Platinum International Technology Fund

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Overview

- Fund performance was affected by weakness in the semiconductor capex space due to concerns about oversupply and emerging doubts about the size of the AI opportunity.
- Market weakness gave us the opportunity to buy into some quality software businesses at attractive valuations.
- In this Quarterly we take a look at our approach to shorting. We short stocks seeking to protect the portfolio by reducing the Fund's net invested position and to take opportunities to increase returns. We outline five key market/firm set-ups that offer shorting opportunities.

Performance

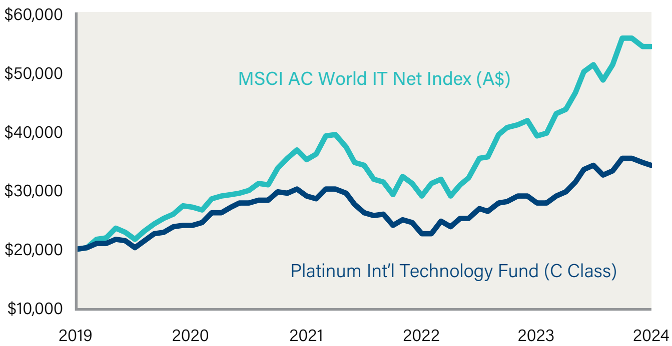
compound p.a.+, to 30 September 2024

	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum Int'l Tech Fund*	-3%	23%	6%	11%	10%
MSCI AC World IT Index^	-3%	38%	15%	22%	6%

\+ Excludes quarterly returns.
* C Class – standard fee option. Inception date: 18 May 2000.
After fees and costs, before tax, and assuming reinvestment of distributions.
^ Index returns are those of the MSCI All Country World IT Net Index in AUD.
Source: Platinum Investment Management Limited, FactSet Research Systems.
Historical performance is not a reliable indicator of future performance.
See note 1, page 5. Numerical figures have been subject to rounding.

Value of $20,000 invested over five years

30 September 2019 to 30 September 2024



After fees and costs, before tax, and assuming reinvestment of distributions.
Historical performance is not a reliable indicator of future performance.
Source: Platinum Investment Management Limited, FactSet Research Systems.
See notes 1 & 2, page 5.

The Fund returned -3.2% in the September quarter. Semiconductor capex stocks (**ASML** down around 20%, **Applied Materials** -15% and **Lam Research** -23%) were major detractors as the market was concerned about memory market oversupply, Intel cutting capex and a cooling in AI enthusiasm.

We made the following changes to the portfolio:

- Two large market drawdowns provided us with the opportunity to buy companies with good long term growth prospects at what we believe to be attractive valuations. We added to design automation[1] software names **Cadence** and **Synopsys** and bought a 1.5% position in **Tokyo Electron**, one of the big five semi production equipment providers.
- We also bought a 4% position in **Nice Ltd**, the leading SaaS provider of enterprise grade call centre software. We like the business as call centre software is mission critical, complex to execute and customers stay with one vendor for 8 to 10 years. Nice is down ~35% from March highs and trades on a meaningful discount to its future growth prospects amidst concerns that AI agents will disintermediate call centre software. We believe that generative AI will be sold as an add-on to make human agents more efficient, and further strengthen the position of market leaders as opposed to disrupting them.
- We funded these positions by trimming defensive names that held up well during the sell offs (**ICE**, **Netflix**) or by exiting companies we think trade on expensive valuations (**Apple** and **AMD**).

Our updated portfolio and Quality/Growth matrix is presented in Figure 1 and 2 (as at 30 September 2024).

Figure 1: Portfolio Holdings

Portfolio holdings – positions above 1%

BUSINESS QUALITY	GROWTH POTENTIAL: LOW POTENTIAL	AVERAGE POTENTIAL	HIGH POTENTIAL
BEST IN CLASS	Visa, ICE Universal Music	Google, Meta, Microsoft, Adobe, SAP, ASML, Oracle, Cadence, Synopsys, Computer Modelling Group	–
ABOVE AVERAGE	Analog, Devices, Texas Instruments, NXPI	Netflix, TSMC, AMAT, Broadcom, Lam Research, Keyence, Constellation, Nice Ltd, Tokyo Electron	Amazon, Veeva Adyen
AVERAGE	–	–	–
BELOW AVERAGE	–	–	–

Source: Platinum

Figure 2: Quality/Growth matrix

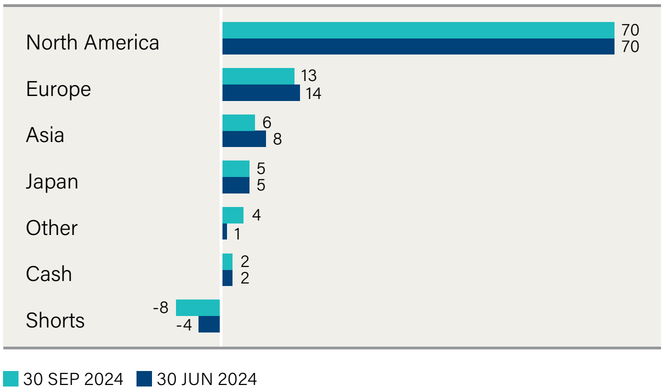
Portfolio exposure

BUSINESS QUALITY	GROWTH POTENTIAL: LOW POTENTIAL	AVERAGE POTENTIAL	HIGH POTENTIAL
BEST IN CLASS	5%	39%	1%
ABOVE AVERAGE	6%	34%	12%
AVERAGE	–	–	–
BELOW AVERAGE	–	–	–

Source: Platinum

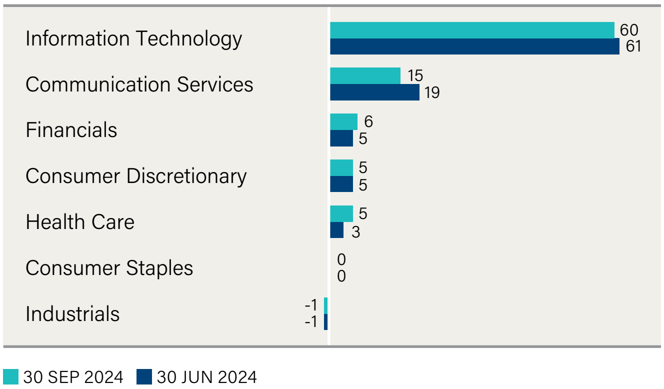
1 Companies use design automation software to develop complex electronic systems.

Disposition of Assets %



See note 3, page 5. Numerical figures have been subject to rounding.
Source: Platinum Investment Management Limited.

Net Sector Exposures %



See note 4, page 5. Numerical figures have been subject to rounding.
Source: Platinum Investment Management Limited.

Top 10 Holdings

COMPANY	COUNTRY	INDUSTRY	WEIGHT
Broadcom Inc	US	Info Technology	6.0%
Alphabet Inc	US	Comm Services	5.7%
Meta Platforms Inc	US	Comm Services	5.4%
Amazon.com Inc	US	Cons Discretionary	5.4%
ASML Holding NV	Netherlands	Info Technology	5.2%
Taiwan Semiconductor	Taiwan	Info Technology	5.2%
Microsoft Corp	US	Info Technology	5.1%
SAP AG	Germany	Info Technology	5.0%
Veeva Systems Inc	US	Health Care	4.3%
Constellation Software Inc	Canada	Info Technology	4.3%

As at 30 September 2024. See note 5, page 5.
Source: Platinum Investment Management Limited.

Commentary – how we manage shorting

In previous Quarterlies, we outlined our valuation framework and discussed technology business models. In this commentary we discuss shorting. Whilst the short portfolio is small relative to the size of the long portfolio (5% to 15% weight under normal conditions), it performs the important dual role of seeking to offer downside protection and generate incremental performance.[2]

Our short strategy is relatively straightforward. We look to short weak companies run by underperforming management. Companies that typically attract our attention include those with:

- weak market positions in a "winner-takes-most" markets
- declining sales and weak balance sheets
- aggressive accounting practices
- overly promotional management teams
- aggressive insider sales.

Within this pool of companies, there are five set-ups we think greatly improve the odds of our success.

1. Failures (~20% of the short portfolio)

These are companies that used to be good businesses with strong market positions but where we now expect Return on Invested Capital (ROIC) to decline either due to forces outside management's control and/or management failing to adapt to structural change.

One example is **TV networks**. Historically, networks made 40%+ ROIC in the US thanks to tremendous pricing power. Firstly, network TV was the primary form of mass entertainment and commanded large audiences. Second, TV was one of the only ways for brands to reach these large audiences. Third, the technological constraints of linear programming limited the ad space available, making prime time extremely valuable. Today, none of these factors hold true due to social media and streaming and we expect ROIC and margins to continue declining. Advertisers can now reach bigger audiences with a higher return on ad spend due to algorithmic targeting on social media.

2 Given the sometimes contentious nature of shorting investment cases we prefer to omit specific company names from this commentary.

2. Fads (~30%)

One feature (or bug) of tech is the 'hype cycle'. That's where an interesting technology with narrow applications and limited market size is extrapolated by investors – with help from insiders and investment bankers – to be the "next big thing". It then attracts an eye-watering valuation. As the growth slows and reality sets in, valuations collapse. One example is **plant based meat** in the late 2010s. Some believed plant based meat could be as big as 15% of the entire pork and meat market in the US and Europe. By 2022, it was clear consumer interest in the category was fleeting, expectations were optimistic and the industry was plagued by competition and overcapacity.

3. Broken growth stories (~20%)

These are very fast growing companies but where we have very little confidence in the underlying unit economics and the ultimate path to profitability due to structural reasons such as weak business models, excessive competition or low customer switching costs. One recent example is a fast-growing **ECG devices company**. Despite marketing itself as a medical device company, the business model was more akin to a diagnostic testing facility as the company is reimbursed on a per-test basis instead of selling equipment to hospitals. Once we load in the full costs of generating the tests we have serious doubts that the business can be profitable even if they hit full US market penetration. We also had evidence of aggressive accounting practices and exaggerated clinical trial claims.

4. Capital cycle shorts (~25%)

In industries with low barriers to entry, some companies capture high ROIC because of temporary supply shortages. However, this typically induces a supply response – existing participants and new entrants will invest more capital in the sector to add capacity and compete for share. That drives down ROIC and potentially pushes the market into oversupply. One recent example is the **silicon carbide (SiC) supply chain**. SiC wafers are made into SiC power semiconductors and when used in an electric vehicle, deliver better performance and energy efficiency relative to silicon counterparts. Three years ago, SiC wafers were in short supply. One company dominated the supply chain and commanded ~50%+ gross margins (vs ~30% for silicon wafers). We don't think those margins are sustainable because customers are investing in their own supply chains and competitors from China were able to ramp quickly and will likely add significant capacity next year.

5. Concept stocks (~5%)

These vary in shape and form but all "sell" a concept of how great the business will be with very little evidence to support their claims. One example is an **AI data centre** company which we shorted last year. Prior to being an AI data centre, the business went through a series of incarnations, the latest being a crypto miner during the crypto bubble. Management decided to "pivot" to being an AI data centre and put out what we politely describe as "hopeful" targets. We think their credibility is low given their lack of experience and their uncomfortably close ties to an investment bank.

Outlook

With tech indices remaining at all-time highs, we remain disciplined and are resisting the temptation to go down the quality or risk spectrum in search of higher (but more risky) returns. We continue to look for "best in class" and "above average" companies underappreciated by the market – such as Nice Ltd and Tokyo Electron last quarter.

We will continue to monitor the generative AI narrative. One area of emerging debate is whether the industry is investing too much in capex (see some recent comments from Meta's Zuckerberg and Alphabet's Pichai). The path to monetisation for generative AI products is another area of debate. To date, adoption of generative AI products across the SaaS ecosystem is underperforming expectations (including ours). Consumer AI apps like OpenAI are trying to find a viable business model and will likely lose $5bn this year. Industry analysts like Gartner are turning more cautious on the pace of enterprise adoption. Our base case is that big tech will continue to invest in generative AI – they have the financial capacity and motivation to do so. The VC-funded part of the ecosystem (including AI start-ups renting capacity from hyperscalers and tier 2 cloud service providers) could be more at risk.

Notes

Unless otherwise specified, all references to "Platinum" in this report are references to Platinum Investment Management Limited (ABN 25 063 565 006, AFSL 221935).

Some numerical figures in this publication have been subject to rounding adjustments. References to individual stock or index performance are in local currency terms, unless otherwise specified.

1. Fund returns are calculated by Platinum using the net asset value unit price (i.e. excluding the buy/sell spread) of the stated unit class and represent the combined income and capital returns over the specified period. Fund returns are net of fees and costs, pre-tax, and assume the reinvestment of distributions. The MSCI index returns are in AUD, are inclusive of net official dividends, but do not reflect fees or expenses. MSCI index returns are sourced from FactSet Research Systems. Platinum does not invest by reference to the weightings of the specified MSCI index. As a result, the Fund's holdings may vary considerably to the make-up of the specified MSCI index. MSCI index returns are provided as a reference only. The investment returns shown are historical and no warranty is given for future performance. Historical performance is not a reliable indicator of future performance. Due to the volatility in the Fund's underlying assets and other risk factors associated with investing, investment returns can be negative, particularly in the short term.
2. The investment returns depicted in the graph are cumulative on A$20,000 invested in C Class (standard fee option) of the Fund over the specified period relative to the specified MSCI index in AUD.
3. The geographic disposition of assets (i.e. other than "cash" and "shorts") shows the Fund's exposures to the relevant countries/regions through its long securities positions and long securities/index derivative positions, as a percentage of its portfolio market value. Country classifications for securities reflect Bloomberg's "country of risk" designations. "Shorts" show the Fund's exposure to its short securities positions and short securities/index derivative positions, as a percentage of its portfolio market value. "Cash" in this table includes cash at bank, cash payables and receivables and cash exposures through derivative transactions.
4. The table shows the Fund's net exposures to the relevant sectors through its long and short securities positions and long and short securities/index derivative positions, as a percentage of its portfolio market value. Index positions (whether through ETFs or derivatives) are only included under the relevant sector if they are sector specific, otherwise they are included under "Other".
5. The table shows the Fund's top ten positions as a percentage of its portfolio market value taking into account its long securities positions and long securities derivative positions.

Disclaimers

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