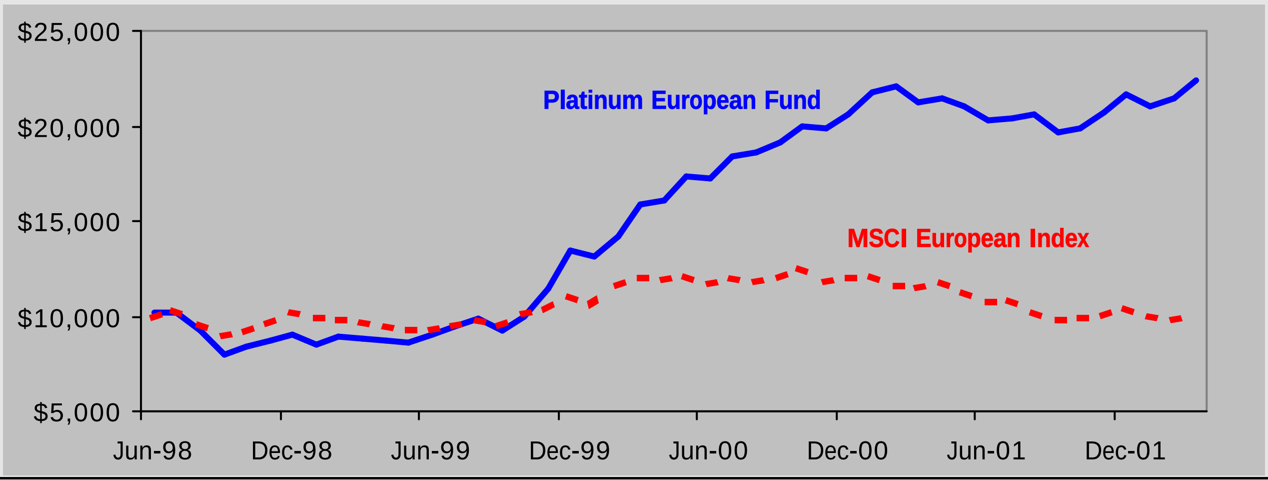
The Platinum European Fund

Performance

REDEMPTION PRICE: $1.8176

VALUE OF $10,000 INVESTED SINCE INCEPTION (30 JUNE 1998 – 31 MARCH 2002)



Market – most stocks up, but index dull and A$ recovering

European stocks were generally up over the quarter, with a range of economically sensitive sectors (autos, travel/leisure, machinery, auto parts, chemicals, steel) showing 10-15% gains, while tobacco (+18%), software (+13%), energy (+13%), and real estate (+12%) also participated. Clearly, the focus for most of the quarter was the seemingly improved prospects for economic recovery. However, offsetting these gains were renewed setbacks for the (still heavy index weights of) telecom equipment (-18%) and telecom operators (-15%). Small losses for the important sectors of food retail, insurance and media contributed to the dull overall MSCI Europe performance of +1% in local currencies for the quarter.

The Euro continued to struggle between 86-89c (US) for the period, and the improvement in the A$ (from 51c to 53.5c) meant that the A$/Euro cross rate increased nearly 7% (to 61.24 euro cents), cutting the MSCI performance to a loss of 4% measured in A$ (Swiss francs, Sterling and the Scandinavian currencies were stronger than Euro which is why the A$ measurement of MSCI was not down even more).

The Platinum European Fund benefited from the strong performances of some of its cyclical stocks, including industrial gases company Linde (+25%), elevators/escalators leader Schindler (+21%), the Dutch distributor Hagemeyer (+21%), and Italian media giant Mediaset (+20%). Offsetting this was a poor performance from our German chemical/pharmaceutical conglomerate Merck, which fell 15% over the quarter as Glucophage generics arrived on the market, and investors worried about the prospects for a key potential product.

Over the past few months we have increased the hedge out of Euros in favour of the A$, at prices around 58 euro cents. With 58% of the portfolio thus positioned in A$, and 42% in various European currencies (of which over half that amount in non-euro currencies – Swiss francs, Swedish Krona and Danish Krone etc), the portfolio was at least partly protected from the rise in the A$/Euro cross rate. The Fund thus rose 4% over the quarter measured in A$, 8% more than the index.

Commentary

March 2002 European company meetings report

In the middle two weeks of March we visited 40 companies in Europe, travelling to Switzerland, Paris, Brussels, the Netherlands, Stockholm and London. Of these 40, the Fund was invested in 10 already, and has subsequently sold one and bought three new ones. The first thing to say is that as to the much discussed “economic recovery”, only one of those 40 companies was able to give us any indication that there was some evidence of improvement, and even that one example was tenuous. Many of the companies are active in the US, where things were generally still worse than in Europe, and the clear conclusion was that things are not worse than the last few months of 2001, but they are not yet improving from that low level. Clearly, the Q1 2002 vs Q1 2001 comparisons will still be very weak, with industrial volumes commonly showing 7-15% (or more) declines. The "second half recovery" at this stage is a purely mathematical truism relating to easy comparisons from mid-2001 onward. This picture tends to confirm our suspicion that the economic recovery implied by the industrial confidence survey improvements mostly relates to general restocking and that there is little underlying strength to capital expenditure plans.

Much more interesting were the details of the individual meetings. Broadly speaking, we saw three groups of companies in March. These were logistics/distribution companies, including both third party warehousing/freight forwarding businesses and actual industrial product distribution companies such as Rexel (France) and Hagemeyer (Netherlands). Second, we saw several food (and general) retail companies, ranging from the multinational giants Carrefour (France) and Ahold (Netherlands) to a discount specialist in Belgium. Kingfisher, a DIY and electrical retailer mentioned at some length in the last quarterly report, also gave us some time in London. Third, we saw a range of companies which represent the industrialising of various cottage industries, from the French private hospital system to European agribusiness and the global bakery supplies industry.

Logistics/Distribution

As mentioned in the "stock story" on Hagemeyer earlier (pages 8 and 9), the logistics and distribution businesses are in a sense coming of age. The potential to reduce working capital tied up in supply chains combined with sophisticated software and cheered on by the trends to consolidation and outsourcing have both demanded industrial expertise and provided good growth opportunities in this area. A Swiss freight-forwarding business we have followed for years confirmed these trends with the expansion of their "logistics" offering (ie. they see the freight forwarding business as being in slow decline while customers such as Nortel now require them to manage the entire worldwide warehousing and replenishment of its products). In addition, the Swiss company has created an international network by buying into the US and setting up a relationship with Sembawang in Singapore, and revealed their interest to take-over Stinnes of Germany (Europe's leading trucking/logistics company, and among the largest holdings of the Platinum European Fund).

Rexel and Hagemeyer are basically distributors of Siemens, Schneider, GE etc products to electricians large and small in most of Europe and increasingly in the US as well. They are changing from vassals of these manufacturing giants to key enablers of efficient management of vast volumes of such goods. It was very interesting to see a UK-based distributor of plumbing products (again with large North American interests) describing its strategy and the trends of its industry in largely the same language. Clearly there is nothing special about lights or taps, it's the software/consolidation/outsourcing trends that are driving behaviour (and opportunities) in the distribution area.

In addition, we saw two software companies – one a Swiss company transforming itself from a warehouse machinery provider (ie. pick'n'pack robots etc) to a warehouse (and supply chain) software company. That is not an easy task (and the company has the debt to prove it) but it was an interesting angle on the topic at hand. And we saw Hagemeyer's main software supplier in Sweden (Intentia, a distribution software specialist for whom Hagemeyer is the largest customer), whose product and tailoring of its product is so crucial to Hagemeyer's efforts to execute its promising business strategy.

Retail

The "back office" aspects of retailing (stock management, re-ordering, warehouse configuration etc) are of course very similar to those referred to above so comparisons here were instructive. However the bigger points to emerge from the meetings with retailers were just as much about the "front office" aspects of formats, pricing, private label etc.

Investors have long been fascinated in the US by retailers who establish a successful format which can then be "rolled out" across the vastness of the United States. Companies such as WalMart or Home Depot open one or two outlets a week (and these are almost the size of the MCG playing surface, remember), and part of the definition of successful is that the businesses are sufficiently profitable to finance this remarkable growth internally. As we have noted before, one of the great strengths of US management is their apparent ability to "scale-up" and manage an army (WalMart has well over a million staff!). Two of the factors helping this style of retailer in the US are space (there are few restrictions, outside special cases such as parts of New England, on opening large stores), and the indifference of American legislators to the destruction of small retailers and their "downtown" or "inner-city" locales in favour of the out of town "strips" and malls.

Neither of these factors apply in Europe and the retail scene, to the frustration of those wishing to replicate successful investment strategies from the

US, requires far different skills. In France, for example, there are heavy restrictions on large store openings of which there has not been a single one since 1996. In Italy Rinascente is the hypermarket leader with around 35 outlets (the market could support 5-10 times this number, but Italians sensibly value small shops and so protect them from unlucky Rinascente and others). Consequently the main growth strategies for the European players are either opening stores elsewhere in the world (of which Carrefour is the undisputed king having been active for three decades in many countries, excluding the US), and opening and/or buying small stores – supermarkets, hard discount outlets and convenience stores.

The German hard discount retailer Aldi has made its two owners (the brothers Karl and Theo Albrecht) third only to Bill Gates and Warren Buffett in personal wealth. One of the fascinating things about the emerging momentum of hard discount retail formats in ex-German Europe is that Aldi is impenetrably private – how could people worth US$25 bn not be a household name?! People pitching for business when Aldi arrived in Australia told us that they were not allowed to take notes of the meeting, were searched on the way in and the way out etc. Thus what should be well understood is a bit of a mystery – except to say that the format of 800-2,500 SKUs (stock keeping units – ie. product lines), mostly private label (but probably manufactured by one of the big branded consumer goods companies), no brand marketing, and 30% lower prices than mainstream brands in a regular supermarket is starting to take off, and not just for Aldi. The French majors such as Carrefour and Casino are hurrying to take advantage of the trend, and the returns on capital are very attractive. This is the “roll-out” growth story for retail in Europe (outside Germany).

Industrialising cottage industries

Technological change, new legislation, or consumer/industrial trends are some of the motivations for “cottage industries” (ie. heavily fragmented, largely privately held industries) to consolidate and evolve into large public companies. The “mad cow” crisis and other food scares, along with the increasing dominance of large scale food retailers (which means that foods such as meat, poultry etc are key parts of the retail offering), have forced parts of the ultimate cottage industry of agriculture to become corporatised. Consumers need to trust the shops they buy from, and the shops need to be able to be sure of the origin not only of the chicken they are selling, but the inputs to its feed. The Dutch company Nutreco (which we visited last year, invested in late in 2001 and visited again in March) supplies large Dutch supermarket chains with poultry. This poultry is grown from chicks produced by the company, which are sold to farmers who feed them with feed produced by the company, and then sell them back to Nutreco for sale to the supermarkets. Hence a sealed system is created (importantly, without the company actually owning the farms) and the credibility of Nutreco is available to the supermarket and hence to the customer. Nutreco offers similar services in pork, and in salmon, where it is the world's leader in fish feed and in fact in fish farming (though the farming is sufficiently volatile due to unpredictable salmon prices that the stock collapsed to allow our entry last year).

Another example is the French hospital sector where private clinics (traditionally owned by individual - or groups of - surgeons for example) are being bought up by a company to take advantage of the greater efficiency a profit-motivated operator brings with bulk buying of equipment, optimising the allocation of surgical specialties etc. The French government has allowed this with tacit approval rather than loud encouragement as the country's healthcare system is among the world's finest and risking it for the sake of penny pinching would be politically foolish. However, like every healthcare system, it is increasingly expensive to run (with all the usual healthcare implications of an aging population), so government is allowing private hospitals to be corporatised and to take market share from the public hospitals.

There are several other such “roll-up” companies we met with of which the fund has invested in three – these three are more interesting than the two above and with more attractive valuations. Additionally, earlier in the quarter, we invested in the Swiss based SGS Surveillance, the world market leader in goods inspection, testing and verification – it is also an investment based around the trend toward accountability and the legal requirements for traceability etc in an increasingly uncertain world.

Portfolio Activity and Outlook

BREAKDOWN BY INDUSTRY

Categories	Examples of Stocks	Mar 2002
Miscellaneous Services	Fraport, Stinnes, Hagemeyer	21%
Chemicals/Materials	Linde, Givaudan, Novozymes	18%
Capital Goods	Océ, Schindler, Siemens, Alstom	13%
Consumer	Adidas-Salomon, Michelin, Henkel, Escada	11%
Financials	Deutsche Boerse, Alleanza, Assicurazioni Generali	8%
Retail	Hornbach, Rinascente	8%
Healthcare	Novartis, Nicox	7%
Tech/Media	Ericsson, Intentia	4%

European markets, observed one of the better strategists in the market, have “run out of valuation support”. (Even the best strategists struggle with plain English!). We observed this three months ago and the index has done little since though as usual there is plenty of movement among the underlying stocks. Given our recent trip where we found several promising investment candidates in Europe, we continue to feel positive about the portfolio while not being terribly optimistic about the markets overall.

At 31 March the Fund was 90% invested and 12% short for a net exposure of around 78%.

Currencies will continue to be a headache as the undervalued A$ battles with the uncertain economic recovery and plenty of speculative “long” positions, while the Euro still struggles to make headway against the perversely expensive US$.

Toby Harrop
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