# PLATINUM EUROPEAN FUND

**Toby Harrop** Portfolio Manager

## EUROPEAN MARKETS MARGINALLY HIGHER; LITTLE CONSISTENCY IN THE PATTERN OF STOCK MOVES

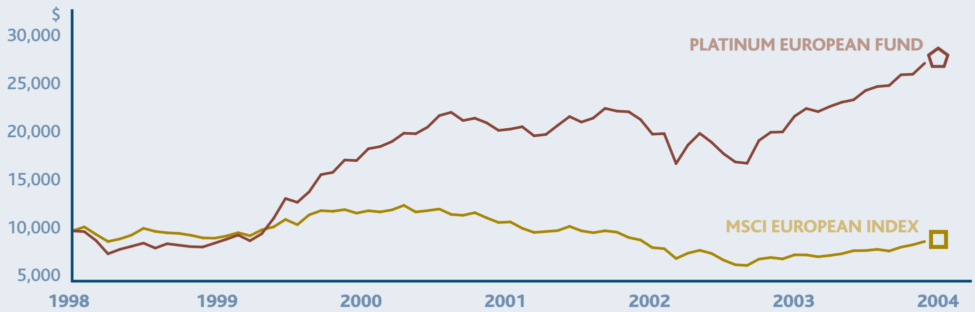
European stock markets were marginally higher over the three months to 30 June: a gain of about 3% was the end result after limited action for the overall market en route. Notably there was little pattern observable in the stock movements as investors continue to ponder the relative strategic merits of the defensive, cyclical and technology parts of the market in the light of still-mixed economic (and interest rate) signals. Geographically, Germany's DAX was 5% stronger, France and Italy were +3%, the UK +2%, Switzerland was unchanged for the quarter while Finland was down 13% – mostly due to Nokia.

Cyclicals such as auto parts (+15%, including Continental +24%) and autos (+11%, helped by Fiat +23%) were strong, but so was the classic "defensive" area of health care (+12%, with good performances from the German pharmaceuticals). On the weak side, only telecom equipment (-16%) stood out, and a lot of that performance was due to Nokia falling 29%, as investors (at last!) began to question the sustainability of the company's extraordinary hand-set profitability.

The MSCI European index expressed in Australian dollars advanced a handsome 12% over the quarter, as the Australian dollar fell sharply against most currencies. For the year to June 2004 the index was 24% higher.

The Platinum European Fund was 9% higher for the three months, as good performances from pharmaceutical companies (Merck +29%, Schering +25%, and Lundbeck +14%) were offset by losses on our Yukos position, losses on our DAX short, and the unfavourable effect of the hedge into Australian dollars. The Fund was up 34% for the year to June 2004.

**VALUE OF $10,000 INVESTED SINCE INCEPTION** 1 JULY 1998 TO 30 JUNE 2004




Source: Platinum and Factset. Refer to Note 2.

**MAGNIFICENT MONSIEUR MARCHIONNE (A TWO-EDGED SWORD)**

One of the investments which has served the Fund well is the Swiss-based inspection and certification group SGS (or SGS Surveillance). This is a company we have looked at for over a decade, perennially expecting the expansion of world trade, and the ever-greater requirements for testing, inspection and certification, to unleash this sprawling conglomerate's great potential. Unfortunately, through the 1990s, potential it remained, as the old guard (owners and management) argued over strategy, and the group became bureaucratic and failed to harness its scale. In Italy meanwhile, the so-called Agnelli holding companies, aside from controlling car-maker FIAT, were investing in various other industries, usually fairly astutely. It was thus of considerable interest to us that they built a large investment in SGS, and when (in early 2002) they installed as CEO the highly regarded M. Sergio Marchionne (who had risen to prominence through aluminium group Alusuisse and risen further running the specialty chemical maker Lonza), we reckoned that SGS had the leader it needed to realise its promise. We bought a good position for the Fund, and visited the company in Geneva at the next opportunity. It is worth noting as an aside that the Lonza share-price suffered upon M. Marchionne's departure (although to be accurate the pharmaceutical outsourcing business of Lonza has become more difficult than foreseen).

Over 2002 and 2003, M. Marchionne's plans and their implementation at SGS became clear to the stock market; meanwhile the rapid growth of Chinese production for export provided high profile growth opportunities (eg. consumer goods must be inspected and tested in China, to meet quality and safety standards for western markets – and WalMart et al employ companies like SGS to do it). SGS thus became a favoured share, doubling in price. We reduced the position when it became really stretched, but recognised that it was still a very interesting investment as the earnings were moving up sharply (from low levels).

Thus, in May, when the core of the Agnelli empire – FIAT itself – made the call for salvation, it was somewhat of a shock and disappointment that M. Marchionne accepted the job as FIAT chief, and inevitably SGS saw its share price hit on the news. Was the hero of the piece indicating that he had done all he could for SGS? Were we wrong to think that the organisation could still improve its operations, harness its scale, and grow in a growing market? Worse still, why would he want to accept the poisoned chalice of running a sub-scale mass market regional car company with Italian labour union difficulties and the Japanese juggernauts seemingly unstoppable in taking market share in Europe? Without being glib, it is no secret that M. Marchionne is a (very capable) fellow in a big hurry, that in fact the Agnelli clan are effectively his boss, that improving FIAT (from a deeply indebted, strategically challenged position) would be as heroic as it will be difficult, and that in reality there is a half acceptable escape route which is a complex put option arrangement to sell FIAT to GM. Perhaps the Agnelli merely need someone from outside Turin to pull the trigger and exit the car industry. Moreover, the Agnelli family remain the largest shareholders in SGS, Marchionne is staying as vice-chairman of the company, and he has appointed an SGS veteran – chosen because he knows the group thoroughly but also because he is the most enthusiastic proponent of M.Marchionne's "new SGS" management approach – as his replacement. By late June the shares were CHF50 below their CHF700 price before the management change, and over CHF100 below where we were reducing the position late in 2003 at the peak of the market hype for the story. At CHF655 we have been buying again, and are impatient to meet the new CEO.

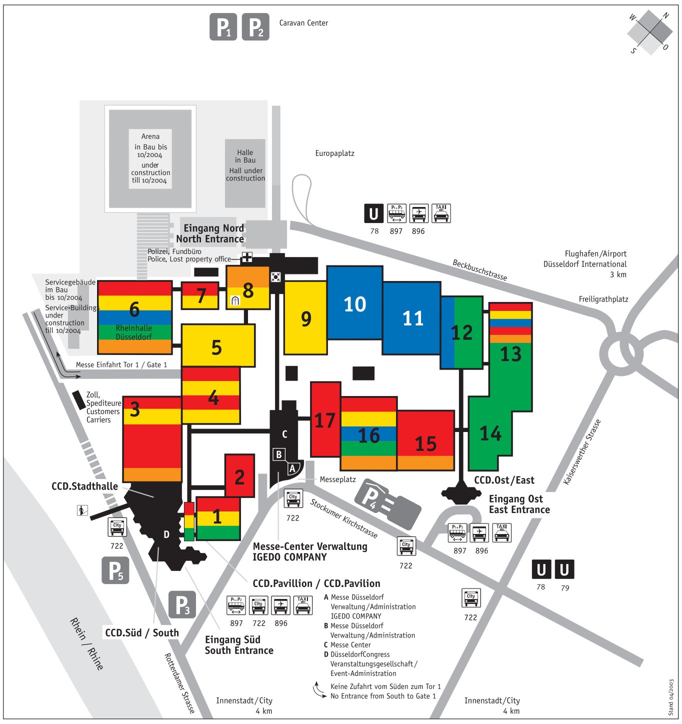
## YUKOS, PAPER COMPANIES INVESTING (?) IN RUSSIA, PRINTING MACHINERY TRADE FAIR

The Russian oil giant Yukos has been a poor performer for the Fund. We invested 1% of the Fund in the stock late in 2003, and the share price was down by about 30% as of 30 June (and still falling). The difficulty, as has been exhaustively reported, is that the company's chairman and largest shareholder, Mikhail Khodorkovsky, failed to respect the understanding that Russia's billionaire "oligarchs" could only keep their ill-gotten assets if they stayed out of politics. After 8-9 months in custody Khodorkovsky has presumably grasped the idea, but as the ongoing court case is revealing, there is a real chance that President Putin demonstrates the strength of his desire for less interference in politics by removing assets (perhaps all the assets) from Yukos itself, rather than merely relieving Khodorkovsky of his shareholding. If in fact the company is left with its oil fields then the stock is worth a multiple of the current price; if not, then…

On a trip to Europe in April, we included a visit to Helsinki to see parts of the paper industry, and one of the interesting issues relates to the supply of timber from Russia. Actual paper making capacity in Russia is small – there is a million tonnes or so of newsprint (capacity), but little in uncoated grades and next to nothing in coated papers. The country has plenty of trees, but limited/old pulping capacity; the government is reluctant to lose control of resources, and obviously wants to encourage downstream processing (pulp/paper making) for employment, economic growth etc. Recently the Russian parliament almost passed laws allowing outsiders (like the giant Finnish paper companies) to buy forest land; instead they allowed timber-cutting rights to foreigners, but no long term lease or ownership arrangement. Meanwhile, the Russians have been tinkering with the taxes and tariffs on unprocessed timber to push the price up to a level that becomes unattractive to the Scandinavians – unless of course they would like to invest in a pulp mill in Russia?! (ie. pulp exports would not attract such taxes). Today a world-scale (say 800,000 tonne capacity) chemical pulp mill would cost perhaps Eu1bn to install, so it is not surprising that the Finnish companies are squirming with worry about investing in Russia – the Yukos affair cannot be very comforting.

Our company meeting tours through Europe have at their core two or three industries on which we are focusing. On April's trip, paper was one such area, a second – coincidentally – was the printing machinery business. Industry trade shows are a valuable part of our research process; having all the competitors in one location, allowing a series of formal meetings with company executives as well as informal access to technicians and salesmen, allows us to cut through to the key issues pretty effectively. In early April, we attended the opening day of the "drupa" fair in Dusseldorf. This trade fair is a once-in-four-years extravaganza for the printing industry, where the focus is the new machinery from the (mostly) German and Japanese giants. Although we knew to expect a large scale event, an exhibition the size of seventeen football stadiums is both daunting and logistically awkward! These are after all large machines, with one of the big German companies requiring two entire halls (ie. stadia) to show their wares, spending an outlandish Eu40mn+ on the 10 day event. We have been looking for investment opportunities in this area for some years, all the while conscious that the "convergence" of analogue and digital printing is likely to be destructive of profitability for many players and beneficial to few. However the scale of the change – eventually high quality, high speed printing plants handling variable data, fully digitally (like a simple office printer!) rather than all the plate setting of the traditional analogue machines – is such that share prices have been dramatically unstable, thus offering investment opportunities. Our conclusion remains – the usual drupa surge of orders notwithstanding – that in general we are still in the midst of disruptive technological change for the industry, so that our conviction on company profitability is modest (at best). An instructive meeting with a large commercial printer in London was a hard-edged reality check after the dreams and excitement on show in Dusseldorf.

### THE DRUPA PRINT FAIR



# CHANGES TO THE PORTFOLIO; OUTLOOK

During the quarter we sold the last of German optical retailer Fielmann, where last year's panic over the removal of government subsidies on corrective lenses allowed us to buy a good company, at a modest valuation (when the share was around Eu30). By April, when the stock was nearly 50% higher, however, we decided that the PE multiple of over 20 times was less interesting in the light of the current dull earnings prospects (the subsidy-removal impact is real for a year or so). The stock has gone on to Eu50 – to our chagrin! – but at this price it is getting expensive. Also in the retail area we ended our brief but enjoyable shareholding of UK newsagency chain WH Smith, when a "financial buyer" announced their intention to bid – subject to due diligence – at about 40% above the prevailing share price. The stock moved most of the way to the expected bid price and we sold our position into the market (fortunately, as it turned out, because the planned takeover subsequently became complicated by issues around the company's pension fund liabilities, and the stock lost much of the bid premium).

Also we sold our British Gas holding (the stock had run up well and the story was widely told), and we sold industrial gases group BOC, where the panic over the company's possible asbestos liability (which gave us our entry point last year) had faded away (as had the discount in the share price). The position in Merck continued to be scaled back into the strong performance of the share.

In April we were surprised at the strong share price of Deutsche Bank, in response to scarcely believable rumours that US giant Citigroup would buy the German icon. We thus sold short Deutsche Bank shares and closed after the fading fantasy lowered the stock price.

We added to several existing positions, notably SGS, Deutsche Post, Credit Agricole, Medion and Siemens. We introduced four new positions to the Fund – one of which was a company we met on our recent trip, the others in previous trips. Finally, we added to the A$ hedge when the Aussie was around Eu58c in May (a bit early as it transpired), so that at the end of June the Fund was 33% exposed to the Australian dollar, 45% to the Euro, and the remainder to Swiss francs, Danish and Swedish crowns etc. The Fund has zero exposure to the pound sterling.

At the end of June (post-distribution), the Platinum European Fund was 81% long, and 10% short for a net exposure of 71% to European equities.

This position reflects an enthusiasm for the larger holdings in the portfolio, tempered by a caution that the market, overall, lacks significant areas of undervaluation. Usually – though unfortunately not always – such a situation is a warning that the broad advance has run its course; it would be a considerable surprise if the next twelve months sees such strong share markets as the last twelve.

**Toby Harrop** Portfolio Manager

**BREAKDOWN OF FUND'S LONG INVESTMENTS BY INDUSTRY** (% OF ASSETS)

| CATEGORIES | EXAMPLES OF STOCK | JUN 2004 | MAR 2004 |
|---|---|---|---|
| **PHARMACEUTICAL/BIOTECHNOLOGY** | NOVOZYMES, NOVARTIS | **14%** | **14%** |
| **MISCELLANEOUS SERVICES** | DEUTSCHE POST, SGS SURVEILLANCE | **13%** | **15%** |
| **CHEMICALS/MATERIALS** | LINDE, MERCK KGaA | **13%** | **12%** |
| **CAPITAL GOODS** | OCÉ, SCHINDLER, SIEMENS | **12%** | **7%** |
| **FINANCIALS** | CREDIT AGRICOLE, NORDEA | **9%** | **5%** |
| **TECH/MEDIA** | ERICSSON, INFINEON TECH | **8%** | **11%** |
| **CONSUMER** | ADIDAS, HENKEL | **7%** | **9%** |
| **RETAIL** | HORNBACH, DOUGLAS | **5%** | **9%** |

Source: Platinum

## 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 World Accumulation
Net Return Index in A$

**Platinum Asia Fund:**
Inception 3 March 2003, MSCI Asia Free ex Japan
Net Return Index in A$

**Platinum European Fund:**
Inception 1 July 1998, MSCI Europe Accumulation
Net Return Index in A$

**Platinum Japan Fund:**
Inception 1 July 1998, MSCI Japan Accumulation
Net Return Index in A$

**Platinum International Brands Fund:**
Inception 18 May 2000, MSCI World Accumulation
Net Return Index in A$

**Platinum International Technology Fund:**
Inception 18 May 2000, MSCI Global Technology index in A$

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.

Platinum Asset Management Limited ABN 25 063 565 006 AFSL 221935 as trustee for the Platinum Asset Management Trust (**Platinum**) is the responsible entity and issuer of the Platinum Trust Funds (**the Funds**).

The Platinum Trust Product Disclosure Statement No. 5 (**PDS**), is the current offer document for the Funds. You can obtain a copy of the PDS from Platinum's web site, **www.platinum.com.au**, or by contacting Investor Services on 1300 726 700 (*Australian investors only*), 02 9255 7500 or 0800 700 726 (*New Zealand investors only*) or via invest@platinum.com.au.

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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