PLATINUM ASSET MANAGEMENT

Platinum International Fund

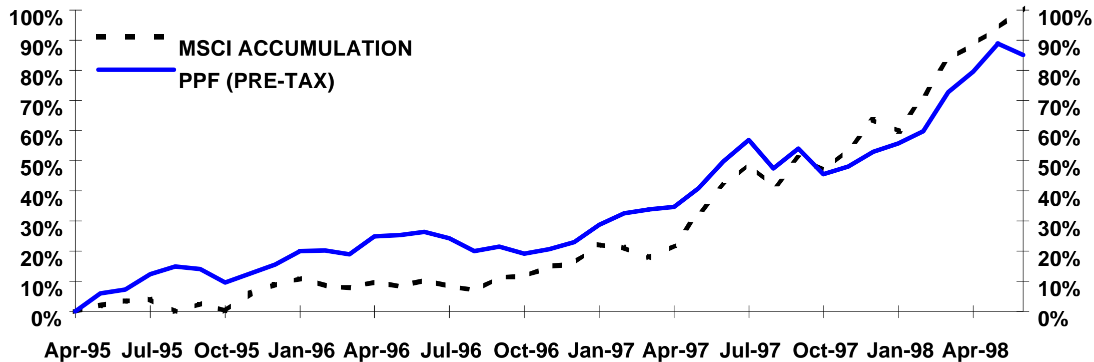
(formerly Professional Fund)

QUARTERLY REPORT

30 June 1998

Performance

Europe continued to lead the bull charge with the likes of France and Germany up by 18% and 24% respectively in A$ terms. Asia melted further led by Indonesia (down 50%) while Japan held its ground. The emerging markets of Latin America suffered from the Asia contagion with Brazil being off by close to 17%. The irrepressible US market lumbered upward and onward and ended the quarter up 10%. We have generally had a good start to the year achieving 7% in the quarter and 21% for the first six months.



PPF Cumulative Performance versus MSCI World Accumulation Index

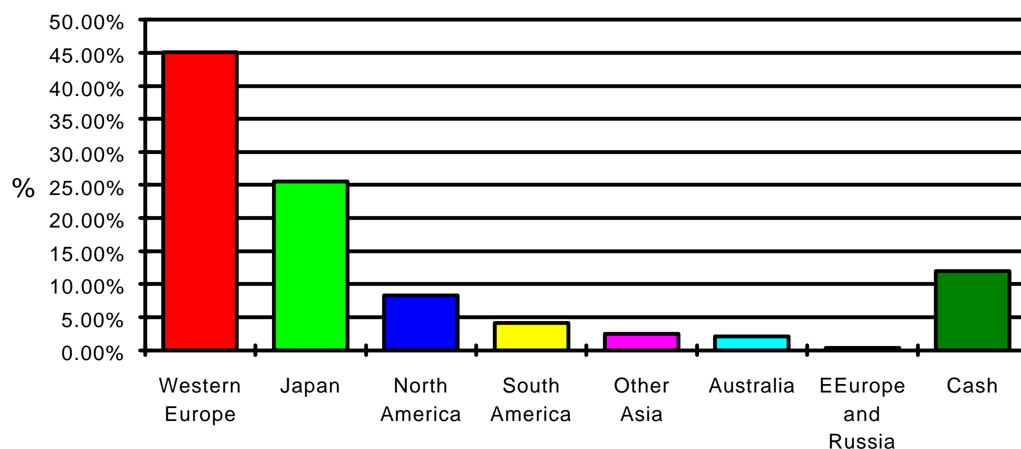
Top Ten Holdings (as at 30 June 1998)

Stock	Country	Industry	Holding
Rinascente	Italy	Retail	4.9%
Swiss Industrial Group	Switzerland	Packaging/Engineering	3.1%
Acuson	US	Medical Equipment	2.8%
Hornbach	Germany	Retail	2.8%
Sony Corporation	Japan	Electrical Equipment	2.7%
Mikuni Coca-Cola	Japan	Bottler	2.7%
Douglas	Germany	Retail	2.6%
Fuji Photo Film	Japan	Photographic Equipment	2.5%
Lagardere	France	Media/Defence	2.5%
Siemens	Germany	Electrical Engineering	2.4%
TOTAL			**29.0%**

Breakdown of Portfolio by Themes

Category	Holding	Examples
Retail	20%	Rinascente, Sainsbury, Hornbach, Douglas, Continente, Valora
Consumer/Stable Growth	16%	Fuji Photo, Nintendo, Wella, SIG, Sony, King World Productions, WPP
Pharmaceutical/Medical	12%	Yamanouchi, Daiichi, Diagnostic Products, Acuson, Draegerwerk
Information Technology	12%	Samsung, Canon, Kyocera, Toshiba, Qualcomm, Siemens, Lagardere
Food/Beverage	10%	Coca-Cola Bottlers, Pernod Ricard
Cyclicals	8%	Sekisui House, St Gobain, Pilkington
Finance	8%	San Paolo, Toro, Itausa
Traded Goods and Other	5%	Schindler, Octel

Disposition of Assets



Commentary

The striking feature of world markets at present is their dichotomous nature. The weak are being pummelled while the strong are applauded. It is difficult to find any historic precedent where markets have so differentiated between the two. In particular, we find emerging markets being valued as though they will always have high risk premia and presumably low growth. Quality listed companies in South East Asia and Latin America are now found trading on low trailing PEs, typically 7-12x. Such quality companies have very strong business franchises supported by a history of high profitability and growth and in general, modest levels of debt (lesser companies are being valued more harshly still). The explanation for these low valuations may lie in the fact that their host countries have surrendered their independence to the whims of international capital providers which we warned of in September 1997. However, do investors really believe that these companies have gone ex-growth or that risks have risen to such high levels that they warrant differentials in valuations of the order of 1/2-1/3x comparable businesses in the developed world?

Turning to the “Western markets”, we can observe a narrowing of leadership and a preference for companies with seemingly clear growth prospects. Here one identifies well-known, brand type companies or at an extreme, the likes of internet stocks, mobile telephony and associated businesses. We are being asked to pay high multiples of sales on the basis of prospective customer sign-ups and in some cases dubious assumptions that the present level of gross operating margins will be sustained even when the helter-skelter growth subsides.

For your interest, we show below a table of typical internet stocks. Note that we do not bother giving you PE ratios but instead show you how these stocks are priced as a multiple of annual sales. These have become the icon of this stage of the bull market.

Company	Price US$	Market Cap US$ bn	Price to Sales Ratio x	Price Change Year to Date
Amazon	124	6.1	27	+312%
America Online	110	23.8	10	+144%
At Home	52	6.1	827	+106%
Doubleclick	72	1.2	22	+173%
Lycos	79	1.5	24	+91%
Netscape	41	4.0	8	+69%
Onsale	26	0.5	4	+42%
Infoseek	38	1.2	24	+249%
Excite	99	2.4	28	+230%
Yahoo	173	8.0	89	+150%
S&P 500 Index	1146	9074.0	2	+18%

The origins of this dichotomy lies, we believe, in the deflationary tendencies that are so evident (these in turn have their origins in massive currency imbalances that created surplus capacity in manufactured goods). In their attempts to avoid the eddies of sloth, investors have charged headlong into the more promising pastures of Europe and the US. Moreover, within these markets themselves there has been the same tendency with investors preferring to pay high valuations for large, predictable earners in preference to their smaller, though equally steadily growing, brethren. Given our philosophy to invest in under-priced, neglected stocks, it is evident that we find the oppressed more interesting than the lauded. However, we are unwilling to simply buy the deeper value because of the great uncertainties and weak macro-economic factors which will bear down on many businesses for the time being. Our preference is to mostly occupy the middle ground of companies with strong businesses that are growing and where valuations are attractive in a world where the risk free rate (ie. government bonds) looks like staying around 5%. In Europe, this growth is often seen in restructuring/rationalisation plays and/or consumer sensitive companies. In Japan, our focus is very specific with the emphasis split almost evenly between drugs, Coca Cola bottlers and exporters/technology stocks. The few holdings we have in the United States are profit margin recovery plays led by new product introductions. Sprinkled throughout the portfolio there are several deep value plays.

Outlook

It would be surprising if the dispersion in valuations between perceived good and bad does not narrow.

It is true neither that the Eastern hemisphere is without interesting opportunities nor that the Western hemisphere has found the elixir of ever increasing profits and low risk. Our sense is that at present valuations, the risk adjusted attraction of specific stocks in Eastern markets is at least as attractive as those in the West.

While we are very conscious of the economic and social disruption caused by the collapse of confidence in Asia, some very interesting opportunities are emerging. Moreover, changes are being instituted and in particular the illiquidity of the Japanese banking system has now been addressed.

Our recent visit to Japan reinforced our view that companies have become much more conscious of globalisation and the need to make respectable returns on funds employed. Although these lessons are being learned reluctantly, the response one now receives in company meetings is more positive and direct. It does not take a lot of imagination to envisage a scenario which is very positive for the better companies within the country and this should translate into higher returns. Further, we note that even in this dull market (down 3% over six months (U$)) we have made good returns from Japanese stocks (earning 12% in aggregate in the last six months).

In the rest of Asia, we are starting to take more interest now but remain wary about profit transparency.

Within Europe, we are likely to continue to see rotation within the market just as has occurred in Wall Street. We will continue to try to move with the emerging trends, however the focus will remain on restructuring/rationalisation ideas which are now entering their second phase. As the portfolio composition suggests, several of the domestic-focused retailers meet these criteria.

The US market is showing the same tendencies as we have highlighted in the past with the most popular stocks being attributed ever higher valuations. There is a clear tendency for the smaller stocks to under-perform the S&P index. Those with capitalisations of $2 billion or less have typically declined by more than 20% from their 52 week high; indeed by greater amounts for those with caps below $0.5 billion. Conversely, companies with capitalisation above $20 billion are still close to their 52 week high.

Conclusion

The changes we have made within the portfolio, and the preference for moderately valued companies with growing profits, gives us some comfort in an environment of generally extravagantly priced equities. Further, we will maintain our short against Wall Street and have introduced some hedging of the UK FT Index and German DAX to provide additional protection.

Stock Story - Diagnostic Products (USA)

Diagnostic Products is a David fighting against the Goliaths of the medical equipment and pharmaceutical sectors. A small, family-run business, it was started in 1971 in the kitchen of the founder to develop tests ("assays") to detect such things as infertility, folic acid, prostate cancer, and thyroid problems. The company has a strong track record of growth but despite compounding sales at over 20% remains small, with less than US$200 million in sales.

In the Seventies and Eighties, tests were done by combining a patient's blood sample with a radioactive reagent (the key product supplied by the diagnostic company) and measuring the radiation using a standard geiger counter. However, over time the industry has been shifting away from radioactive tests because of safety concerns and the high labour costs of manual testing. Automated testing using non-isotopic antibodies has grown rapidly, with as many as two hundred tests being run on the fastest machines every hour. The machinery involves a carousel to incubate the test tubes containing combined blood/reagent samples. These are fed into a device that fires light photons at the mixtures and measures the reaction, achieving high levels of accuracy. The test tubes are barcoded which eliminates human error and allows minimal labour input. Once the samples are loaded in the carousel, a computer controls the process: the appropriate reagents are added, incubation times monitored, test results measured and reported, and on the new machine further tests are ordered and carried out if the results are inconclusive. The highly paid laboratory technician can do all this in her sleep! Once a machine has been leased or bought by a laboratory, supplies of reagents must be ordered frequently to carry out the tests, making this an attractive "razor and blades" business. Indeed, when we visited the company we found them adjacent to Los Angeles airport, a convenient location for shipping reagents with a limited shelf life to laboratories around the world.

The Goliaths of the industry are companies such as Abbott, Roche, Chiron and Johnson & Johnson. With ample resources, these companies were quick to bring automation to the market. Diagnostic Products was late in following the shift in testing and bought an embryonic company, Cirrus Diagnostics, in 1992. This allowed the company to make the transition to automation and over 3,500 "Immulite" machines have now been placed in laboratories around the world. However, although the machine offers one of the widest arrays of tests and superior accuracy, it is less automated than the competition. Equal to the challenge, the company developed a new generation machine which has been introduced ahead of competitor proposed new offerings and appears to exceed their performance. Selling or leasing machines is important because the reagents are specific to each company's machine; the blades cannot be sold if the razor is not sold first. Because the new

machine is more automated and suits the major hospitals and laboratories, the demand for reagents will increase significantly.

An exciting development is the scheduled launch next year of the “Immugold”, a diagnostic process for rapid results. Traditional test methods process samples for more than an hour because the blood has to be incubated with the reagent for a set period. The new technology, patented by Diagnostic Products, detects fluorescence occurring when sample blood molecules bind to the reagent on a thin strip of gold. Initially targeted at emergency rooms and doctors’ offices where the rapid results would be in demand, this may also be the accepted testing technology of the future. Although large companies have an advantage in distribution and name recognition, they have no monopoly on major innovations. We would expect to pay handsomely for a company with a record of growth and innovation, and with a predictable, bright future. It seems like a steal on less than 15 times next year’s earnings and twice book value (the US market is on 23 times those earnings and almost six times book value).

Kerr Neilson
Managing Director
13 July 1998