PLATINUM ASSET MANAGEMENT

Platinum International Fund

Quarterly Investment Report

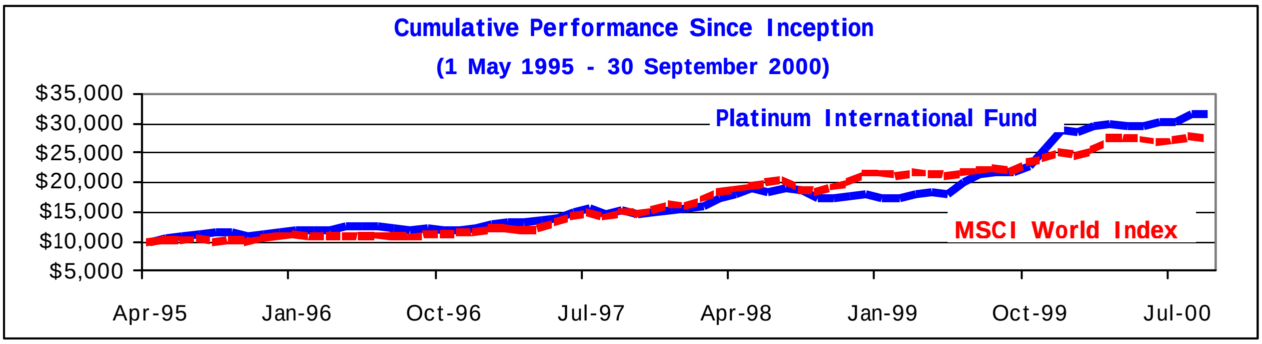
September 2000

Redemption Price: $1.5202 Fund Size: $135 million

Performance

There has been little momentum on the long side this quarter and indeed for the year to date. The weakness of the Euro and the steep lift in the oil price have punctured investor optimism and brought into question the level of valuation of high growth stocks. There has been a systematic shuffling of the pack with the dot coms being the first to fade in December/January (prices are now down by up to 90%); this was followed by the telcos and subsequently by the telco equipment suppliers by around July. Now we are starting to see the untouchables doubted, the likes of Oracle, EMC, Siebel: the consequence of this is that the Nasdaq has fallen by 11% year to date (–7% for the quarter) and with it the likes of the *Neuer Markt*, Kosdaq index etc. The broader markets have not shown the same destruction on account of rotation into hitherto dull areas like utilities and financials. As a consequence, the overall MSCI World Index is up 12% year to date (+5% for the quarter).

The Fund has benefited from its early migration away from TMT (telecoms, media and technology) and from adding to existing low valuation plays. There have been some successes with shorting the likes of Intel, Nokia and Cisco. Offsetting this good work has been the cost of hedging into the A$ and Euro. The consequence is that the Fund has risen by 4.3% over the quarter and 9.6% for the year to date.



Changes to the Portfolio

There has been little thematic change in the portfolio. In Japan we reduced our exposure to domestically sensitive companies like house building and coke bottlers. Further, we added Mitsui OSK which is the world's largest owner of oil tankers and natural gas carriers. Unlike in Europe where its competitors have surging stock prices, the market is only now starting to appreciate its strategic position.

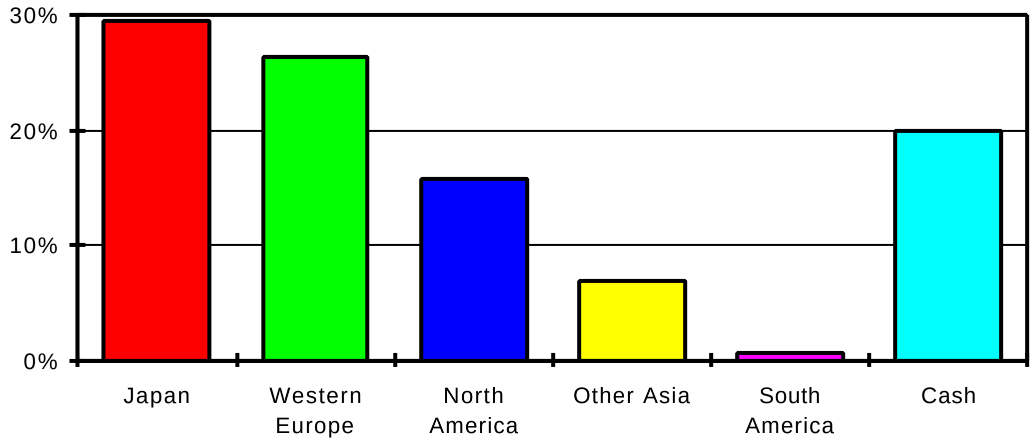
In the US, we added to Ambac (credit insurance) and bought more AMD, Verizon, Lucent, National Semiconductor and Novell after sharp price retracements. Later in the quarter, the doubling in the price of JD Edwards offered a good exit price for the stock and we used a similar move in the price of Peoplesoft to bring the holding below 5% of the portfolio. Acuson was bid for by Siemens at a 60% premium; Silicon Valley Group was also bid for at a similar premium in early October.

In Europe we sold the remaining Ericsson and Smiths Industries. Toro was bid for at a 40% premium. The only new holding was Adidas-Salomon, which is going through a thorough overhaul. We added to most of our existing positions.

Breakdown by Industry

Categories	Examples of Stocks	Sep 2000
Cyclicals	RMC, Akzo, Bayer, Stinnes, Linde	16%
Technology Hardware	Toshiba, Samsung, National Semi, AMD, Fujitsu	13%
Telecoms	NTT, DDI, SK Telecom, Lucent	11%
Software & Media	Novell, Peoplesoft, Nippon & Tokyo Broadcasting	8%
Medical	Acuson, Draegerwerk, Medison, Merck KGaA	8%
Consumer Brands	Lotte Confectionary, Japanese Coke Bottlers, Adidas Salomon	7%
Retail/Services/Other	Hornbach, Raytheon, Loewes	7%
Financials	Lippo, Japanese Brokers, Nordic Baltic Holdings	6%
Consumer Durables	MEI, Citizen Watch, Sony	6%

Disposition of Assets



The fund's short position is 2% against the Nasdaq 100, 9% against the S&P500 and 13% against individual companies.

Currency

As noted above, we have been poorly placed with regard to the US$ with our hedges into the A$ and Euro. However, the arguments we now hear against these currencies, have a vacuous ring. While unable to be precise, we sense that they are close to a bottom and when there is a reversal, it could be explosive.

Presently 44% of assets are hedged into A$, 12% into US$, 33% remain in the Euro, Pound and Swiss Franc and 4% in Yen.

Commentary

Priced for perfection was an oft-heard expression over the last two years. Productivity has certainly carried its weight; inflation has been remarkably subdued, and now with the slowing of the US economy, the threat of more expensive money has been held in abeyance. However, two imperfections have arisen. The oil price has risen sharply and the weak Euro, which was initially shrugged off, is having unexpected consequences.

The current oil price movement is not far short of the spike experienced during the first oil shock of 1973. A price of some US$30 per barrel is nearly three times that of January 1998 and indeed the average oil price for this year will probably be twice that of 1999. The consequence of earlier shocks was to drive the world economy into recession. This time around, the benefits of lower oil dependency, broad technology-led growth, a milder inflationary undertone and a somewhat less panicky consumer response should militate against too dramatic an impact. OPEC is seemingly less belligerent too and has agreed to bolster its production by a total of 3.2 million barrels per day, a rise of over 11%, and equivalent to approximately 4.2% of world consumption. However, because of bottlenecks throughout the supply chain and the desire by some to increase their national strategic reserves (China, Korea and Poland), it is unlikely that the oil price will recede below $30 for some time.

That there will be a negative impact on consumer spending is clear. Unlike the 1973-74 episode where inflation was prevalent and growth scarce, the world today is rather different. The ability of firms to pass on these cost increases is much reduced. Hence, one should expect compression of companies' profit margins in the face of rising input costs.

The weak Euro is exacerbating these cost pressures as oil is priced in US$. Since its formation in January 1999, the Euro has depreciated by 25% versus the US currency. European companies are feeling the squeeze throughout – fuel, chemicals, plastic packaging etc. For American based multi-nationals, there is the added insult of their European-sourced profits being translated into fewer US$. Hence the profit warnings from Gillette, P&G, DuPont et al.

As signs of a general slow-down build, so the focus has moved away from concerns about the Federal Reserve Board or other Central Banks intervention towards the likely fulfilment of the growth promised in the valuation of tech and other highly rated stocks. Looking at information technology, it is interesting that business computers and peripheral equipment now account for $60 out of each $100 spent on durable equipment in the US versus $10 in 1975. Just as in earlier periods (the PC boom of 1985), one senses that the market is readying itself for a reassessment of the growth in IT spending, and by extension, that perhaps the sector deserves a lower valuation. We believe the earning cautions by Intel, Apple, Dell & Co are precursors of this adjustment.

In their search for new opportunities, investors have rotated into financials and utilities. Other areas that have historically proved attractive refuges have lost that lure. Pharmaceuticals are under pressure from Mr Gore's populist promises; consumer goods are suffering from having already achieved the benefits from improved systems and upward pricing drift and now face more difficult times in the face of limited volume growth and the cost pressures alluded to above. Retailers are likewise facing a less buoyant future as a result of the legacy of earlier large additions to selling space and a fickle public. Marks & Spencer, the venerable UK-based store group epitomises these problems and has suffered the additional burdens of complacency and arrogance. Changing shopping patterns are taxing even the more agile groups including Gap and Hennes & Mauritz. After years of continual growth, they are struggling to read consumers' present desires. Adding to their problems is convergence of shopping habits and the frightening prospect of Walmart adding 40 million square feet in 2001 – 8% of its current selling space. For perspective, one million square feet is the equivalent of a good sized regional shopping centre!!

Even though there is significant rotation, there is still a massive difference in the valuations between so-called "growth" and "value" stocks. Some recent work by Goldman Sachs on their global universe of 1,300 companies shows how the valuation of “growth” stocks has moved up from 22 times earnings in 1991, to 57 times now, while “value” stocks have remained on PEs of 11 times. Implicitly, “growth” stocks reveal rising expectations about the future, so much so that Goldman calculates that these shares are pricing in 15% pa cash flow expansion over the next 15 years compared with a 2% pa rise for the “value” stocks. The implicit growth differential is at an extreme and more interesting still, is that the past ten years' earnings record of the “value” universe has been 8% pa, while the “growth” universe has achieved 19% pa.

We would be surprised if the valuation gap doesn't narrow. It is common to hear financial commentators referring to respectable, if unexciting companies, as“dead money”. We nevertheless find that it is precisely these companies that are the target of take-over bids. In the last quarter, we have received bids for three of our holdings, Acuson, Silicon Valley Group and Toro simply on the grounds of industrial logic.

These bids were pitched at up to 60% above the prevailing market price. Further, this process can be expected to continue as globalisation favours size and reach. On a risk-adjusted basis we would rather place our bets on industrial logic than investment fashion.

Optimists who favour the high valuation segment continue to point to the strong inflows into mutual funds and the evident growth prospects that result from the internet revolution. We have no argument with either of these observations other than to point to supply. Investment bankers have hardly been idle of late, recommending to their clients all manner of schemes that will supposedly unlock shareholder value. Tracking stocks are all the rage but more delicious still is the prospect of listing small in-house technology hot houses in the belief that their listing will unleash an even greater level of animation on the part of shareholders. No longer can market participants be trusted to value individual parts of the business yet the greatest conglomerate of all, GE, is valued above 40x (with 1/10 of EPS coming from non-recurrent pension benefits).

Conclusion

As noted above, the valuation of shares is highly dichotomous. Greater attention is now being paid to the business dynamics and valuations of many high-tech companies. At the same time, companies sensitive to deteriorating growth such as chemicals, paper, forest products and construction materials are back to levels of 6-8 years ago.

We believe there will be further erosion in the valuation of high growth companies but that there is a large constellation of opportunities in the middle ground. These are generally smaller companies that have the ability to achieve growth and yet are priced to deliver almost none.

Stock Story – Peoplesoft (US)

Peoplesoft were one of the early providers of software products designed to run on networked PC's (known as a client-server environment) that could be used by large companies to run their businesses. Peoplesoft built leading positions in human resources and financial applications while competing against companies such as SAP and Oracle. From 1993 to 1998, revenues increased more than twenty fold to over $1.3 billion.

Two major problems appeared in early 1999. Companies started to cut back on software purchases, having already completed year 2000 remedial work on their IT systems. Then the focus of corporate IT spending moved to the internet and companies became more focused on spending on “outward facing” applications that concentrated on managing customer and supplier relationships rather than internal processes such as human resources. Given this “outward” focus, it became necessary to “web-enable” software applications so that they could be accessed over the internet even if they were not loaded on the individual PC (ie. by using a web browser). Peoplesoft, along with the other leading enterprise software companies saw sales of new products collapse and profits disappear.

In May 1999, Craig Conway joined the company, initially as chief operating officer and then as CEO. Conway's history included eight years at Oracle in senior sales and marketing roles as well as with two successful software start-ups. The critical decision was made to completely "redesign" all of Peoplesoft's applications so that they could be accessed through a web browser. This was a significant effort that required rewriting over 30,000 screens, and a research and development investment that absorbed over 25% of revenues during the last year. The other important development was the acquisition of Vantive who were the number two player in customer relationship management (CRM) software, one of the new fast growing areas. The company also partnered with Commerce One to develop e-procurement software used by companies to hook into business to business electronic exchanges. Peoplesoft continued to develop new applications in areas such as supply chain and analytics.

This effort culminated in the launch of Peoplesoft 8 in July 2000, a suite of web-enabled applications addressing both their traditional segments as well as the new fast growing segments. The company is well positioned versus its traditional competitors who are at the very early stages of re-writing applications for the web or still struggling to enter new areas such as CRM. Versus the many new entrants in the software market, not only does the company have an already profitable and cash-flow positive business, with cash balances in excess of $600 million, but it also has the advantage of a significant existing and highly satisfied customer base. The last stages of the turnaround are now under way with the company building up its sales force for the launch of Peoplesoft 8.

Platinum initially purchased Peoplesoft during 1999 at prices around $15. The stock price then ran up with the explosive take-off in technology and telecom stocks only to return to $15 in the second quarter sell off. By this stage, the "bull case" had become even clearer with the development of Peoplesoft 8 near completion. At this point, Platinum doubled its position in the stock. At the prevailing price of $15, the company was valued at just over twice revenues which we expect to grow at a rate of 30% for at least the next three years. Meanwhile, major competitors such as Oracle are valued at almost 20 times revenue while growing at similar rates (at best). Subsequent to our recent purchases the stock has moved up to over $30 as the early signs for revenue growth post the launch of Peoplesoft 8 are very encouraging. We have tended to cut our position as the stock rises to ensure that overall exposure stays around 5%.