PLATINUM CAPITAL LIMITED

ACN 063 975 431

Quarterly Report

31 MARCH 2002

Performance

Markets cast off some of their doubts as the quarter progressed. The table below highlights investors recent preference for cyclical areas, such as energy and materials, but also shows that they hedged their bets by staying with consumer staples. The massive debt burden taken on by the telecom companies when they bought competitors and bid for third generation mobile licences continued to weigh heavily on their share prices. The IT sector also suffered as expectations of a cyclical rebound wilted in the face of the reality of the magnitude of the over-investment during the tech bubble.

Against an overall decline by the MSCI for both the quarter and the year (-3.8% and -12.4% respectively), Platinum's performance is pleasing (+6.7% and +16.9% (pre-tax) respectively). The main driver of this outperformance was the running down of cash balances after the Trade Centre attacks in September. Some of this money went into previously owned tech shares but these were quickly resold so your company largely escaped the carnage within the IT/telecoms sectors. We made very substantial returns from aggressively positioning the Company in Korean shares when that market was out of favour some 12 months ago. Fossicking among depressed gold shares was rewarded and our overall currency positioning has been sound. Short selling cost us money last quarter.

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

NET ASSET VALUE

31 January 2002	171.28*
28 February 2002	174.84
31 March 2002	177.32

* This was after making provision for a 5 cent interim dividend paid on 22.2.02.

MSCI WORLD INDEX – INDUSTRY BREAKDOWN (A$)

SECTORS	3 MONTH	1 YEAR
Energy	5.0%	-3.7%
Materials	3.5%	0.6%
Industrials	-3.4%	-12.8%
Consumer Discretionary	-2.8%	-12.6%
Consumer Staples	1.6%	-1.6%
Health Care	-5.0%	-9.3%
Financials	-3.5%	-14.0%
Information Technology	-10.6%	-17.5%
Telecommunications	-17.4%	-33.8%
Utilities	-4.0%	-22.4%

Changes to the Portfolio

We have been adding to some existing positions while trimming others, notably in Korea, such as LG Chemical, LG Household and Health, and Lotte Confectionery. Other sales were Nordea and Akzo Nobel. There have been four new names introduced to the portfolio in the last three months: Hagemeyer, Henkel, Michelin and EDS.

Hagemeyer is a very old established Dutch based trading company which went badly astray investing indiscriminantly around the world. There was a change in management some two years ago following which the business was refocussed on its biggest division, electrical wholesaling. This may not normally fire up one's imagination but there is a fundamental need for a stockist/distributor to sit between the manufacturer and the end user. In this case the user is the electrical contractor and the manufacturers comprise the giants of the industry such as Philips, Siemens, GE and Schneider. The really exciting element relates to Hagemeyer rolling out its integrated supply solution. Apart from a general improvement in activity this roll-out should add to earnings quality and growth (see Hagemeyer stock story). The present very low valuation reflects past problems and not present strengths.

DISPOSITION OF ASSETS

REGION	MAR 2002	DEC 2001
Western Europe	40.0%	41.6%
Emerging Markets (incl. Korea)	15.5%	15.8%
Japan	14.9%	15.1%
North America	13.4%	14.0%
Australia	1.3%	0.9%
Cash	14.9%	12.6%

The company's short position is 28% against individual companies, mainly US.

BREAKDOWN BY INDUSTRY

CATEGORIES	EXAMPLES OF STOCKS	MAR 2002	DEC 2001
Cyclicals/Manufacturers	RMC, Bayer, Linde, Océ	23%	24%
Retail/Services/Logistics	Hornbach, Jones Lang LaSalle, Fraport, Stinnes	11%	12%
Technology Hardware	Toshiba, Samsung, AMD, Foundry	11%	10%
Consumer Brands	Adidas Salomon, Lottecon	9%	11%
Financials	Deutsche Boerse, Alleanza	9%	9%
Software & Media	Mediaset, Novell, Nippon Broadcasting, Seoul Broadcasting	7%	8%
Medical	Draegerwerk, Merck KGaA, Novartis	6%	6%
Telecoms	NTT, Verizon, Korea Telecom	6%	5%
Gold and Other	Gold Fields, Newmont Mining	3%	3%

Henkel interests us from the restructuring it has done recently and the fact that it now derives over 70% of it sales and profits from branded goods such as Persil washing powder, the leader in the category in Europe. The market is not giving the company the benefit of the doubt and still rates Henkel as a mediocre chemical company.

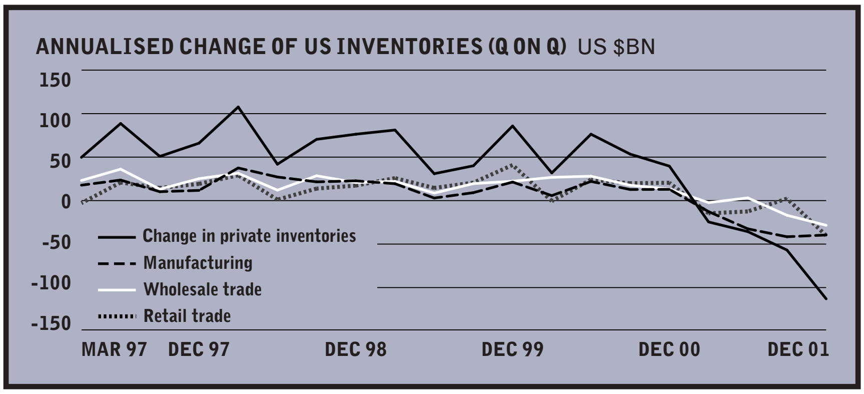
No one can have missed the publicity given to accidents involving the Ford Explorer which caused such animosity between Ford and Firestone. We believe this and the fact that the three major suppliers to the global tyre market are deeply indebted will lead to a significant shift in relationships within the industry to the betterment of profitability. Recent price rises have stuck and there is evidence that manufacturers are prepared to walk away from original equipment contracts if the terms are too pernicious. As the global leader, Michelin is best placed.

As many clerical functions take on more of the character of an industrial process so outsourcing gains momentum. In addition, many IT functions can be more readily outsourced and even, allowing for the servicers' margin, it can make sense for corporations to cede this task to others. EDS fulfills this roll admirably. At present its share price is being adversely influenced by concerns of off-balance sheet liabilities. We believe these to be over-blown and see the price weakness as a buying opportunity.

Currency Commentary

The shift in our currency preference was to add further to our A$ hedging at the expense of the Euro. Nearly 60% of the Company is now denominated in Australian dollars and the balance is largely Euros and Swiss Francs.

The power of low cost money, with the Fed fund's rate at a 40 year low of 1.75%, has worked much more effectively than we had dared to hope. Not only have we seen a strong rebound in consumer spending in the US, but business confidence in Europe has also rebounded; for four months in a row now the IFO survey of expectations in Germany has been rising. This has been anticipated by the market so, as noted earlier, there has been a surge in the value of cyclical stocks.



The focus has now switched to the prospect of tightening interest rates (Sweden and New Zealand have already raised rates). A measure of this is revealed in the forward rates which imply rises of 100 basis points late in the northern summer. As we remain somewhat ambivalent about the strength of the recovery we suspect these forward rates may exaggerate the actual outcome, although, there have been some surprisingly large price rises in several commodities which are *prima facie* in abundant supply eg. steel, various plastics, etc. Nearly all the companies we visited in March expressed disappointment with order levels, with only one out of the 40 companies seeing any indication of improvement. De-stocking has been taking place at an abnormal rate (see the attached figure of US inventories).

The piece we wrote last quarter on Enron proved prescient so we do not share the general feeling of surprise and betrayal. We have long bored our readers with complaints of wholesale transference of corporate ownership via vast stock options – which in addition fail to be accounted for correctly. We have complained about accounting practices, dubious recognition of revenues and worse still, the role played by investor relations officers to apply spin at every turn. Another matter that gets less than due coverage is the predilection of investment bankers to value shares on operating earnings – so called EBITDA (Earnings Before Interest, Tax, Depreciation & Amortisation). This may suit those pursuing M&A fees but does little to inform real investors. The "D&A" part masks all manner of accounting iniquities and the "I" part confuses the fact that shareholders are the last in line to get free cashflow, the source of dividends, retained earnings and the ultimate reason for INVESTING.

The above comments may not seem important to some but illustrate a system that is facing serious imbalances. The Enron debacle and revelations of dubious associated dealings highlighted the amount of off balance sheet risk that prevails. This risk becomes more real as interest rates turn and positions have to be covered.

It has been the ability of the Government's sponsored enterprises such as Freddie Mac and Fannie Mae to cope with massive housing mortgage refinancing that allowed the US consumer to fund housing at progressively lower rates throughout the economic slowdown and simultaneously to free up funds for the purchase of other goods. These entities have progressively increased their exposure to interest rate risk and credit risk. They are, in fact, monumental hedge funds with equity gearing of 64 times through their guaranteeing of mortgages against default and their ownership of portfolios of mortgages. A high proportion of their borrowings are funded short term which at present low rates allows them to make good spreads. To mitigate the risk of a rise in rates they are obliged to be aggressive users of options instruments. As matters stand today a rise in rates need not necessarily cause them great loss but there is no telling whether there will be a period of volatile interest rates nor is one able to predict the behaviour of borrowers. It is difficult to calculate the option premiums they are paying annually but between the two of them it could be as high as $4 billion. Receiving those fees are investment banks and other institutions. In unstable times these interest rate "insurance policies" could become credit risks as margin calls mounted.

The important thing for investors to recognise at this point is that the tide may have now turned. Regulation of corporations will become more stringent, money will tighten and input prices may be on the rise. This is the very opposite of the experience of recent years and implies downward pressure on the reported profits of some companies.

As we look at world markets we continue to be attracted to the values we find in Europe. While this economic block may be slower to come out of the trough than the US we are reasonably comfortable the shares we own are realistically valued. Above is Morgan Stanley's price earnings ratio projections for the US, Europe and Japan.

We are reluctant to follow the crowd and tilt the portfolio decisively in favour of cyclicals because of the reservations voiced above. We have been adding to companies that are in defensive industries because they are attractively priced but somewhat neglected as investors chase after cyclicals; this is another way to say that the market is already building into cyclicals a fair degree of recovery.

PROSPECTIVE PRICE EARNINGS RATIOS

REGION	2002	2003	2004
Europe MSCI	18.8	15.8	14.9
US	30.6	24.8	23.4
Japan	24.1	18.7	17.9

The other fashionable area at present is emerging markets. We see Korea as our representative in this arena though we also have some money in China and India. Some of our Korean shares have been exceedingly strong and as noted above we have tended to sell into that strength. For completeness it should be said that we remain comfortable with our positions in Japan with the caveat that we continue avoiding the Japanese Yen.

Conclusion

Many markets have already built in valuations which partly reflect the anticipated recovery in economic activity globally. Valuations are reasonable in some areas but in a broad sense are not compelling, particularly as we believe there will gradually be leakage of funds out of overvalued sectors such as retailing in the US and some big capitalisation names. These remain our area of attention for shorting. At this stage we believe that high valuations and uncertainties such as rising oil prices and the traumas in the Middle East will restrict the scope for a broad and aggressive advance in share prices globally.

Kerr Neilson
Managing Director

Feature Article: Hagemeyer (Netherlands)

Retail chains, which supply a target market with a defined selection of products, are a familiar concept to most western consumers. In a parallel universe, a less familiar group of companies provide a similar service to the industrial/commercial/business customer. In particular we refer to companies who supply electrical, safety, building or plumbing products to small builders, large contractors and industrial (or institutional) buyers. The underlying business concepts of customer catchment area, product selection, pricing and service are the same as for retailing. Attention to logistics, stocking levels, inventory turnover, gross margin, and sound IT systems are just as crucial.

Hagemeyer is a Dutch distribution company specialising in electrical products (anything from warehouse lighting to home security systems), health and safety products (eg. hard hats or protective gloves) and other MRO products (maintenance, repair and operations – anything in an industrial facility which is not for transformation and resale).

With retail the question may be whether a supermarket is merely renting out space to the branded goods purveyors, (or is it selecting, buying, promoting, differentially pricing, and allocating good or bad shelf space etc to goods)? Similarly, the question with the distributors is whether they are mere vassals of Siemens, GE, Philips etc, or whether their role "adds value" and is thus profitable and defensible. Over the last decade or so a shift has occurred from the former ("vassal") to the latter ("value-added crucial link in supply chain"). This shift can be perhaps traced to the disengagement of the manufacturers from distribution. Siemens sold its German distribution business in 2001 to a venture capitalist – its subsequent bankruptcy perhaps suggests there is more to the task than meets the eye! GE is the last of the US manufacturers to have its own distributor (ie. for the US market), but it is only the US #4, it is not so profitable, and its existence probably speaks to GE's proclivity for opacity in pricing and profitability…

But more generally, the emergence of sophisticated software and managerial systems for coping with vast product ranges, diverse customers and the ever-greater demands for quick delivery is requiring the distribution company to become a "logistics" expert. Given a range of say, 60,000 electrical products, for which the demand will be quite different in the various regions of Germany, how many should be stocked at the local Hagemeyer outlet (called a store), and how many should be kept at one of the vast regional warehouses (called a "DC" for distribution centre)? When does it make sense to accept the higher transport costs to completely fill an order from the DC rather than "open" it three times at different stores before delivery, or would it be optimal to deliver some today and some tomorrow? How should the various options be priced and to whom? There are certainly not prices displayed on these items and one customer will pay quite a different price for his light fittings than the next customer. And how do you (the distributor) cost the different options to ensure you are making money where and when you think you are?

Right now, for example, Hagemeyer is transforming the distribution logic of its US business by building a DC in the south-east (the company's strong region – it will then build another on the mid-Atlantic coast). This DC will stock 80,000 products, and the hundreds of Hagemeyer stores will be able to cut the range of stock they hold from up to 20,000 lines down to 1,500-2,500 fast moving items.

Interestingly, building products companies and plumbing suppliers (and of course Hagemeyer's competitors in the electricals field) are all going through the same process at the moment – this "coincidence" is probably a function of the demands of customers, the consolidation of suppliers, and the stimulus provided by modern supply chain software and systems.

Hagemeyer, however, is interesting to us for two reasons. One is its price (see over) and the other is that the company is taking the evolution of the distributor's role to its next logical step while others watch and wonder (with increasing attention, we detect). That next logical step is what the company refers to as "Integrated Supply", where for large industrial customers (eg. a car plant), Hagemeyer can take over the supplying and management of the customer's entire MRO requirement (ie. those products not forming part of, in this case, the car being built – or the robots building it). As with all these things, the number of items needed in an industrial plant (from heavy duty cleaning products to lighting and air filtering etc) is many more than you first imagine. And just as importantly, companies tend to buy such products erratically and unprofessionally and then store them without discipline (compare this to the devotion they bring to wringing the last cent from their hapless parts suppliers, and their insistence that panels, window glass etc are delivered into the plant only as they are required to go onto the assembly line). MRO products are, after all, *not that important* compared to engines and assembly robots.

And perhaps *"not that important"* would be the favourite words of any company in the business of providing services to another. To Hagemeyer (and its subsidiary CamBar who developed the integrated supply strategy 15 years ago), MRO products are important. Hagemeyer is professional and focused in buying them, and is very disciplined in storing them (ie. not having more on hand than is required). In addition, the integrated supply offering removes the fundamental basis of dissension between suppliers and users – which is of course price. When Hagemeyer enters into an integrated supply arrangement with a new customer, a fee is agreed, and any savings which are made above those contracted (eg. if Hagemeyer achieves a better price with one of it suppliers) are passed straight on to the customer. The books are open on both sides so that a sort of partnership is achieved. Done properly, integrated supply contracts are low risk, reliable return annuity streams (to Hagemeyer). And the plan is to just replicate the service again and again – this is a market where the market leader (CamBar) has 50 contracts in the US (it is just starting in countries like Australia and does not really exist yet in Europe) and 500 US contracts would only be scratching the surface. Of course the integrated supply service sounds easy but can only work when there is a dense distribution network and great buying power behind it. Hagemeyer's sales in 2001 were E8.8bn (A$14.6bn).

Hagemeyer has a history stretching back to its establishment as a family business by the brothers Hagemeijer in the Dutch East Indies (in Surabaya) in 1900. As the company's home page diplomatically observes, "Hagemeyer's history has had its share of both highs and lows". One of these "lows" had been reached by the late 1990s when the company was a collection of distribution businesses that made acquisitions to grow but was not sure where its core lay. New management arrived in 1999 and sold the consumer products distribution businesses and various other diversifications that the company had entered over the previous decades. The decision was taken to focus on the "electro-technical" products (and related safety gear) as the core of the business and in September 2000 Cameron & Barkley of Charleston, South Carolina was purchased and the strategy of building a great electricals distribution and MRO business was under way in earnest. Despite a good rally from April 2000 when new management started to shake the company out of its apathy, the stock fell heavily in 2001 as the slowing global manufacturing economy began to harm volumes (and distribution, despite the endless changes that the business undergoes, is fundamentally a volume game). By late last year the valuation (at 8-9 times depressed earnings) reflected the economic cycle but included nothing for the benefits from the tighter focussing of the company, nor for the potential of the integrated supply strategy. We met the CEO late in 2001 in Sydney (Hagemeyer has large Australian and Asia-Pacific businesses) and again in March 2002 at the company headquarters in Amsterdam. Just as importantly, we met one of the company's leading proponents of the integrated supply strategy in December 2001 and it was then that we understood the renewed sense of purpose and energy at the core of Hagemeyer. We bought stock around E19 and will continue to build the position if and when it comes back from current levels.

Toby Harrop
Portfolio Manager

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