PLATINUM JAPAN FUND

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PERFORMANCE

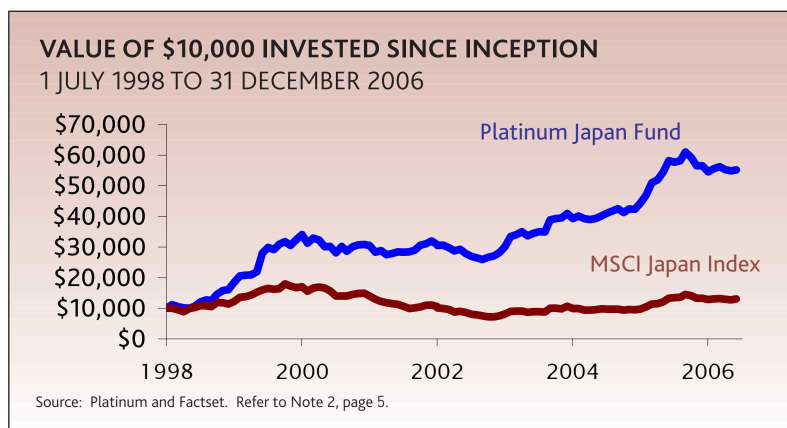
The Fund has produced a very disappointing return for the quarter and the last 12 months. The main culprit has been the strong Australian dollar which rose by 9% against the yen over the year and by 7% alone in the December quarter. The Australian dollar even outperformed the strong Korean won. Essentially we have misread the Japanese yen which we had imagined would have begun to strengthen after 50 months of economic expansion. This caused us to favour entities which would benefit from a more buoyant domestic economy and as a result we downplayed exporters and commodity type of businesses. With the weak yen, some of these companies have been spectacular with the likes of low-rated companies such as steels rising a full 40% in the month of December alone. Beneficiaries of a domestic recovery were in fact laggards with the retailers and financials underperforming the Nikkei. Among these were the Regional Banks which were weak on account of interest rate rises being deferred by the BOJ (Bank of Japan). To the extent that we had exposure to exporters such as Toyota, the performance was excellent, as were our property holdings such as NTT Urban.

Apart from Livedoor, we have not identified any specific lapses in our stock selection. As always, there were opportunities which were foregone such as selling Nintendo too early and perhaps not squeezing more out of the export-orientated shares we owned. The wash-up for the year was an underperformance against the index of 4.1% and by 1.3% for the December quarter.

DISPOSITION OF ASSETS

REGION	DEC 2006	SEP 2006
JAPAN	70%	70%
KOREA	17%	17%
CASH	13%	13%
NET SHORTS	8%	3%

Source: Platinum



Source: Platinum and Factset. Refer to Note 2, page 5.

CHANGES TO THE PORTFOLIO

Major Purchases: Sony, East Japan Railway.

Major Sales: Tokyo Gas, Samsung Fire & Marine, Mitsui Sumitomo Insurance.

COMMENTARY

During our December visit to Japan, an area to which we devoted a considerable amount of time were businesses that would benefit from the new game console cycle. Specifically we met with Sony, Nintendo and game developers such as Square Enix and Namco Bandai.

Having last written about this at the end of 2005, we have been astonished at the change in sentiment towards Nintendo and this gives us reason to question the market's current negative view of Sony.

Central to Nintendo's strategy has been the company's emphasis on what it calls 'Gamer Drift' - the loss of once loyal game players due to the increasing complexity of games that require huge investments of time to enjoy. Nintendo's fixation on this issue (unlike Sony or Microsoft) may have stemmed from their much younger user base and a shrinking demographic in their home market. In fact, in Japan the market for video games matured around 1997-98 and today game software sales are 20% lower than the annual peak of almost 100 million titles. Hardware sales too have been generally flat, despite the introduction of new consoles.

Nintendo once dominated the home console market, but corporate arrogance and a fear of piracy let Sony steal the crown from them with the PlayStation and their market share dwindled even further to as little as 13% with the Game Cube. About two years ago when the market started shifting its focus towards the next generation of consoles, analysts were, somewhat presumptuously, suggesting that Nintendo couldn't compete with the technical savvy of Sony or the balance sheet of Microsoft and should exit the hardware business altogether, following Sega's example.

About this time, Nintendo announced and subsequently released the Nintendo DS, a portable game console with two screens, one of which was touch sensitive. The DS's initial reception was unenthusiastic and it was seen as an underpowered competitor to Sony's PlayStation Portable (PSP) until the market saw the benefits of Nintendo's two hit games, Nintendogs and Brain Training.

Starting in Japan, these two games ignited sales and drew in customers from demographics that had hitherto been virtually unrepresented in gaming - notably women and middle-aged adults. Nintendo has sold more than 10 million copies of Nintendogs and the DS has become the fastest selling game console in Japan.

In some ways the DS was a dress rehearsal for the 'real' battle between Nintendo, Sony and Microsoft which has just started with the release of all three new game consoles (the Wii, PlayStation 3 and Xbox360) onto the market. Nintendo has had to prove to consumers and game developers that they were worth supporting. Just as the DS's pen-based input was a natural fit for older game players, the Wii's motion-detecting controller has the potential to attract older game players to action-based games such as tennis or bowling. Because there is nothing new to learn, the barriers to participation are low.

"The next generation begins when we say it does".

Ken Kutaragi, video-game division chairman at Sony. (*E3, May 2006*).

While analogies can be made between Sony's arrogance today and Nintendo's ten years ago, the negative sentiment towards Sony seems to have been overdone. It may be expensive and production problems have hampered its release, but the PS3 is without a doubt a powerful machine almost ahead of its time. Compared to Nintendo, Sony is actually taking a much larger risk with the

PS3, both financially and strategically. In addition to initially losing $300 for each PS3 sold (compared to a small profit at Nintendo for each Wii), Sony is actually trying to position the PS3 as the centrepiece of the living room, eventually becoming the access point to all one's media consumption, such as high-definition movies and downloaded content from the Internet. Even if it doesn't take the form of a PS3, Sony is hoping the Cell processor (a seven core CPU) which it developed with Toshiba and IBM, will be at the heart of whatever device becomes popular.

Apart from concerns in the game console arena, investor sentiment toward Sony has also been weighed down by recalls of notebook batteries, yield problems in the production of Blu-ray diodes and the ongoing reorientation of management responsibilities. However, when one tries to remove this emotive over-burden, we can identify several areas of success which we believe will allow Sony to have a dramatic turnaround in its profitability over the next 18 months. Most notably, the success of the Sony Ericsson mobile phone joint venture, the current wins at the box office with *Casino Royale, Click and Da Vinci Code*, and the build-up of production of large LCD TVs (the panels being derived from a joint venture with Samsung Electronics). In addition, the electronic components division is beginning to benefit from its cost cutting exercises and as products such as the cell CPU chip migrates to finer line geometries, the profitability will be considerably enhanced.

Sony remains a very powerful technology and marketing entity with a full suite of offerings ranging from hardware through to software such as film studios and game developers. Its distribution channels in the US and Europe are second to none and while the brand has been somewhat tarnished from missed opportunities more than from technical failures, it still has the ability to achieve somewhat superior prices to many competitors. While the market in the next 6-12 months will be focused on the relative successes of Nintendo's Wii versus the PS3, the surprise may be that the intensity of competition will actually expand the game console market.

OUTLOOK

Our recent trip to Japan left us confident in the nation's economic rejuvenation. As is the norm these days, growth is being driven by high corporate profit share, reinvestment and exports rather than consumption although it seems that this will improve with mild wage increases. The liveliness of the recovery remains somewhat dampened by the inevitable effects of government retrenchment from its former supporting role. Probably more importantly, the consumer seems as uninterested in borrowing as ever and this is being reinforced by a credit crunch in the riskier end of the market as the government clamps down on the lending spreads of the consumer credit companies, *Sarakin*.

In market terms, 2006 has been similar to 2005 only in terms of there being great optimism, followed by great frustration. However, we believe there is nothing fundamentally wrong with the case for Japan despite all of the gnashing of teeth. Much of the commentary stems from the failure of the Japanese economic model to resemble the much favoured western model. Instead of the unbridled pursuit of so-called shareholder value, the Establishment in Japan discourage hostile takeovers or private equity buyouts. Even so, there is clear evidence of large organisations moving with the times towards outsourcing and to the discarding of ill-fitting divisions to be melded with those of other organisations in the pursuit of industrial logic. We have also seen the early movers begin to consolidate the small Regional Banks and we believe that before the year is out, this will become a growing trend. Share buy-backs are also taking place by those who genuinely have no better use for the free cash but the intent behind this is, in many cases, purer than the motivation we see elsewhere. As we have said before it is far from clear that the Japanese "method" of wealth accumulation which pursues concerted R&D and capital expenditure is inferior in the long run. If this is matched by less cosy cross-shareholding structures, which is the case, so much the better!

From a technical viewpoint the market looks primed to resume its bull run. The local investors are pitifully under-exposed to their home market, just as was the case in Germany, two years back, with just over 7% of their financial assets in common shares. They continue to chase yield abroad or in the home market via REITs and as was the case in the rest of Asia after the 1997/98 melt-down, few are prepared to take large bets on equities. All our quantitative work suggests that Japanese companies offer some of the best value in world markets and that is before one fully adjusts for the quality of these entities. When we first started singing the praises of Toyota several years ago and suggested that it would be the largest auto maker within a short time, most regarded us with scepticism. We continue to argue that over the next few years, the technical competence of Japanese companies and their financial strength will result in their usurping some of today's champions.

Who said things were getting better? (A chained, cooked chicken photographed outside a smart restaurant).

$US50 for strawberries.

Stocks may be cheap but fruit certainly isn't! A couple of fancy melons for $US280.

$US60 for oranges and grapefruits.

NOTES

1. The investment returns are calculated using the Fund's unit price and represent the combined income and capital return for the specific period. They are net of fees and costs (excluding the buy-sell spread and any investment performance fee payable), are pre-tax and assume the reinvestment of distributions. The investment returns shown are historical and no warranty can be given for future performance. You should be aware that past performance is not a reliable indicator of future performance. Due to the volatility of underlying assets of the Funds and other risk factors associated with investing, investment returns can be negative (particularly in the short-term).

2. The investment returns depicted in the graphs are cumulative on A$10,000 invested in the relevant Fund since inception relative to their Index (in A$) as per below:

Platinum International Fund:
Inception 1 May 1995, MSCI All Country World Net Index

Platinum Asia Fund:
Inception 3 March 2003, MSCI All Country Asia ex Japan Net Index

Platinum European Fund:
Inception 1 July 1998, MSCI All Country Europe Net Index

Platinum Japan Fund:
Inception 1 July 1998, MSCI Japan Net Index

Platinum International Brands Fund:
Inception 18 May 2000, MSCI All Country World Net Index

Platinum International Health Care Fund:
Inception 10 November 2003, MSCI All Country World Health Care Net Index

Platinum International Technology Fund:
Inception 18 May 2000, MSCI All Country World Information Technology Index

(nb. the gross MSCI Index was used prior to 31 December 1998 as the net MSCI Index did not exist).

The investment returns are calculated using the Fund's unit price. They are net of fees and costs (excluding the buy-sell spread and any investment performance fee payable), pre-tax and assume the reinvestment of distributions. It should be noted that Platinum does not invest by reference to the weightings of the Index. Underlying assets are chosen through Platinum's individual stock selection process and as a result holdings will vary considerably to the make-up of the Index. The Index is provided as a reference only.

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Before making any investment decision you need to consider (with your financial adviser) your particular investment needs, objectives and financial circumstances. You should consider the PDS in deciding whether to acquire, or continue to hold, units in the Funds.

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