geographical changes over the quarter. Some long-held individual positions moved out of our buy/sell range and holdings were adjusted accordingly. There have been several opportunities to exploit anomalies. For example we sold out of the US airlines that we had bought into the teeth of the oil spike which yielded a profit of over 50% in three months.

Another recent opportunistic purchase was China Mengnui Dairy Company when its share price collapsed from around the mid-HK$20 to HK$7 on implications of product contamination. The case for putting half a percent of the Company into China Mengnui Dairy was based on the observation that the contamination was perpetrated by the milk aggregators not the packers. Moreover, the government wishes to protect this important rural industry and continues to promote milk as a dietary supplement in schools. We believe it will work with the industry to quickly re-establish consumer confidence with tight regularity oversight. We estimated that sales will take 12 to 18 months to get back on track and that the withdrawal of contaminated stock and associated compensation may well deplete the company's coffers but will not put the whole business at risk. It could then resume expanding its product range and network and quite probably resume its historic growth rate of some 20% pa particularly as consumption of milk products in China is a tiny two litres per head, versus 20 litres per head in Taiwan.

GEOGRAPHICAL DISPOSITION OF PLATINUM ASSETS

REGION	SEP 08	JUN 08
NORTH AMERICA	24%	24%
EUROPE	23%	23%
EMERGING MARKETS	19%	20%
JAPAN	19%	19%
CASH	15%	14%
SHORTS	24%	28%

Source: Platinum

PLATINUM CAPITAL LIMITED – TOP 20 STOCKS

STOCK	INDUSTRY	SEP 08
MICROSOFT	TECHNOLOGY	3.4%
MITSUBISHI UFJ FINANCIAL	FINANCIAL	3.2%
INTERNATIONAL PAPER	PAPER	2.7%
HUTCHISON WHAMPOA	TELCO/TRANSPORT	2.6%
SIEMENS	ELECTRICAL	2.6%
CISCO SYSTEMS	TECHNOLOGY	2.3%
BOMBARDIER	TRANSPORT	2.2%
JOHNSON & JOHNSON	HEALTH CARE	2.2%
SANOFI-AVENTIS	HEALTH CARE	1.9%
BANGKOK BANK	FINANCIAL	1.9%
SAMSUNG ELECTRONICS	ELECTRICAL	1.9%
HORNBACH BAUMARKT	RETAIL	1.8%
OBAYASHI CORP	CONSTRUCTION	1.7%
JGC CORP	CONSTRUCTION	1.6%
SAP	TECHNOLOGY	1.6%
DENSO CORP	AUTO	1.5%
HENKEL	RETAIL	1.4%
PPR	RETAIL	1.4%
HENDERSON LAND DEV	PROPERTY	1.4%
BMW	AUTO	1.4%

Source: Platinum

COMMENTARY

In recent years various financial authorities, in particular the US Federal Reserve, have responded to any sign of economic slowdown by dropping the cost of short-term money and thus widening the lending spreads available to banks. This in turn encouraged both lenders and borrowers to become more and more careless about the dangers of debt. We are now witnessing the high priests of finance attempting to will away the huge burden of over-indebtedness facilitated by these earlier policies.

The trouble is that this time round the genie is out of the bottle. Some of the debt-acquired assets have proved to be close to worthless and the same leveraging techniques that

boosted profits so well in the good times are now having directly contrary consequences. Worse still, many financial institutions have geared themselves up to such an extent that losses representing only a modest proportion of their balance sheets have nonetheless been large enough to wipe out their capital bases. The high priests can do what they like but if the whole financial system is not to collapse an absolute necessity is that it be de-geared. There is, therefore one fact we must clear-sightedly face:

Debt is being repaid, reduced or denied and this will impinge on the value of assets.

In these circumstances fund managers find themselves in an invidious position. How do they communicate with clients in a meaningful way without drawing on over-worked phrases such as "invest for the long-term" or "expect high volatility" or such?

We do not know the answer to this but are clear on some basic principles:

a. By owning fine companies, we are able to *participate in the clear trend*[1] *of rising global (material) living standards*.

b. We must be sure to pay the *appropriate price* for future income streams.

c. By *changing the composition* of a well-managed portfolio, we can enhance the return and reduce some of the risks.

d. Investors at large are *hard wired to over-react* to the most recent events and will tend to extrapolate from the current environment. This adds opportunity but also risk.

This is a background offering both challenge and opportunity. We believe we can meet the former by sticking to our well-tested investment methods and principles while recent market sell-offs have created some very attractive fundamental values. Let's look at an example.

We have recently been investing in a large company, with sales last year of over US$40 billion having grown steadily by 9% pa over the last decade. Profits in recent years have improved at an even faster pace helped by a prolific R&D effort that has created many clever new products. This in turn has resulted in market share gains and an expanded customer base while retaining strong ties with its original main outlet which itself has been growing at speed and in strength. Though annual sales have risen 2.5 fold in 10 years, the profits by 3.5 fold and the book value from US$10 billion to US$22.8 billion, the market capitalisation is now just US$16.6 billion. Offset by accumulated net cash and investments, the enterprise value falls to only US$8 billion. This is below its market capitalisation of 1988!!

So what is the problem? Are its sales going to nosedive; is its principal customer about to go bust and leave it with unpaid bills; has it created an environmental accident of extreme proportions; has one or more of its products created a civil liability suit that will bring the company close to extinction?

These are the sort of issues we consider when choosing candidates for our global portfolio. We look at both short- and long-term risks and, in addition, try to see companies through the eyes of other investors. Importantly, we also try to segregate the probable from the unknowable. Lastly, we try to balance the tendency of investors to allow recent events and information to have undue weight when assembling their judgement.

The concern described above is Denso, a Japanese manufacturer of motor components, part of the Toyota family. Its share price

1 Though the share of the economic pie will shift periodically between geographic areas and among resources, labour and capital, there is a fundamental order that has ensured a rebalancing over time. Returns have exceeded inflation by a good margin. The real return to holders of US equities from 1900 to 2005 was 6.5% pa, 5.5% for the UK, 4.5% for Japan and 3.1% for Germany.

is depressed partly because Japan is unfashionable and partly because the motor industry is going through a down phase.

It has been a long time since any sort of metal bashing company has been regarded as exciting by investors yet Denso is at the forefront of the development of energy efficiency and hybrid vehicles, alternative drives and sophisticated electronic components. Denso is a Japanese company but supplies motor manufacturers worldwide. Demand for cars is depressed short-term but will recover. If immediate problems cause one or other of the US car makers to go under, some component suppliers will almost certainly go as well.

It is highly likely that in future Denso will be a bigger and stronger company with earnings and dividends on a rising trend. Consider also, as a bonus, what a good buying opportunity it provides for private equity and sovereign funds. We will probably hear less of private equity funds[2] now that debt is less available but sovereign funds could well become more active in equity markets as bank deposits and US Treasuries attract them less.

Denso is a case in point illustrating the values available in some unfashionable markets. Japan has been in the economic slow lane since its own banking crises of the late 1980s. Foreigners have been the big swing factor in its share market ever since, as the locals lost their nerve and preferred the safety of government bonds or cash in the ensuing 18 years of flat to falling consumer prices. This market has been through the very thing that is now threatening other markets and investors are still weary of Japanese shares even at give-away prices.

This is not simply a repetitive plea for Japan but is an excellent example to remind clients of the persistence of trends and the unwillingness of most to look for the break from past patterns. The whole Japanese market is a dream-world for unlocking value and its companies are beginning to use their cashed-up balance sheets to pick through the wreckage of Western markets. Note in particular, the opportunistic purchase of 21% of Morgan Stanley by Mitsubishi UFJ Financial Group, one of our top three holdings, and Nomura's purchase of the Asian and European businesses of Lehman for no goodwill. Among smaller Japanese companies there are now many examples of gifts like Denso, some at even better value on account of being smaller businesses, sporting PEs in single figures and with half their capitalisation in cash or investments.

Generally speaking we cannot emphasise enough the importance of paying the appropriate valuation of standardised earnings. As has been our recurring theme, the earnings of many recently fashionable companies are way above trend and so even though valuations now look enticing on price earnings grounds, being say 30% below the historic average of 14 to 15 times, the "e", earnings, are simply not likely to be sustained.

This is where a good fund manager can make a valuable contribution. When all the numbers and discernable facts point to a company being abnormally cheap using 20 to 30 year relationships of price to book, enterprise value to sales and taking into account the company's inherent cash generating capacity, the shares have a high probability of providing a handsome return. This addresses the key a, b, c, and d principles highlighted above.

2 We encountered one unusually perspicacious Pennsylvanian family who, having been an early supporter of private equity as it redirected its interests from sun-set industries, began to remove itself from private equity a full 18 months ago. We saw the wisdom of this as deal valuations reached silly levels and private equity funds were increasingly resorting to high leverage or exotic concepts to achieve satisfactory returns.

OUTLOOK

Markets are likely to remain highly volatile and one should be prepared for earnings disappointments in the months ahead. An economic downturn caused by financial crises can be expected to result in a slower recovery than a standard recession. There are likely to be recurrent concerns about credit markets and an increasing realisation that the banks need to bolster their shareholder funds from rights issues and, in some cases, partial or full government ownership. In any event, politicians and regulators are going to impose additional restrictions on these central agents in the economic system. Future returns in the banking industry are likely to be a lot lower than in the last five years.

The experience gained from the credit bubble of Japan in the late 1980s may be more instructive than some would admit[3]. What is encouraging is that the Nikkei had a very strong 30% rally once the problem was generally understood. We would expect the same thing now, possibly after acceptance that the growth of the Chinese economy must slow down eventually to more normal levels.

We can identify broad swathes of value across the globe, not usually in the recent hot spots of resources and energy. They are also not for the most part in defensive industries. We will continue to take advantage of the overpricing of some areas with our shorting activity. The best prospects of good returns are in sectors currently neglected because of their dull near term prospects.

Will we make you money in the next few quarters? We cannot know. We are now in the earnings down-cycle and valuations in some cases are unusually attractive, providing opportunities that will be seen in retrospect as once-off opportunities. We must accept, however, that in the short-term the outlook for profits is poor.

Kerr Neilson
Managing Director

3 In that credit-fed boom, impetus was added to share price rises by ever tighter cross-ownership and the self reinforcing spiral of rising land and property values. In this crisis, the added boost came from derivatives and the self-reinforcing effect of rising valuations as easy credit led to frantic overbidding in the form of take-overs, share-buybacks, private equity and other exploitations of OPM (other people's money).

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