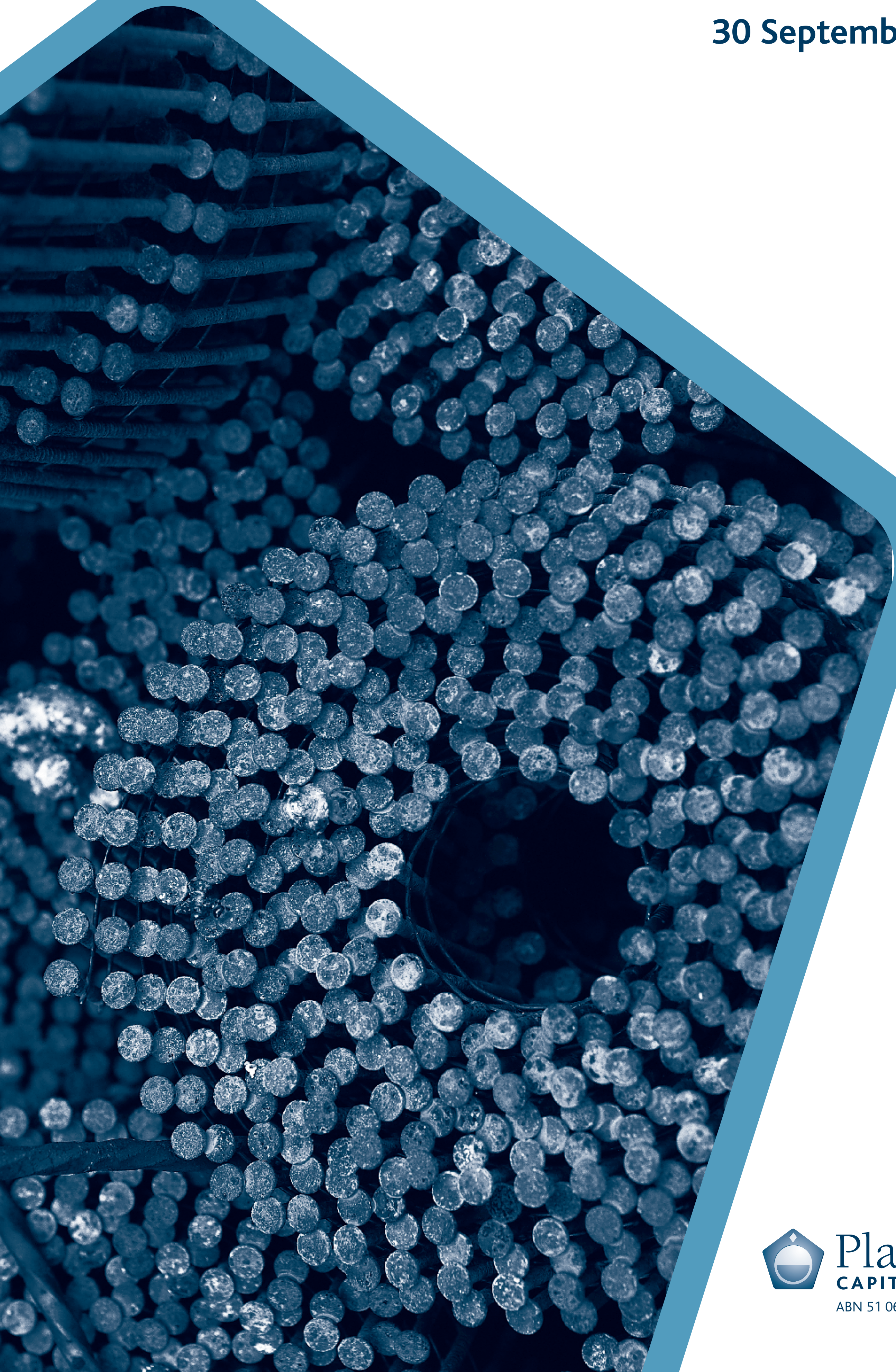
Platinum Capital® Limited Quarterly Report

30 September 2009



Platinum® CAPITAL LIMITED

ABN 51 063 975 431

PERFORMANCE

The pattern of market movements established during the June quarter persisted over the latest three months. Investors continued to favour lesser quality and more highly leveraged companies over those with more predictable earnings and more robust business models. This renewed willingness to embrace risk is probably explained by the remarkably swift change in sentiment concerning monetary stability and the surprisingly strong company earnings that have been reported post the "global financial crisis" (GFC). It is doubtful if this pattern will persist as the recovery flattens out from its very steep initial trajectory and as more traditional values come to be attributed to higher quality. The table below highlights the vast improvement of investor sentiment in the latest quarter.

Looking at Platinum's performance, it is the tail of our holdings, which by its nature tends to be composed of smaller companies, which has been the largest contributor to our performance. Some of these companies suffered disproportionately in the crisis as their prices were marked down in the chase for liquidity. The disposition of our assets has also played a part, with our high exposure to Asia and, in particular, China and Korea, being very profitable. Our Japanese stocks made a small loss but strong outperformance in North America and Europe more than compensated for this.

When disaggregating returns among longs, shorts and currency for the last three months, we find that longs rose by around 14%, but that shorts and the appreciation of the rampant Australian dollar cost the company just over 5% with the rise of the A$ being responsible for a good two thirds of this negative effect. The net outcome for the quarter was that the company rose by 8.9% (pre-tax) versus the MSCI World index which rose by 8%. For the last twelve months the outperformance is much more stark with the company rising by 21.5% while the MSCI lost 10.7%. We believe that the five and 10 year figures are the most valuable timeframe in which to assess a manager's skill and these are respectively 7.7% and 13.6% compound pa for Platinum versus the MSCI's return of 0.5% compound pa for the last five years and -1.5% compound pa for the last 10 years.

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

MSCI* WORLD INDEX SECTOR PERFORMANCE (AUD)

SECTOR	QUARTER	1 YEAR
FINANCIALS	15%	-17%
MATERIALS	11%	-3%
INDUSTRIALS	10%	-13%
CONSUMER DISCRETIONARY	8%	-7%
INFORMATION TECHNOLOGY	8%	-2%
CONSUMER STAPLES	4%	-10%
TELECOMMUNICATIONS	4%	-7%
ENERGY	3%	-15%
HEALTH CARE	3%	-12%
UTILITIES	2%	-14%

* Morgan Stanley Capital International
Source: MSCI

NET ASSET VALUE (CPS)

31 JULY 2009	137.16
31 AUGUST 2009	139.30
30 SEPTEMBER 2009	140.66

Source: Platinum

CHANGES TO THE PORTFOLIO

A very strong market in smaller companies has been used to further reduce our positions in such companies particularly Airports of Thailand, Gamuda and effervescent property stocks in Hong Kong like Henderson Land. We have completed our exit from AES, a power producer that we bought at the worst of the crises when debt and exposure to emerging markets was highly unfashionable.

Setbacks in China allowed us to add to holdings of China Life and China Resources Enterprises. Reed Elsevier also had a setback when it placed new stock to repay some debt and this gave us an excellent top-up opportunity. Among companies we have initiated positions in are Sotheby (the auction house), Allianz (insurance), Electronic Arts (video game publisher), MGIC (a US mortgage insurer) and Nikon (cameras and IC production equipment).

GEOGRAPHICAL DISPOSITION OF PLATINUM ASSETS

REGION	SEP 09	JUN 09
ASIA AND OTHER	25%	23%
EUROPE	24%	21%
JAPAN	23%	24%
NORTH AMERICA	21%	20%
CASH	7%	12%
SHORTS	17%	18%

Source: Platinum

SHORTING

Our positions have changed little over the quarter with the emphasis on highly priced cyclical companies and a small generic short on the S&P 500 index. It is difficult to make positive returns from a short book in markets driven largely by momentum and paying almost no regard to differentiation by quality.

CURRENCIES

As noted above, the Australian dollar continued to punish our returns. We commented on this last quarter and arguably, have remained too cautious. With the RBA leading the field with a reversal of interest rate policy it looks as though only a growth scare will dent the A$. We have, nevertheless, reduced our exposure to the A$ further and added a position in other currencies which are in a similar position to the A$ yet with less foreign debt. These are the Norwegian kroner and Indian rupee. Our exposure to the Japanese yen is about half our physical position in Japanese shares as we believe ultimately the authorities in that country will have to address their compromised fiscal status. Regarding the US dollar we are ambivalent in a sea of negative sentiment.

COMMENTARY

We concluded in our March quarterly that "The nature of the world's current problem is highly complex and the outcome will depend heavily on how individuals respond to uncertainty. We are clear that there was a great deal of fear factored into prices as we entered March...". Almost immediately after we made this comment the massive economic stimulus and financial support packages introduced by governments worldwide started to bolster confidence. Credit markets began to free-up and destocking reversed sharply into restocking. China delivered an outstanding performance as it re-accelerated its economy, despite poor demand from export markets, which led to a beneficial knock-on effect throughout large parts of Asia and further positive ripple effects through to producers of primary products such as Australia, Africa and South America.

As regards the fear we mentioned, this has all but evaporated as investor confidence has leapt in response to the lifting cloud of uncertainty. We now find many shares and even some country indices trading at levels higher than those that prevailed before the Lehman collapse. It is, however, not certain that this rebound is safe or sustainable. The G7 nations have incurred vast public mortgages in exchange for private debt obligations and losses. Further, bank balance sheets are now deeply impaired and willingness to lend is much reduced. In aggregate, the loan to deposit ratio of leading banks is about 120%, while the current and potential debt obligations for G7 governments are in excess of 160% of GDP.

After the initial sharp fall in company earnings there have been some good recoveries. Helping this process has been an astoundingly rapid reduction in the operating costs of businesses as management laid-off workers and removed capacity. There is, however, a high correlation between robust earnings forecasts and robust government stimulation which means some caution is required when looking beyond the short-term.

On the first anniversary of the "GFC", one was inundated for commentary from the press about the lessons learned. Astonishingly, most discussion was accompanied by the suggestion that the crisis was a complete surprise and the remedial action indubitably praiseworthy. It is as though there has been a communal sigh of relief about a near miss and we can now resume our previous behaviour. The question of *fiat* money (see the case of Zimbabwe below) has also occupied the media as has the prospects of the world moving off the US dollar standard.

We have noted before in these reports and would like to emphasise again our view that the English speaking world has for some years been on a debt binge not so different to that of the Japanese in the late 1980s. There are differences but these are not so great as to cause one to believe that we can avoid a long work-out. Rather than heeding the endless chatter about the kind of recovery ahead, we suggest there are two indicators that should be watched: employment levels and bank lending.

Zimbabwe – a live model of fiat money in action

On the subject of fiat money, that which derives value from government promulgation, we have just returned from Zimbabwe, the newly crowned heavyweight champion of money creation. The problems in that country epitomise the issues of economic mismanagement and the subsequent use of the printing presses to cover a fiscal deficit[1]. The broad lessons are universal and mimic the experience of Germany in the 1920s[2] and Argentina in the late 1980s.

In the latter days of currency debasement, governments almost invariably intervene with price controls to try to offset the exploding supply of money. The populace becomes fixated on trying to arbitrage valuation discrepancies between physical assets and property and shares are the vehicles of refuge. Capital flight is the purview of the wealthy

1 Testament to this lies in the bound bundles of 100 unused Zim $10 billion notes that one is offered by hopeful street vendors for US$1-2. Admittedly the Zim $100 trillion notes are a little more difficult to come by and sell for about US$1 each!

2 Those eager to study this subject might seek a copy of "The Economics of Inflation" by Costantino Bresciani-Turroni, first published in English in 1937 by George Allen & Unwin Ltd.

elite. Industrialists drain cash from their businesses while operating plant becomes rundown or obsolete. As ever larger bundles of notes are exchanged for ever diminishing purchases, economic activity shrivels and a complete disorientation of value sets in[3]. Price controls destroy companies' working capital and physical controls can become so severe that retailers can risk incarceration for removing stock from the shelves on charges of crimes against society[4].

In Zimbabwe, trusted foreign currencies gradually took over from the local dollar even though it was unlawful to use anything other than the national currency. This requirement was hardly modelled by the central bank which started simply expropriating firms' foreign exchange earnings in its desperation to meet external obligations. The end came when the populace refused to transact in Zimbabwean dollars. By late 2008 the government was forced to acknowledge that the US$ was the principal means of exchange[5].

Businesses have lost most of their working capital from the hyper-inflation. Zimbabwean dollar bank deposits have become worthless, which has the peculiar effect of expunging debt from the system but leaves the banks without a lender of last resort[6], and an unwillingness to participate in an interbank market. Solvency concerns dictate that bank lending is now a tiny fraction of the estimated US$700 million of bank deposits. In these circumstances the economy's growth is governed by the growth of its stock of hard currency. It is for this reason that an impotent President Mugabe so berates the West about sanctions. He simply cannot pay to keep himself in power via the printing press and hence his former impregnable position is now severely compromised. Top officials are earning US$300 per month and **all** other civil servants US$150 per month.

Businesses have been remarkably agile in adjusting to the new circumstances but have an enormous backlog of capital expenditure required and very little working capital. This puts them at the mercy of imports. Wages are low at 50c to $1 per hour but employment growth will be slow as the expansion of output has to proceed from a very low base.

The attachment of the economy to an external peg imposes interesting dynamics on the political front, the imperative of acquiring foreign currency forcing Mugabe to bow to international pressure to implement a measure of effective power sharing.

From an investment point of view the tiny Zimbabwean market capitalisation restricts immediate possibilities although it is worth keeping under review.

From a wider perspective the analysis above should serve to alert us to those problems that would face any country where the central bank lost control over their financial levers of the economy. It may even have some very far-reaching lessons for a country which has for a long time had a degree of dependence on its currency having worldwide reserve status.

[3] During the hyperinflation in Germany in 1922, the market capitalisation of Daimler was the equivalent of the price of 327 of its automobiles; in Buenos Aires, I was told of a banker having the use of a taxi for a full day for the cost of US$1 and in Zimbabwe, a drug company with 200 employees met its entire salary bill for November 2008 with the payment of the equivalent of US$1!

[4] At one stage Delta Zimbabwe calculated that it was required to sell its beer for about a quarter of a cent per bottle.

[5] Argentina explicitly linked its currency to the US dollar and Germany in 1924 reset its currency against gold.

[6] Without foreign reserves the Zimbabwe central bank loses its relevance. It cannot lend to the government nor the banks and nor can it set interest rates as these are set by the issuer of its currency, the US Federal Reserve Board.

OUTLOOK

We believe there are sufficient positive influences to drive the world economy forward. The expansion will, however, be uneven with good growth experienced by the emerging powerhouse nations, particularly in Asia, but only modest recovery experienced in the fully industrialised areas, the US, Japan and Europe.

Within these latter areas some commentators' forecasts of corporate earnings strike us as optimistic so that average companies are, in our opinion, fully valued. Having said this, there still appear to be a reasonable number of good, high quality concerns which are cheap compared to their historic valuations and against the market as a whole.

Our research continues to identify some of these attractive opportunities and this is our best guide to making you money in the coming months.

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