Platinum®
ASSET MANAGEMENT

# Annual Report 2018

## Platinum Asset Management Limited

ABN 13 050 064 287

## Directors

(as at 23 August 2018)

Michael Cole
Stephen Menzies
Anne Loveridge
Brigitte Smith
Tim Trumper
Andrew Clifford
Kerr Neilson
Elizabeth Norman
Andrew Stannard

## Shareholder Liaison

Elizabeth Norman

## Company Secretary

Joanne Jefferies

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## Auditor and Taxation Advisor

PricewaterhouseCoopers
One International Towers
Watermans Quay
Barangaroo NSW 2000

## Securities Exchange Listing

Platinum Asset Management Limited shares are listed on the Australian Securities Exchange (ASX ticker: **PTM**)

## Website

www.platinum.com.au/PTM

# Contents

# Chairman's Report 2018



The year saw a number of interesting developments for the Company (ASX ticker: PTM).

First and foremost, investment returns remained strong with most of our funds delivering outstanding returns (both in absolute and relative terms) for the 12 months to 30 June 2018. All of our Platinum Trust® Funds and the Platinum Global Fund (mFund) delivered double digit returns for the 12 months to 30 June 2018, and seven of those nine funds delivered returns in excess of 14% over the same period[1]. These figures highlight the depth of talent and expertise at Platinum[2] covering multiple regions and industry sectors.

It was pleasing to see the significant industry recognition of Platinum's achievements by Morningstar in March 2018, with Platinum receiving the much-coveted *Australian Fund Manager of the Year 2018* award as well as the *Fund Manager of the Year* award for the *International Equities Category, Australia 2018*[3]. These achievements are particularly noteworthy given the increasingly intense competition in the global equity asset management space.

## Funds Under Management ("FUM")

FUM as at 30 June 2018 was approximately $25.7 billion (post 30 June 2018 cash distributions), an increase of 13.1% from the 30 June 2017 closing FUM of approximately $22.7 billion.

The main contributor to FUM growth was the strong investment performance of our funds, which added approximately $3.5 billion to FUM for the financial year. Net fund inflows contributed approximately $1 billion while net distributions reduced FUM by approximately $1.5 billion. The distribution was the highest ever paid for the Platinum Trust® Funds and was a direct result of the strong realised investment gains made during the financial year.

It is pleasing to note the improvement in fund flows in the 2018 financial year relative to the previous financial year which saw net fund outflows of $1.7 billion. This can partly be attributed to the lagged effect of the improvement in investment performance for most of our funds and mandates over the last two years.

## Operating Performance

In the current year, fee revenue for the consolidated entity increased by 5.2% to $328.7 million (2017: $312.5 million) on account of the increase in inflows and strong investment performance. Performance fees contributed $21.9 million to the total fee revenue.

The growth in revenue is particularly pleasing in light of Platinum's decision to reduce its management fees for the standard fee option for each of the Platinum Trust® Funds and the Platinum Global Fund (mFund) from 3 July 2017. When we first announced the reduction in management fees for these funds in April 2017, we estimated that the Company's 2018 revenue

1. Historical performance is not a reliable indicator of future performance. The returns for the Platinum Trust Funds/ Platinum Global Fund are calculated using the relevant fund's net asset value (NAV) unit price (i.e. excluding a buy/ sell spread) for C Class, and represent the combined income and capital returns in the specified period. All returns are pre-tax, net of fees and costs and assume the reinvestment of distributions. All returns are sourced from Platinum Investment Management Limited.
2. References to 'Platinum' are to Platinum Investment Management Limited.
3. Morningstar Awards 2018 ©. Morningstar, Inc. All Rights Reserved. Awarded to Platinum Asset Management for Australian Fund Manager of the Year 2018, and Fund Manager of the Year: International Equities Category, Australia.

may decrease by as much as $24 million or 9% from the 2017 financial year. The increase in revenue achieved during the 2018 financial year was therefore a true reflection of both Platinum's enduring investment philosophy, which delivered strong realised gains, as well as the continuing trust and recognition from our clients.

In terms of other investment income, the investments held by the Platinum Group® delivered investment gains for the year of $24.6 million (2017: $21.1 million).

The headline expense figure increased materially from the previous financial year (up by $22.0 million to $85.0 million). This was primarily due to the increase in staff remuneration expenses (up by $15.0 million to $49.2 million), mostly paid to the investment team for the excellent one- and three-year relative and absolute investment returns to 31 March 2018.

The profit after tax attributed to owners was $189.2 million, representing an increase of $3.2 million or 1.7% from the 2017 financial year figure of $186.0 million.

Based on this profit figure, the basic and diluted earnings per share (EPS) for the 2018 financial year increased to 32.36 cents per share, from 31.74 cents per share for the previous financial year.

## Remuneration Matters

Included in the 2018 Remuneration Report on pages 29 and 30 of this Annual Report is a message from the Chair of the Nomination and Remuneration Committee. I encourage all shareholders to read this message, which outlines the remuneration policy of the Platinum Group® and the focus of Platinum on performance-based remuneration. The alignment of employee remuneration with investment returns generated for clients is a key underpinning of this remuneration policy. In such a competitive environment, it is vital that Platinum is able to attract and retain high calibre individuals.

As a result of the strong one- and three-year absolute and relative investment returns, Platinum rewarded its investment team with an increase in variable short-term cash and deferred incentive awards. As a result, staff expenses increased for the 2018 financial year in recognition of the strong investment outperformance delivered.

As a member of the investment team, Andrew Clifford (as Platinum's Chief Investment Officer) received a variable award for the 2018 financial year. I note that Andrew Clifford received no variable award for the 2016 or 2017 financial years. Two other executive KMPs received variable awards for the 2018 financial year, namely, the Company's Director of Investor Services and Communications, Elizabeth Norman and the Finance Director, Andrew Stannard.

## Dividends

The Directors have declared a 2018 final fully-franked ordinary dividend of 16 cents per share. This will be paid on 21 September 2018.

A 2018 interim fully-franked ordinary dividend of 16 cents per share was paid on 19 March 2018.

Whilst the Company has a Dividend Reinvestment Plan in place, it has not been activated and is unlikely to be activated in the near term.

# Chairman's Report 2018 – continued



## Launch of New Products

The 2018 financial year represents the third consecutive year in which Platinum has launched new investment products that aim to broaden Platinum's investor base, with the objective of increasing inflows and fees over time. In addition to offering a new performance fee class under each of the eight Platinum Trust ® Funds, Platinum also launched two ASX-quoted actively-managed funds during the 2018 financial year. The Platinum International Fund (Quoted Managed Hedge Fund) (ASX ticker: PIXX) and Platinum Asia Fund (Quoted Managed Hedge Fund) (ASX ticker: PAXX) are feeder funds that invest primarily in the unlisted Platinum International Fund and Platinum Asia Fund respectively, thereby providing investors with access to the portfolio composition of these flagship funds with strong long-term track records, their portfolio managers and investment strategies. However, being quoted on the ASX, these innovative products allow investors to conveniently buy and sell units through their stockbrokers with the knowledge of a real-time indicative net asset value before placing a trade. We have been delighted with the level of investor support for these new funds. At 30 June 2018, total FUM in these quoted managed funds was $312.5 million (post cash distribution).

As part of its international distribution strategy, Platinum plans to shortly launch a range of investment vehicles targeting institutional investors in the United States and Canada. Platinum has appointed AccessAlpha Worldwide LLC to distribute these products and promote Platinum's global equity capabilities in North America. We believe that the US and Canadian institutional market should, over time, offer strong growth prospects for Platinum.

## Appointment of New Chief Executive Officer/Managing Director

With full endorsement from the Board, Andrew Clifford took over from Kerr Neilson as the Managing Director and Chief Executive Officer of the Platinum Group® from 1 July 2018. Andrew assumed this new role in addition to his role as Platinum's Chief Investment Officer. Andrew is a co-founder of Platinum and has worked alongside Kerr for more than 30 years. The transition is part of the orderly succession planning of the Platinum Group®.

Kerr Neilson continues as an Executive Director of the Company and a full-time member of Platinum's investment team. Kerr will continue to contribute investment ideas, mentor junior members of the team, as well as provide support to further Platinum's various offshore distribution initiatives.

## Director Renewal

As part of the Company's director renewal programme, the Board was delighted to welcome two additional non-executive Board members this calendar year, Ms Brigitte Smith and Mr Tim Trumper.

Brigitte has 20 years' experience in venture capital, business strategy and start-up company operations. She co-founded and is the Managing Director of GBS Venture Partners Ltd (GBS) and also sits on the board of Moximed Inc, a portfolio company of GBS. Prior to founding GBS, Brigitte worked in the US and Australia in operating roles with early stage technology based companies, and at Bain & Company as a strategic management consultant. I am excited about the breadth of industry and business experience that Brigitte brings to the Board.

Tim is an experienced non-executive director, a former CEO, and an advisor for high-performance global and Australian companies. His career has spanned diverse sectors including artificial intelligence and machine learning, big data, digital transformation, mobility and transport, financial services and media. Tim is the Chairman of NRMA, an advisor and shareholder in Quantium, Australia's leading data and analytics company, and a director of the Population Health Research Network (PHRN). He also holds interests in several private high growth innovative companies. Tim has deep experience with the utilisation of data to drive innovation and corporate strategy. His core interest relates to how directors can guide data governance and facilitate successful business transformation.

In accordance with good governance, the Board intends to continue to review and monitor the skills required by the Board.

## Royal Commission

With the Hayne Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry now well advanced, the hearings to date have highlighted the importance of creating greater transparency between financial institutions and their end customers, particularly with respect to the way in which fees are being charged.

Two key issues are worthy of comment:

Firstly, the Royal Commission has highlighted that diversified financial service providers have struggled to create a common culture and value system across disparate business units within a group. The culture of these disparate businesses often reflects, sometimes unfavourably, the competitive behaviours of industry peers within their sector, rather than the core values of the group itself.

As diversified financial institutions focus on restoring trust and rebuilding their brand, an increasingly likely outcome will be that financial institutions will narrow their service offerings to core activities and exit non-core operations.

The extensive conflicts of interest issues, caused by combining product manufacturing and financial advice within the vertically integrated business model, have been acutely highlighted by the case studies before the Royal Commission. Standing in stark contrast to such conflicted practices, Platinum maintains an independent business model and a singular focus on product manufacturing with the emphasis on delivering the best investment outcomes for retail and institutional investors.

Secondly, many financial institutions find it challenging to balance the competing interests of shareholders, staff and customers. This seems most acute where financial services providers have protections that are often the result of regulatory frameworks giving effect to public policy priorities.

# Chairman's Report 2018 – continued



Platinum, by contrast, participates in a highly competitive funds management marketplace. It regularly competes against a large pool of active global investment managers based locally and overseas, as well as passive global fund managers. Platinum's sustainable competitive edge is to consistently deliver superior investment returns over the medium- to long-term, aligned to Platinum's commitment to preserve investors' capital.

Platinum's business model is predicated on the premise that if we continue to deliver superior performance to investors on a risk adjusted basis, we will be successful. To achieve this outcome Platinum employs highly talented fund managers and strives to create an environment that attracts and retains good people who share Platinum's values and performance driven culture.

Our core belief is that if investment outperformance is delivered, the level of FUM will grow and profitability will follow, enhancing the returns to shareholders. Platinum's business model of placing superior investment performance at the forefront of everything we do has remained unchanged since its founding over 24 years ago. We believe it is this process that best aligns the interests of Platinum's shareholders, employees and clients.

## The Board and Its Associated Committees

The Nomination and Remuneration Committee and the Audit, Risk and Compliance Committee have both had a busy and productive year.

The Nomination and Remuneration Committee oversaw changes to the composition of the Board and a change of Chief Executive Officer. It also closely monitored the Company's remuneration framework throughout the financial year.

The Audit, Risk and Compliance Committee oversaw many recent regulatory changes as well as provided oversight in the launch of new products.

## Environmental, Social and Governance (ESG)

The Company participates in the global Carbon Disclosure Project (CDP) which enables companies, cities, states and regions to measure their environmental impact. In addition, for over 11 years, we have strived to make the Company "carbon neutral" by purchasing carbon credits (which invest in rainforests) to offset the carbon emissions made by the Company (for example, our electricity usage and air travel).

As mentioned last year, Platinum incorporates environmental, social and governance (ESG) considerations into its investment process by employing a robust framework which it believes can lead to more informed and holistic decision-making and, ultimately, better investment outcomes for investors. Platinum's approach towards the incorporation of ESG factors is further explained in its Responsible Investment Policy, which is available on its website[3]. I would also encourage those interested in this topic to read the Platinum Trust® Funds' Product Disclosure Statement for more information.

3. https://www.platinum.com.au/PlatinumSite/media/About/Responsible-Investment-(ESG)-Policy.pdf

## Conclusion

No words can do justice to the contribution that Kerr Neilson has made as the founder and Chief Executive Officer of the Platinum Group® for the last 24 years. Kerr remains an icon in the industry and has remained true to his conviction in his determination to manage money well for Platinum's investors and clients. The excellent returns generated by Kerr, Andrew and their broader team since 1994 through the various market cycles are a testament to the integrity and robustness of Platinum's investment process.

I encourage you to read Kerr's final Managing Director's letter to shareholders, as it highlights the solid investment performance of the underlying funds, key initiatives that have been undertaken, the investment outlook, and some reflections from Kerr on recent industry events.

**Michael Cole**
Chairman

23 August 2018

# Founding Managing Director's Letter 2018



Andrew Clifford keeps reminding me how extraordinary the **world's economic system** really is. For all the unfavourable events or the media speculation about some new impending disaster, the world economy as a whole seems to blithely trundle forward with **remarkably few stops or reversals**. Consider that, in aggregate, the growth in world output in the last 118 years faltered only during the Great War, in the early 1930s, immediately after WWII, and most recently in 2009.[1] In more recent times, social transfers have acted as economic stabilisers. I think you will concur that this underlying trend through wars, high inflation, pandemics and so forth is a very different picture to that which resides in the minds of many of us. It is so, I suggest, because many of us are bombarded with media reports of doom and gloom, and we instinctively derive our assessments from the experience of working in individual companies which have faced setbacks or from being citizens of countries that have, in fact, seen their economies shrink over a specific period.

Making observations about countries or the world economy is, however, of limited value when investing in real assets. There can exist a **huge divergence** between the prices of individual stocks and the state of their host economies over long periods of time, and the prices of assets can exhibit far greater volatility than is justified by the underlying health of the companies or whole economies[2]. In addition, two key changes have been particularly favourable for equities since about 1960. The **first great change** was the willingness of investors to **accept a lower running yield** from holding equities versus bonds, the emergence of the so-called reverse yield gap.[3] This conceptual change recognised that the greater variability of outcomes derived from holding equities was warranted by the superior combined returns of dividends plus growth that equities delivered in aggregate over time. It justified a lower starting yield from owning shares relative to so-called risk-free assets like bonds offered by governments. This **process of re-rating** has continued ever since, expedited or perhaps crowned in the post-Lehman crisis period by the **unusually generous creation of money** supplied by the world's leading central banks. This central bank intervention has for some time acted as a **price control on the global cost of money**.

The **second change** has been the **shift of profit share from labour to capital**. This has been significant[4] and may be explained in the context of the liberalisation of global markets which has encouraged a spectacular rise in global trade[5]. Amongst other changes, new supplies of labour have been harnessed and the competitive advantage of well-managed companies has been expressed.

1. Based on global real GDP (2011 USD) since 1900. (Source: Maddison Project Database, version 2018. Bolt, Jutta, Robert Inklaar, Herman de Jong and Jan Luiten van Zanden (2018), "Rebasing 'Maddison': new income comparisons and the shape of long-run economic development", Maddison Project Working paper 10)
2. Contrast, for example, Japan and India. Over the 15 year period from 2002 and 2017, the EPS (earnings-per-share) of Japanese companies grew 16.4% p.a. versus 8.7% p.a. by Indian companies. Yet, the Japanese stock market rose 5% p.a. (in USD) while the Indian stock market rose 15% p.a. The variance can be far more dramatic at an individual stock level. Japanese conglomerate Itochu was recently trading on an estimated current year price-to-earnings (P/E) multiple of 6.6 times, while delivering a dividend yield of 3.6% and generating a return on equity of 16.5%. By contrast, Japanese online payment company GMO Payment is on an earnings multiple of 122 times this year's earnings and has a dividend yield of 0.3%.
3. The idea of the equity risk premium meant that shares typically yielded more than bonds, which was the norm until the late 1950s when the pattern reversed. Yield on US and UK government bonds rose sharply in the 1960s-70s (driven by sky-rocketing inflation) while the dividend yields on stocks rose far more moderately and trended lower overall compared to the first half of the century.
4. Profit share of GDP in developed markets grew from around 44-45% in the 1970s to 48% in 2015. (Source: Morgan Stanley)
5. Over the same period, world trade as a percentage of GDP grew from around 26-30% in the early 1970s to more than 55% in 2015. (Source: World Bank)

More recently, the full flowering of the global information super-highway has seen the great tech firms swarm across national borders to create market opportunities that were unimaginable in the physical asset-heavy world of earlier times: markets that were formerly stymied by capital and regulation are seemingly instantaneously addressable and there emerge trillion dollar trans-national monsters.

Why do I write about this? Firstly, to reinforce that we are often **led by our feelings and pay too little attention to the underlying facts**[6]. Secondly, it seems so few **understand the pivotal role that share ownership** plays in growing their wealth. There seems to be only a tenuous understanding that ***companies, not governments or regulators, are the system***. In other words, one's welfare is inextricably tied to the performance of companies, whether one is an investor or not. Moreover, money will migrate to those exciting areas that are meeting expanding needs or wants, but this can result in over-excitement and mis-pricing. Choosing the right areas at the right price is hopefully what investment managers like Platinum Asset Management can deliver. How many times have you heard the observation that the stock market is nothing more than a gambling den? This is generally followed by a long lecture that recounts some experience of loss in the stock market. Closer scrutiny would mostly reveal that the loss was caused by either fear or greed. Seldom does one hear a coherent appraisal of the inherent value of the stock purchased versus the price paid.

Lastly, I write to remind shareholders that we might be at or **approaching the terminal velocity of these two great thunderous forces**. If that is the case, one needs to find sensible managers to help navigate the years ahead. As a parting observation, there is a huge and almost unprecedented dispersion in the valuations of dull but profitable companies from those immaculately fashionable, profitable and fast-growing companies.[7] What should one do when one's instincts so favour these internet-enabled beauties versus the dull and, by comparison, unappealing alternatives? The former have rerated while the latter have fallen in absolute value to historically attractive levels. By way of illustration, one might buy a company that is not growing, on, say, a P/E of 7 times. This entity could theoretically deliver $14 in cash flow over each of the next 10 years, a total of $140 per share. By contrast, you might prefer a fast growing company selling on a P/E of 25 times. How fast does the latter need to grow over the next 10 years to produce the same theoretical cash flow as the first?

The figure is approximately 26% each year. There are very few companies with such a record. Looking at the past returns across the globe, this universe comprises less than 5% of the world's top 1000 listed companies.[8]

6. In the 50 years between 1900 and 1949, there was a de-rating of -0.7% per annum in global equities. Between 1950 and 2017, we saw a re-rating of +1.5% per annum in the valuation of shares globally. This, together with real dividend growth, gave a real return (in US$) of +6.7% p.a. between 1950-2017, versus +3.1% p.a. between 1900-1949. (Source: Credit Suisse Research Institute)

7. The divergence between growth and value stocks in developed markets is at its highest level in the last twenty years except for the dotcom bubble, as measured by the differential in price-to-book (P/B) multiples, and not far off when measured by price-to-earnings (P/E) multiples. (Source: Bernstein)

8. Of the top 1000 global companies ranked by market capitalisation, only 5.1% have achieved net income growth for 10 years by 20-30% per annum. This record reflects the period from 1950 to 2015. (Source: Credit Suisse HOLT, as published in The Base Rate Book dated 26 September 2016.)

# Founding Managing Director's Letter 2018
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## Investment Performance

Across our suite of funds, performance has been solid. The returns slipped somewhat in the last month of the financial year with growing concerns about trade protectionism. As you may be aware, we use cash and shorting strategies to alleviate volatility, predominantly in our International Fund, and unitholders have enjoyed a cumulative net return of approximately 83% over the last five years, and 14% for the last 12 months.[9] As was inferred in the paragraph above, it is not difficult to follow the leaders but the question is how much one wants to invest in them. With the rise of index ETFs and mandate-driven momentum fund managers, the exciting parts of the markets are well served.

## Funds Under Management (FUM) – Retention and Growth

In an investment world characterised by massive product proliferation, helped along by the present enthusiasm for ETFs and 'passive' investing, we understand the **importance of our brand and distribution**. The amount of choice is bewildering to all but the most enthusiastic investors. Those with a casual interest may either find it all too difficult and avoid participating in equity investment funds or, alternatively, seek simple answers that can mask complexity. (As a general principle, we would note in such circumstances that an investor should try to understand each manager's investment style and to blend these and stay the course rather than perpetually skipping from the former performance leader to the new title holder.) With this in mind, we understand the importance of a strong brand, but equally important is our need to serve the advisory industry by imparting deep product knowledge.

For investors with a greater understanding of the complexity of investing, the attraction of our brand lies not only in past performance, but in the explicit enunciation of our stock-picking approach which is reinforced by our quarterly reports and online commentaries. These publications give investors an insight into **our process and mentality** that contribute to systematic long-term successful investing. They also convey the authenticity of intent which, in a world awash with pretence, is easy to identify. Old style barking, half-truths and exaggeration are long dead.

Our **interaction with financial advisors** in Australia and New Zealand has flourished. As noted in the past, what distinguishes Platinum's investment specialists is that these individuals are former investment analysts and can therefore speak authoritatively about our investment decisions and portfolios, rather than simply following a sales script that lacks depth and understanding.

To add further to the quality of our communication in the field, individual portfolio managers and analysts accompany the investment specialists to visit advisory firms to give additional insights of changes taking place in specific industries. This in turn empowers financial advisors to speak more authoritatively to their clients. In addition, we have an annual roadshow directed at the financial intermediaries. During the year, the team addressed approximately 1500 professional advisors covering 33 cities and towns around the country.

9. Source: Platinum Investment Management Limited. Returns are C Class returns to 30 June 2018, after fees and costs, pre-tax, and assume the reinvestment of distributions. Past performance is not a reliable indicator of future returns.

The **redesign of the website** has been well received. While there is some distortion from the waxing and waning of investor interest in global investing, we can discern a progressive rise in usage of the website as indicated by page views per visit, returning users and so on. ***The Journal***, which contains topical investment subjects and video presentations from our investment professionals, is proving very popular. We encourage you to recommend the site to friends who want to gain more understanding about investing – the **Investment Fundamentals** section provides a handy starting point.

Our biannual meeting with clients took place in March. Some 1,900 direct investors attended this **roadshow** and the client feedback was very positive. Sydney and Melbourne witnessed the biggest turnouts with respective audiences of over 700 and 500.

The **UCITS funds** (Irish-domiciled) that we launched nearly three years ago are progressing well. We have spent many weeks visiting potential investors in the principal European cities and these three funds have now grown to A$444 million. We are planning to establish a representative office in London. We believe that our strong investment performance and unique attributes provide a strong base to expand this business measurably.

September 2017 saw the **launch of our two quoted managed funds (QMFs)** – abbreviated as **PIXX** and **PAXX**. These are feeder funds which, through an ASX quoted entity, channel money into the existing unlisted managed funds, Platinum International Fund and Platinum Asia Fund. Both underlying funds have long track records of 23 years and 15 years, respectively, and each has a history of substantial absolute and relative performance. Through the QMFs, investors are able to **gain exposure to the actively-managed and diversified portfolios of the underlying funds, Platinum International Fund and Platinum Asia Fund**. Moreover, the QMFs provide investors with the **convenience of buying and selling units via the ASX, obviating the lengthy application form** required for the unlisted funds. Furthermore, the QMFs provide investors with the added advantage of knowing each **fund's indicative net asset value** when placing a trade, whereas the forward-pricing method used by unlisted managed funds means that unit prices are not known when investors make an application. The ***annual distributions* of the QMFs also approximate to those of their underlying funds** – distributing net income and realised capital gains, rather than a *franked dividend*, as is the case for our *listed investment companies* (Platinum Capital Limited (ASX ticker: PMC) and Platinum Asia Investments Limited (ASX ticker: PAI)). The table on page 12 shows the split of our funds under management including these entities.

# Founding Managing Director's Letter 2018

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**Funds Under Management ($mn, to 30 June 2018)**

| FUNDS | OPENING BALANCE (1 JULY 2017) | FLOWS | INVESTMENT PERFORMANCE | DISTRIBUTION AND OTHER* | CLOSING BALANCE (30 JUNE 2018) | % OF TOTAL |
|---|---|---|---|---|---|---|
| **Retail offerings** | | | | | | |
| Platinum Trust Funds (excluding funds fed from PIXX and PAXX) and Platinum Global Fund (mFund) | 16,249 | 997 | 2,302 | (2,621) | 16,927 | 66 |
| Quoted Managed Funds (PIXX and PAXX) | – | 341 | 10 | (38) | 313 | 1 |
| Listed Investment Companies (PMC and PAI) | 858 | – | 155 | (79) | 934 | 4 |
| MLC Platinum Global Fund | 961 | (144) | 153 | – | 970 | 4 |
| **Institutional mandates** | | | | | | |
| Management Fee Mandates | 2,089 | (28) | 360 | – | 2,421 | 9 |
| UCITS (Platinum World Portfolios PLC) | 263 | 132 | 49 | – | 444 | 2 |
| "Absolute" Performance Fee Mandates | 474 | (53) | 77 | – | 498 | 2 |
| "Relative" Performance Fee Mandates | 1,819 | (211) | 442 | 1,142 | 3,192 | 12 |
| **TOTAL** | **22,713** | **1,034** | **3,548** | **(1,596)** | **25,699** | **100** |

Source: Platinum Investment Management Limited

* The 'Distribution and Other' figure is comprised of the cash distribution from the Platinum Trust Funds/PGF/PIXX/PAXX (as applicable) and the transfer of clients to the "relative" performance fee mandate.

## Staff

Of the company's 98 employees, 31 are engaged in managing clients' money. Within the investment team, the individual sector and regional teams are well settled, and our challenge is to balance ideas of pure value with the more exotic and higher-priced areas of markets such as information technology, microbiology and those service companies that have the appearance of perpetual growth machines. To assist our judgment, we keep developing and applying robust quantitative methods to complement detailed fundamental research.

The company's support functions continue to perform in an exemplary manner. This is evidenced through the pattern of good value claims, our IT system uptime, and the legal and compliance teams' ability to deal with our increasingly changing regulatory environment.

## Costs

Staff costs account for over half of the company's outgoings. There tends to be a slight upward drift in this cost over time, which reflects small increases in staff numbers and a scaling among members of the investment team to account for growing knowledge and skill. This year, we extended the operation of the Deferred Incentive Plan to staff members whom we believe will carry the company over the next decade. Under the plan, stock is issued to participants with deferred vesting four years hence. These grants are made annually, performance permitting, to allow employees to gradually increase their ownership in the company. We match this obligation with on-market purchases. Dividend equivalent payments also accrue to participants during the vesting period. Upon vesting, employees are free to sell their holdings or hold for up to a further five years before selling, thereby accruing deferred tax benefits until sold.

Members of the investment team were entitled to awards under the Profit Share Plan this year. As a reminder, the Profit Share Plan is an additional pool of reward made available to members of the investment team when the weighted return of total funds under management (FUM) exceeds the relevant index by more than 1% for both the last one and three years. This is a cash payment and is capped at 5% of the company's pre-tax fee income. An employee's share in the pool may vary to accommodate new members or to reflect the relative contribution of each member through time.

Apart from staff remuneration, most costs were slightly higher than last year, predominantly relating to our marketing and business development initiatives in North America and Europe. Custody and administration costs have crept up with increased FUM.

## Fees

In July 2017 we lowered the management fees on the standard fee option of the Platinum Trust Funds and the Platinum Global Fund (mFund). We also took this opportunity to introduce a new **performance fee option** (P Class) to the Platinum Trust Funds. This comes with a lower base fee, set at 1.1% (inclusive of GST), plus an outperformance fee that is levied at 15% on returns above those of the relevant index. Under the standard fee option (C Class), unitholders are now charged 1.35% per annum (inclusive of GST). To date, the performance fee option has been chosen by few. Of the new flows of $1,127 million during the year, the new performance fee option accounted for only $33 million. However, we feel some clients are attracted to the notion of a scalable **fee that rewards evident long-term skill**. When we announced the reduction in management fees for these funds in April 2017, it was estimated that these changes could lead to a decrease in the company's 2018 revenue by as much as $24 million or 9% from financial year 2017. Fee revenue this year in fact grew by 5.2% from last financial year, achieving $328.7 million. This positive outcome was a result of both strong investment performance and an increase in net inflows.

## Reflections on Recent Industry Events

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry has been a stunning revelation to many. One of the first lessons we teach analysts is to understand the antecedents of a company or a situation. To that extent, it would have been somewhat predictable that some bad practices would develop, but perhaps more telling is the predilection towards concentrated market positions within many segments of the Australian economy. This tends to squash innovation and real competition, usually resulting in high cost services.

# Founding Managing Director's Letter 2018

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We note with interest the hiving off of the wealth management and financial advisory divisions of the big banks as they try to "create a simpler, better bank"[10]. From our point of view, whether it is CBA's spin-off of Colonial First State Global Asset Management into a stand-alone listed company, or ANZ's sale of its pensions and investments business and dealer groups to IOOF, such moves are not necessarily optimal for customers. **Coming under new ownership but continuing with similar practices of conflicted advice and pushing in-house products is unlikely to broaden or enhance the choice for investors.**

Advisors face many difficulties when giving *personal advice*. To do it well requires great diligence, knowledge and the need for face-to-face contact with clients, which hinders their ability to scale their businesses. Many advisors utilise platforms for the administration of their clients' investments, but the added costs, from the assorted administrative charges to grandfathered commissions, are not always disclosed to clients in a clear and comprehensible manner.

Partly in reaction to the increased public scrutiny following the Royal Commission hearings, platform providers have started to cut their fees, some now advertising administration fees as low as 0.15%. However, according to analyst reports from Macquarie Research, the real reduction is far less dramatic and the total cost for a client account of $200,000, having regard to these advertised fee reductions, would be in the order of 0.9% once other costs likely charged by the platform provider are tallied up. **Does this cost justify what is essentially an automated administrative service?** The convenience of a smartphone app and consolidated reporting is a form of utility, but does not ultimately contribute to the growth of one's wealth. This cost sits on top of the fund managers' fees. **Why should this administrative service be priced at a similar level to that which attempts to create wealth?**

## Outlook

I handed over the running of the business to Andrew Clifford and our executive team from 1 July. I do so with great confidence in Andrew's proven ability and the fact that his support team is unusually talented, hard-working and wise. I shall remain an Executive Director of the company and a member of the investment team, spending time investigating investment opportunities as well as mentoring the younger members of the team. From time to time, I shall also assist in conveying the Platinum investment philosophy to new potential investors.

I would like to thank all our employees for their dedication over the years and for their forbearance in putting up with me. It has been a marvellous experience to witness their commitment to winning, whether it was in the markets, or supporting clients with queries or technical difficulties dealing with settlements, applications or the most confounding of all, our IT backbone. Thank you all.

Lastly, I would like to thank clients and shareholders for their support. We have tested – and will test – you periodically, but history has shown that it has been worthwhile. Since our founding, **we have generated a net amount of approximately $27 billion for investors in our funds and mandates**, that is after keeping some for the company and passing on over $1 billion in corporate tax to the government. The team has the ability to continue to serve investors and thereby reward our shareholders, and I firmly believe that they will do so.

**Kerr Neilson**
Founder & Director

10. ANZ ASX announcement 17 October 2017; CBA ASX announcement 25 June 2018.

# Incoming Managing Director's Letter 2018



## The Beginning – February 1994

Platinum was founded in 1994 on a simple and singular premise: we had an investment approach that had proven to produce good investment returns. At the core of this approach was the belief that the best returns could be found in companies which were either out-of-favour with the market, or alternatively, where there was significant change underway, be it the competitive landscape, technological developments, or government regulation. Using this as our initial filter for potential investments, we would then commit to deep fundamental research, and would buy an individual company only if it was trading at a substantial discount to its inherent value. Following this process, we would build portfolios one company at a time, based on the value we identified.

In addition to this clear view on how we would achieve good investment outcomes, the other core principle that guided our business was a strong sense of responsibility towards the clients who entrusted us with their savings. We understood that if our investments lost money, our clients would not get back those same savings again. We believed that it was more important to minimise the risk of loss to clients than to achieve the maximum return possible, even if at times this meant that our investment returns would lag behind the competition. Our responsibility to clients also required that we clearly communicate to them and their advisers where their money was invested and why.

Finally, it was clear amongst the founders that, if we were to succeed in establishing the investment business that we had envisaged, delivering good outcomes for our clients must always remain our primary goal. Many asset management businesses start with similar intentions and achieve initial success, only to give way to the imperative of gathering assets as investment performance declines. While this approach may make 'business sense', it is in fact a betrayal of those clients who have trusted the company with their savings. The limitation for the owners of the business of maintaining our focus on investing is clear. If we cannot continue to generate good returns for clients, then not only will the growth of our business be limited, but one would in fact expect it to shrink over time as a result.

These key tenets of Platinum's business, established at the very outset, provide an explanation for many of the important business decisions that have shaped the firm over the last 24 years. A consistent approach to the pricing of our services, and an avoidance of trail commissions and other rebate deals, are examples of our most basic practices that set us apart from many industry peers. While participating in these pricing negotiations and other manipulations typical of the industry would have undoubtedly helped increase funds under management, it would have been so at the detriment of existing clients. New investment strategies, such as our regional funds and sector global equity funds, were not launched at times of great demand for such products, but rather at a time when these regions or sectors were out-of-favour with investors, consistent with our investment approach. The one exception was the Platinum International Technology Fund, which was launched at the height of the tech bubble in 2000, as we saw the impending burst of that bubble. But, instead of encouraging and taking advantage of the euphoria, we included a very strong caution to investors in the offer document.

# Incoming Managing Director's Letter 2018
– continued



## Looking Ahead

We have persisted with our founding principles over the last 24 years, and through different market cycles. Today, Platinum remains an investment led business. We will continue to employ an investment approach that has not changed and which, if well-applied, should continue to produce good outcomes for clients.

The firm's key business units – the investment team, client services and communications, the functional divisions of registry, finance, portfolio accounting, legal, compliance, human resources and technology – have each been built on solid foundations and have improved over time. There will be ongoing efforts to improve the way we work in each of these areas. The strengths of these teams and their people should provide us with the opportunity to gradually grow the business through a combination of investment returns and additional fund inflows. We will continue to seek out clients in both new and existing markets for whom our investment philosophy, focus on absolute returns, and approach to managing our business, make sense and are aligned with their own long-term goals.

Ultimately, the problem our clients face is not just how to earn a good return on their funds, but whom they should trust to look after their savings. Over 24 years, we believe we have earned our clients' trust through a combination of good performance and consistently putting their interests first. The future of Platinum will depend on both our ability to deliver on investment returns and to maintain the trust of our clients. We remain focused on achieving the former, and we are confident that if we deliver good returns, client trust will remain strong.

**Andrew Clifford**
Managing Director

# Financial Statements 2018

## Platinum Asset Management Limited

General information

The financial statements were authorised for issue, in accordance with a resolution of Directors, on 23 August 2018. The Directors have the power to amend and reissue the financial statements.

# Shareholder Information 30 June 2018



The shareholder information set out below was applicable as at 20 August 2018.

## Distribution of ordinary shares

Analysis of number of ordinary shareholders by size of holding:

| | NUMBER OF HOLDERS OF ORDINARY SHARES |
|---|---|
| 1 to 1,000 | 6,383 |
| 1,001 to 5,000 | 14,351 |
| 5,001 to 10,000 | 3,765 |
| 10,001 to 100,000 | 2,214 |
| 100,001 and over | 72 |
| | 26,785 |
| Holding less than a marketable parcel (less than $500) | 325 |

## Ordinary shareholders

### Twenty largest ordinary shareholders

The names of the 20 largest shareholders of the Company are listed below:

| | ORDINARY SHARES | |
|---|---|---|
| | NUMBER HELD | % OF TOTAL SHARES ISSUED |
| J Neilson | 156,037,421 | 26.60 |
| K Neilson | 156,037,420 | 26.60 |
| HSBC Custody Nominees (Australia) Limited | 40,856,268 | 6.96 |
| Platinum Investment Management Limited (nominee) | 29,364,201 | 5.01 |
| Citicorp Nominees Pty Limited | 21,316,164 | 3.63 |
| JP Morgan Nominees Australia Limited | 18,030,916 | 3.07 |
| National Nominees Limited | 7,032,373 | 1.20 |
| Jilliby Pty Limited | 6,500,000 | 1.11 |
| J Clifford | 5,000,000 | 0.85 |
| Pacific Custodians Pty Limited | 3,471,866 | 0.59 |
| BNP Paribas Nominees Pty Limited | 3,343,234 | 0.57 |
| BNP Paribas Nominees Pty Limited | 2,105,592 | 0.36 |
| Citicorp Nominees Pty Limited | 1,847,762 | 0.31 |
| Xetrov Pty Limited | 1,500,000 | 0.26 |
| Michele Martinez | 1,072,309 | 0.18 |
| Navigator Australia Limited | 952,965 | 0.16 |
| HSBC Custody Nominees (Australia) Limited | 894,881 | 0.15 |
| HSBC Custody Nominees (Australia) Limited | 772,264 | 0.13 |
| Nulis Nominees (Australia) Limited | 756,495 | 0.13 |
| Bond Street Custodians Limited | 500,000 | 0.09 |
| | 457,392,131 | 77.96 |

### Unquoted ordinary shares

There are no unquoted ordinary shares, however under the Deferred Remuneration Plan, a total of 3,471,866 deferred rights have been allocated to eligible employees of Platinum, and on vesting and exercise of these rights, an equivalent number of PTM shares (that have already been acquired on-market) will be allocated to these employees. Therefore, no new shares will be issued under the Deferred Remuneration Plan (please refer to the Remuneration Report and Note 19 for further details).

# Shareholder Information 30 June 2018 – continued



## Substantial shareholders

The following parties have notified the Company that they have a substantial relevant interest in the ordinary shares of Platinum Asset Management Limited in accordance with section 671B of the *Corporations Act 2001*:

| | ORDINARY SHARES | |
|---|---|---|
| | NUMBER HELD | % OF TOTAL SHARES ISSUED |
| J Neilson, K Neilson | 312,074,841 | 53.2^ |
| J Clifford, Moya Pty Limited, A Clifford | 32,831,449 | 5.9^ |

^ **Based on the last substantial shareholder notice lodged.**

## Distribution of Annual Report to Shareholders

The Law allows for an "opt in" regime through which shareholders will receive a printed "hard copy" version of the Annual Report only if they request one. The Directors have decided to only mail out an Annual Report to those shareholders who have "opted in".

## Financial Calendar

| | |
|---|---|
| Ordinary shares trade ex-dividend | 30 August 2018 |
| Record (books close) date for dividend | 31 August 2018 |
| Dividend paid | 21 September 2018 |

**These dates are indicative and may be changed.**

## Notice of Annual General Meeting

The details of the Annual General Meeting (AGM) of Platinum Asset Management Limited are:

10am Thursday 15 November 2018
Fort Macquarie Room
InterContinental Hotel Sydney
117 Macquarie Street
Sydney NSW 2000

## Questions for the AGM

If you would like to submit a question prior to the AGM to be addressed at the AGM, you may email your question to invest@platinum.com.au.

# Directors' Report



The Directors present their report, together with the financial statements, on the consolidated entity (referred to hereafter as the 'consolidated entity', 'group' or 'Platinum') consisting of Platinum Asset Management Limited (referred to hereafter as the 'Company' or 'parent entity') and the entities it controlled at the end of, or during, the year ended 30 June 2018.

## Directors

The following persons were Directors of Platinum Asset Management Limited during the whole of the financial year and up to the date of this report, unless otherwise stated:

| | |
|---|---|
| Michael Cole | Chairman and Non-Executive Director |
| Stephen Menzies | Non-Executive Director |
| Anne Loveridge | Non-Executive Director |
| Brigitte Smith | Non-Executive Director (from 31 March 2018) |
| Tim Trumper | Non-Executive Director (from 1 August 2018) |
| Andrew Clifford | Chief Executive Officer/Managing Director (from 1 July 2018)* and Chief Investment Officer |
| Kerr Neilson | Chief Executive Officer/Managing Director (until 1 July 2018)* and Executive Director |
| Elizabeth Norman | Executive Director and Director of Investor Services and Communications |
| Andrew Stannard | Executive Director and Chief Financial Officer |

* **Effective 1 July 2018, Andrew Clifford was appointed as Platinum group's new Chief Executive Officer/ Managing Director. Andrew Clifford has assumed this role in addition to his role as the group's Chief Investment Officer. Kerr Neilson will continue as a full-time Executive Director of the Company.**

## Principal Activities

The Company is the non-operating holding company of Platinum Investment Management Limited ("PIML") and its controlled entities. Platinum Investment Management Limited, trading as Platinum Asset Management, operates a funds management business. The amount of money that we manage, so-called funds under management ("FUM") is the key variable for the business and an important determinant of our profit.

## Operating and Financial Review

FUM at 30 June 2018 was $25.7 billion and this represented an increase of 13.1% from the 30 June 2017 closing FUM of $22.7 billion. The FUM at 30 June 2018 was after the impact of the 30 June 2018 net distribution of $1.5 billion. Average FUM for the year also increased by 13.1% to $26.4 billion from an average FUM of $23.4 billion for the previous year. The increase in FUM was due to net fund inflows of $1 billion and the strong gains made from investment performance of $3.5 billion. Furthermore, the consolidated entity earned investment performance fees of $21.9 million of which $20.0 million was generated from its "absolute" performance fee mandates.

# Directors' Report – continued



Net fund flows have been positive over the last year and it is pleasing to report that most of the Funds managed by the consolidated entity have delivered strong investment performance over the last 12 months, with some of our Funds delivering exceptional returns. For example, our global unhedged fund, Platinum Unhedged Fund delivered 18.6%[1] for the 12 months to 30 June 2018. Our flagship Fund, Platinum International Fund returned 14.2%[1] for the 12 months to 30 June 2018, proving that our tried and tested approach to managing money is working well.

In September 2017, Platinum Investment Management Limited ("PIML") successfully launched two new ASX quoted managed funds, called Platinum International Fund (Quoted Managed Hedge Fund) (ASX ticker: PIXX) and Platinum Asia Fund (Quoted Managed Hedge Fund) (ASX ticker: PAXX). PIXX and PAXX feed directly into PIML's existing flagship funds, the Platinum International Fund and the Platinum Asia Fund, respectively, thus giving investors access to the portfolio composition of these flagship funds, its portfolio managers and investment strategies.

We have been delighted with the level of investor support for these new funds. At 30 June 2018, total FUM in these quoted managed funds was $312.5 million.

Our European-based UCITS funds, Platinum World Portfolios PLC, continue to perform strongly with FUM at 30 June 2018 increasing to $444.9 million.

Out of the $1 billion in net inflows for the 12 months to 30 June 2018, some $473.2 million or 46% was derived from the UCITS funds and the ASX quoted managed funds.

The increase in average FUM from the previous year and the increase in performance fees resulted in revenue of $328.7 million (2017: $312.5 million), which represents an increase of 5.2% from the previous year. Achieving increased revenue is particularly pleasing, considering that effective from 3 July 2017, PIML reduced its total fees and charges for the standard fee option for each of the Platinum Trust Funds and the Platinum Global Fund from 1.5% per annum to 1.35% per annum. PIML reduced its fees because, since commencing business in 1994, PIML had found that the costs associated with accessing international markets had come down as a result of investment efficiencies. At the time of announcing the change (in April 2017), we anticipated that 2018 revenue could decline by as much as 9%.

Other investment income increased to $24.6 million (2017: $21.1 million) which was largely explained by the consolidated income derived from PIXX and PAXX of $8.6 million, PIML's investments in Platinum Asia Investments Limited of $7.2 million and Platinum World Portfolios Plc of $3.8 million.

1. You should be aware that historical performance is not a reliable indicator of future performance. The returns for Platinum International Fund and Platinum Unhedged Fund are calculated using the Fund's Net Asset Value (NAV) unit price (i.e. excluding a buy/sell spread) for C Class, and represent the combined income and capital returns in the specified period. All returns are pre-tax, net of fees and costs and assume the reinvestment of dividends. The index for the Platinum International Fund and Platinum Unhedged Fund is the MSCI All Country World Net Index ($A).

Source: Platinum Investment Management Limited (fund returns) and FactSet (MSCI returns). All data where MSCI is referenced is the property of MSCI. No use or distribution of this data is permitted without the written consent of MSCI. This data is provided "as is" without any warranties by MSCI. MSCI assumes no liability for or in connection with this data.

The headline expense figure increased from the previous year (up $22.0 million to $85.0 million), but this was primarily due to the increase is staff remuneration expenses (up $15.0 million or 43.8% to $49.2 million), which were primarily paid to the investment team, and rewarded the excellent 1 and 3 year relative and absolute returns for our underlying Funds and Mandates.

Taking into account the increased staff expenses of $15.0 million and an increase in non-staff expenses[2], primarily related to the pursuit of growth opportunities, profit after tax for the year attributable to owners was $189.2 million (2017: $186.0 million) which represented an increase of 1.7%.

At 30 June 2018, basic and diluted earnings per share (EPS) increased to 32.36 cents per share (2017: 31.74 cents per share).

As part of its international distribution strategy, Platinum plans to shortly launch a range of investment vehicles targeting institutional investors in the United States and Canada. Platinum has appointed AccessAlpha Worldwide LLC to distribute these products and promote Platinum's global equity capabilities in North America. We believe that the US and Canadian institutional market should, over time, offer strong growth prospects for Platinum.

The consolidated entity is in a strong financial position, with a strong balance sheet. However, the most significant driver of our sustainable future growth is, and will always be, the delivery of superior, long-term, investment returns for our clients.

Our FUM is well positioned to grow over time through the increasing trend for Australian investors to increase their exposure to world stock markets, the strengthening of our relationship with the professional investor community, increased distribution and marketing activity targeting offshore clients and accessing the continuing growth of the self-managed superannuation fund (SMSF) sector.

## Dividends

Since the end of the financial year, the Directors have declared a 2018 final 16 cents per share ($93,313,125) fully-franked ordinary dividend, with a record date of 31 August 2018 and payable to shareholders on 21 September 2018.

A 2018 interim fully-franked ordinary dividend of 16 cents per share ($93,482,311) was paid on 19 March 2018. A fully-franked ordinary dividend of 15 cents per share ($87,757,931) was paid on 22 September 2017.

## Significant Changes in the State of Affairs

There were no significant changes in the state of affairs of the consolidated entity during the financial year and up to the date of this report, other than the change in fee options (in July 2017) as outlined above.

2. Increased FUM related expenses (custody), increased business-development expenses as a result of website enhancement and deferral of a significant amount of the advertising spend from FY17 and increased expenses relating to the launch of PIXX, PAXX and the US/Cayman Funds.

# Directors' Report – continued



## Environmental Regulation

The consolidated entity is not subject to any significant environmental regulation under Commonwealth, State or Territory law.

## Information on Directors

**Michael Cole** BECON, MECON, FFIN

Independent Non-Executive Director, Chairman and member of the Audit, Risk & Compliance and Nomination & Remuneration Committees since 10 April 2007.

Mr Cole has over 40 years of experience in the investment banking and funds management industry. Mr Cole was an Executive Director/Executive Vice President at Bankers Trust Australia for over 10 years. Mr Cole is Chairman of Ironbark Capital Limited.

**Stephen Menzies** BECON, LLB, LLM

Independent Non-Executive Director and member of the Audit, Risk & Compliance and Nomination & Remuneration Committees since 11 March 2015 and Chair of the Nomination & Remuneration Committee since 19 June 2017.

Mr Menzies is currently a Director of Century Australia Investments Limited and Freedom Insurance Group Limited and is the Chairman of Silicon Quantum Computing Pty Limited and is a past Chairman of the Centre for Quantum Computation & Communication Technology. Mr Menzies retired as a partner at Ashurst law firm in 2015 and until his retirement was consistently ranked as one of Australia's leading corporate lawyers. As Head of China Practice for Ashurst, Mr Menzies oversaw the Shanghai and Beijing offices of that firm. Previously, Mr Menzies was National Director of Enforcement at the Australian Securities Commission and has a long history in the funds management sector. Mr Menzies is a Director of Platinum World Portfolios Plc.

**Anne Loveridge** BA (HONS), FCA (AUSTRALIA), GAICD

Independent Non-Executive Director and member of the Audit, Risk & Compliance and Nomination & Remuneration Committees since 22 September 2016 and Chair of the Audit, Risk & Compliance Committee since 24 February 2017.

Ms Loveridge is currently a Non-Executive Director for the National Australia Bank (NAB) Group and NIB Holdings Limited. Ms Loveridge retired as a partner and deputy chairman of PricewaterhouseCoopers (PwC) in 2015. At PwC, she had over 30 years of experience in the Financial Services Assurance practice. Ms Loveridge has extensive senior management and people leadership experience, knowledge of financial and regulatory reporting and risk management.

**Brigitte Smith** B.CHEM ENG (HONS), MBA, MALD, FAICD

Independent Non-Executive Director and member of the Audit, Risk & Compliance and Nomination & Remuneration Committees since 31 March 2018.

Ms Smith has 20 years' experience in venture capital, business strategy and fast growth company operations. Ms Smith co-founded and is the Managing Director of GBS Venture Partners Ltd (GBS) and also sits on the board of GBS's portfolio company Moximed Inc.

Prior to founding GBS, Ms Smith worked in the US and Australia in operating roles with fast growth technology based companies, and at Bain & Company as a strategic management consultant.

**Tim Trumper** MBA, UNE
Independent Non-Executive Director and member of the Audit, Risk & Compliance and Nomination & Remuneration Committees since 1 August 2018.

Mr Trumper is Chair of the NRMA, advisor and shareholder in Quantium, Australia's leading data and analytics company, director of the Population Health Research Network (PHRN) and holds interests in several private high growth innovative companies. He is an authority on the utilisation of data to drive innovation, and corporate strategy.

Mr Trumper is an experienced non-executive director, former CEO, and advisor for high-performance global and Australian companies. His career has spanned diverse categories including artificial intelligence and machine learning, big data, digital transformation, mobility and transport, financial services and media.

Along with fellow directors and Chairman Hon. R J Hawke, Tim helped to establish The Bestest Foundation. This charity has raised over $4 million for disadvantaged Australian children.

**Andrew Clifford** BCOM (HONS)
Managing Director since 1 July 2018 and Chief Investment Officer since 8 May 2013.

Mr Clifford joined Platinum as a co-founding member in 1994 in the capacity of Director of Platinum Investment Management Limited and Deputy Chief Investment Officer. In May 2013, Mr Clifford was appointed Chief Investment Officer. Effective 1 July 2018, Andrew Clifford was appointed as the Chief Executive Officer/Managing Director of the Platinum group. Previously he was a Vice President at Bankers Trust Australia covering Asian equities and managing the BT Select Market Trust – Pacific Basin Fund.

**Kerr Neilson** BCOM, ASIP
Managing Director to 1 July 2018 and Executive Director since 12 July 1993.

Mr Neilson was the Managing Director of the Company from incorporation to 30 June 2018. Prior to Platinum, Mr Neilson was an Executive Vice President at Bankers Trust Australia. Previously he worked in both the UK and South Africa in stockbroking.

**Elizabeth Norman** BA, GRADUATE DIPLOMA IN FINANCIAL PLANNING
Director of Investor Services and Communications since 8 May 2013.

Ms Norman joined Platinum in February 1994 in a role of Investor Services and Communications Manager. Previously she worked at Bankers Trust Australia in product development and within the retail funds management team. Ms Norman's role as a Director of Investor Services and Communications reflects the widening of Platinum's client base and Platinum's commitment to supporting retail and institutional clients with dedicated investment specialists.

# Directors' Report – continued



**Andrew Stannard** BMS(HONS), GRADUATE DIPLOMA IN APPLIED FINANCE AND INVESTMENT, CA
Director and Chief Financial Officer since 10 August 2015.

Mr Stannard joined Platinum from AllianceBernstein where he held the position of Chief Financial Officer for the Asia-Pacific region. Mr Stannard has 28 years of finance experience with expertise in audit, financial control, operations, funds management, financial services regulation and corporate governance.

## Information on Company Secretary

**Joanne Jefferies** BCOM, LLB
Company Secretary since 17 October 2016.

Ms Jefferies is an English law qualified solicitor with more than 21 years of legal experience in the asset management and securities services sectors, in England and across Asia Pacific.

Ms Jefferies joined Platinum in October 2016 as General Counsel and Group Company Secretary, having spent the previous six years at BNP Paribas Securities Services as Head of Legal Asia Pacific, Company Secretary for all Australian subsidiaries and a member of the Asia Pacific Executive Committee. Joanne has previously held senior legal positions with Russell Investments, Morley Funds Management (Aviva Investors) and Lord Abbett, and served as the General Counsel for the UK's funds management industry association, the Investment Association.

## Meetings of Directors

The number of meetings of the Company's Board of Directors ("the Board") and of each Board committee held during the year ended 30 June 2018, and the number of meetings attended by each Director were:

| | BOARD | | NOMINATION & REMUNERATION COMMITTEE | | AUDIT, RISK & COMPLIANCE COMMITTEE | |
|---|---|---|---|---|---|---|
| | ATTENDED | HELD | ATTENDED | HELD | ATTENDED | HELD |
| Michael Cole | 5 | 5 | 4 | 4 | 5 | 5 |
| Stephen Menzies | 5 | 5 | 4 | 4 | 5 | 5 |
| Anne Loveridge | 5 | 5 | 4 | 4 | 5 | 5 |
| Brigitte Smith (since 31 March 2018) | 2 | 2 | 2 | 2 | 2 | 2 |
| Kerr Neilson | 5 | 5 | – | – | – | – |
| Andrew Clifford | 4 | 5 | – | – | – | – |
| Elizabeth Norman | 5 | 5 | – | – | – | – |
| Andrew Stannard | 5 | 5 | – | – | – | – |

### Indemnity and Insurance of Directors and Officers

During the year, the Company incurred a premium in respect of a contract for indemnity insurance for the Directors and Officers of the Company named in this report.

### Indemnity and Insurance of Auditor

The Company has not, during or since the end of the financial year, indemnified or agreed to indemnify the auditor of the Company or any related entity against a liability incurred by the auditor.

During the financial year, the Company has not paid a premium in respect of a contract to insure the auditor of the Company or any related entity.

### Non-Audit Services

Details of the amounts paid or payable to the auditor for non-audit services provided during the financial year by the auditor are outlined in Note 21 to the financial statements.

The Directors are satisfied that the provision of non-audit services during the financial year, by the auditor (or by another person or firm on the auditor's behalf), is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*.

The Directors are of the opinion that the services as disclosed in Note 21 to the financial statements do not compromise the external auditor's independence requirements of the *Corporations Act 2001* for the following reasons:

- all non-audit services have been reviewed and approved to ensure that they do not impact the integrity and objectivity of the auditor; and
- none of the services undermine the general principles relating to auditor independence as set out in APES 110: *Code of Ethics for Professional Accountants* issued by the Accounting Professional and Ethical Standards Board.

### Rounding of Amounts

The Company is of a kind referred to in *ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191*, issued by the Australian Securities and Investments Commission, relating to 'rounding-off'. Amounts in this report have been rounded off in accordance with that Instrument to the nearest thousand dollars, or in certain cases, the nearest dollar.

### Auditor's Independence Declaration

A copy of the auditor's independence declaration as required under section 307C of the *Corporations Act 2001* is set out on page 45.

# Directors' Report – continued



## Auditor

PricewaterhouseCoopers continues in office in accordance with section 327 of the *Corporations Act 2001*.

This report is made in accordance with a resolution of Directors, pursuant to section 298(2)(a) of the *Corporations Act 2001*.

On behalf of the Directors

**Michael Cole**
Chairman

**Andrew Clifford**
Director

23 August 2018
Sydney

## Remuneration Report

### A Message From the Chair of the Nomination & Remuneration Committee

As shareholders know, the core purpose of the Company is to deliver exceptional investment returns to clients over the medium to long-term, consistent with a risk profile that seeks to preserve investor's capital. Platinum believes that long-term investment performance is the primary driver of fund inflows, profit growth and therefore long-term value creation for shareholders.

The remuneration policy is shaped around this core purpose. The Company can only achieve exceptional investment performance by attracting and then retaining superior investment talent, supported by a team of similarly talented client service and operational staff. The long-term success of our remuneration program can be evidenced by our enviable investment performance track record, a history of high retention rates amongst key investment and operational staff, and a history of strong shareholder returns.

Platinum's remuneration program has two key elements, being fixed remuneration (salary and superannuation) and variable incentive awards, which are made either in the form of cash or by way of a deferred equity award. To ensure the alignment of the investment team with strong client investment returns, the size of the variable remuneration pool for the investment team varies with the extent of investment out-performance generated for clients, measured over both 1 and 3 year periods.

That said, there can be times when, despite Platinum's sound stock selection process, capital markets can work against Platinum's investment style and our funds can underperform. This should not surprise shareholders as Platinum's investment approach builds portfolios from the bottom up on an index agnostic basis, so periods of underperformance to an index are almost inevitable. In these transitory periods, the Directors retain the right to make appropriate discretionary awards.

The Board is also conscious of the need to align remuneration outcomes with shareholder returns. We note the trend by some other corporates to focus on Total Shareholder Return ("TSR") as a basis for designing Key Management Personnel ("KMP") and employee remuneration structures. TSR measures share price appreciation or depreciation plus dividend reinvestment between two points in time. Whilst, over long periods of time, TSR will usually reflect the underlying performance of a company's business, it is Platinum's view that there are a number of problems associated with the use of TSR as the primary factor for determining employee remuneration. Shorter term variables, such as the macroeconomic environment or interest rates, are factors outside of the control of employees, but these can often overwhelm underlying developments in the business, and determine a company's share price. The result is that employees may be either unduly rewarded or punished by variables outside of their control. The use of TSR as an incentive tool, in our view, encourages a focus on short-term outcomes such as current year earnings, or short-term investment returns, potentially at the expense of longer-term business outcomes. Given the strong alignment between employees and shareholders that already exists at Platinum due to the majority employee shareholding, we believe that Platinum's shareholders are better served by a remuneration policy that aligns remuneration with the performance that we generate for our clients.

# Directors' Report – continued

Your Nomination & Remuneration Committee has been active in the 2018 year and up to the date of this report. In particular, we have:

- Continued to push forward our program of Board renewal, appointing Brigitte Smith and Tim Trumper to the Board;
- Worked to ensure the smooth transition of CEO responsibilities to Mr Andrew Clifford;
- Reviewed and updated the Board skills matrix;
- Reviewed and approved various revisions to the Analyst and Profit Share plans; and
- Reviewed the impact of UCITS V on the remuneration policies of the firm.

We will continue to refine and review our remuneration arrangements to ensure that they align with the firm's core purpose and we welcome your feedback.

**Stephen Menzies**
Chair of Nomination & Remuneration Committee

**Introduction**

The Company's Directors present the Remuneration Report prepared in accordance with section 300A of the *Corporations Act 2001* for the Company and consolidated entity for the year ended 30 June 2018. The Remuneration Report forms part of the Directors' Report.

The information provided in this Remuneration Report has been audited by the Company's auditor, PricewaterhouseCoopers, as required by section 308 (3C) of the *Corporations Act 2001*.

**Summary of Remuneration Outcomes for 2018**

- As noted in the Chairman's report, investment team remuneration is aligned with the investment returns that are being generated for clients. It was therefore pleasing to see a significant increase in variable remuneration awards this year due to strong investment outperformance. This outperformance has already resulted in increased fund inflows and should substantially enhance the long-term value of the business to the benefit of all shareholders.

- The Investment Team Profit Share Plan (PSP) and Investment Team Plan (ITP) both generated incentive pool amounts this year. This was due to the weighted average of 1 and 3 year investment outperformance across all client portfolios totalling 3.71%. This outperformance approached each Plan's maximum cap of 6% and 5% respectively.

- The combined PSP and ITP plan pools generated cash awards of $20.7m, with discretionary cash awards under the General Employee Plan to non-investment staff totalling a further $5.0m. In addition, under the Deferred Remuneration Plan, deferred remuneration awards were made to the value of $7.5m.

- In addition, following a mid-year review, the Nomination & Remuneration Committee elected to make a one-off, out of cycle, additional deferred award, totalling $5.2m, to several key investment staff. Total deferred awards for the year were therefore $12.7m, with sufficient shares purchased on-market, at an average price of $6.34, to fully hedge this exposure.

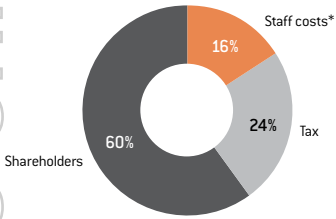
- The allocation of 2018 profits attributed to both shareholders and employees is outlined in the first graph on page 32. It shows that the compensation awarded to employees was modest relative to the returns to shareholders, with shareholders receiving a share of profits nearly four times that of staff remuneration.

- The second graph, on page 32, shows that alignment between employees and the owners of the business also remains very strong, with several key staff being primarily remunerated by way of dividends and capital appreciation, in exactly the same way as other shareholders.

# Directors' Report – continued

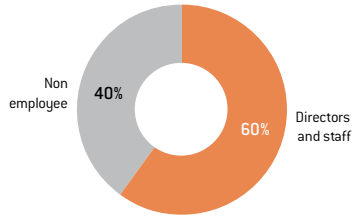


**Graph 1: Actual Share of 2018 Profit (pre tax and pre staff costs)**




* Includes share based payments expense

**Graph 2: Composition of PTM share ownership**




– Mr Kerr Neilson once again waived his ability to receive a variable award in 2018 and this was ratified by the Nomination & Remuneration Committee.

– Due primarily to his significant contribution to the strong absolute and relative performance over the last 1 and 3 years, Platinum's Chief Investment Officer, Andrew Clifford, received a variable award in 2018, as did the remaining two executive Key Management Personnel ("KMP"), being the Director of Investment Services and Communications, Elizabeth Norman and the Finance Director, Andrew Stannard.

**Guiding Principles of KMP and Staff Remuneration**

The core purpose of the Company is to deliver exceptional investment returns to clients over the medium to long-term consistent with a risk profile that seeks to preserve investor's capital. It achieves this purpose by attracting and then retaining superior investment talent, supported by a team of similarly talented client service and operational staff.

The success of our remuneration program can be evidenced by our enviable investment performance track record, a history of high retention rates amongst key investment and operational staff, and a record of highly profitable growth.

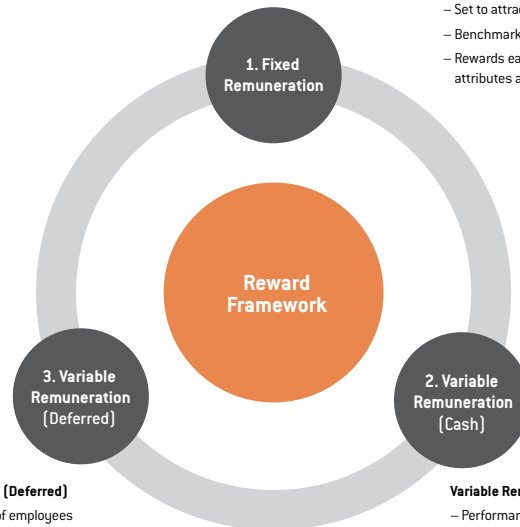
Platinum's remuneration program has two[3] key elements:

1. Fixed Remuneration: This is set at a level sufficient to attract exceptional talent. It includes salary, benefits and statutory entitlements. Fixed remuneration is benchmarked to market at least annually and reflects the scope of the individual role, and the required level of skill and experience.

2. Variable Remuneration: Each employee is assessed annually across a range of quantitative and qualitative factors as well as appropriate risk management and behavioural requirements. Variable award recommendations are generally made annually on a discretionary basis following rigorous review by management and are approved by the Nomination & Remuneration Committee, which comprises non-executive Directors only.

3. Platinum also has two inactive long-term Remuneration Plans, being an "Options and Performance Rights Plan" (OPRP) and an "Fund Appreciation Rights Plan" (FARP). There was no allocation under either plan in either the current or prior year.

Variable awards can be made in the form of cash or a deferred equity award which vests over a 4 year period. This deferral element is designed to foster sustainable growth, as well as sound financial, operational and risk management practices.




**Fixed Remuneration**

- Set to attract exceptional talent
- Benchmarked to market
- Rewards each employee for their skills, attributes and role accountabilities.

**Variable Remuneration (Deferred)**

- Improves alignment of employees and shareholders
- Significant deferral element to foster sustainable growth and sound financial, operational and risk management practices

**Variable Remuneration (Cash)**

- Performance goals set annually at the beginning of each performance period
- Board approves awards annually with reference to individual performance
- Other performance conditions include
  - Company performance
  - Risk Management factors
  - Leadership and Cultural factors

## Variable Remuneration Plans

There were three variable remuneration plans in operation during FY18, which were supported by a Deferred Remuneration Plan. Each plan is overseen by the Nomination & Remuneration Committee. The investment team has access to the Investment Team Plan and the Profit Share Plan. All other staff are covered by the General Employee Plan. Each variable remuneration award is then apportioned between a cash amount, which is generally paid in June and a deferred amount, which will vest in four years so long as the employee remains at the firm during that time.

# Directors' Report – continued



The table below summarises the main characteristics of each plan, each of which are then discussed in more detail in the following section.

| PLAN SUMMARY | PARTICIPANTS | POOL FORMULA | CAP | HURDLE | AWARD TYPE |
|---|---|---|---|---|---|
| Investment Team Plan | Investment team | Weighted average 1 and 3 year performance[4] | 2x salary of investment team (caps out at 5% outperformance) | 0% | Cash and/ or deferred award |
| Profit Share Plan | Investment team | Weighted average 1 and 3 year performance | 5% of adjusted net profit (caps out at 6% outperformance) | 1% | |
| General Employee Plan | Non-investment team staff | Discretionary Award | n/a | n/a | |

*Investment Team Plan (applies to members of the investment team only)*
Under this Plan, the annual investment team award pool is calculated as a percentage of the aggregate base salary of the investment team. The percentage level relates to the weighted average of 1 year and 3 year outperformance of all funds and mandates under management. For each 1% increase in this average outperformance, the pool is increased by 20% and is then capped at 2 times salary when average outperformance is 5% or more.

The pool is allocated across the investment team based on performance assessments that are based on both quantitative and qualitative measures. In a period where there is aggregate weighted average underperformance or where performance is uneven across different funds or fund managers, annual awards for investment team members may then be determined by an individual assessment of each employee's contribution to the investment team, during the period. Quantitative measures used to assess individual performance include the performance of any portfolios under the management of an individual and the performance of the individual investment ideas that the person has proposed. Individual investment performance is usually assessed over a 1 year and 3 year time-frame and is relative to an appropriate benchmark.

4. The Board can elect to make discretionary awards in excess of the pool amount should it be required. In this case, annual awards for investment team members may then be determined by an individual assessment of each employee's contribution.

*Profit Share Plan ("PSP") (applies to selected members of the investment team only)*
The PSP is designed to reward key members of the team for helping in the development of Platinum's business through strong investment performance (generally relative to benchmarks). Individual members of the investment team are issued notional units in the profit share plan. The notional units have no capital value and cannot be sold or transferred to a third party. Notional units are adjusted each year based upon the assessment of each staff member's long-term contribution potential to the future development of Platinum. Each year the profit share percentage is determined based upon the weighted average 1 year and 3 year outperformance of all funds under management. For example, if the average of the 1 and 3 year rolling performance of our Funds exceeds the weighted benchmark by 2.5%, then 1.5% of the Company's management fee-based[5] net profit before tax is made available to this pool.

There is no profit share until weighted average 1 year and 3 year outperformance is greater than 1%. The profit share figure is limited to 5% of profit before tax, though the Nomination & Remuneration Committee may elect to carry over outperformance to future periods if investment returns indicate a profit share in excess of the 5% level.

*General Employee Plan (applies to non-investment team staff)*
Performance is assessed against pre-determined operational performance indicators relevant to each employee as determined by the Directors of PIML and ratified by the Nomination & Remuneration Committee. These performance indicators take into account the responsibilities, skill and experience of each employee and their contribution during the year.

*Deferred Remuneration Plan (applies to all staff)*
In June 2016, the Nomination & Remuneration Committee approved the implementation of the Deferred Remuneration Plan. The main objectives of the Plan are to recognise the contributions made by key employees and to retain their skills within the firm. Eligible employees are selected by the Nomination & Remuneration Committee, generally during the annual award cycle, and the proportion of each variable award that is deferred varies by employee. The number of deferred rights awarded is determined by dividing the discretionary deferred award amount by the PTM share price, using a volume weighted average price (VWAP) of the PTM shares over the seven (7) trading days prior to the award acceptance date. If an eligible employee remains employed at Platinum after the four year vesting period expires, the employee then has a further five years to exercise their deferred right. If an employee resigns from Platinum before they have met their service condition then, in most circumstances, the deferred rights will be forfeited.

5. Excluding investment related revenue and expenses.

# Directors' Report – continued



In order to satisfy the obligation to the Company that arises from the granting of deferred awards, the Company intends to, over time, purchase shares on-market and then hold these shares within an Employee Share Trust. Upon vesting, eligible employees will receive one ordinary share in PTM from the Employee Share Trust in satisfaction of each of their rights. No amount is payable by any eligible employee on either award or on exercise. There is flexibility within the plan for the Committee to award cash or some other instrument rather than deferred shares, but the Committee currently envisages awarding shares only.

Eligible employees will have no voting or dividend rights until their deferred rights have been exercised and their shares have been allocated. However, the deferred rights also carry an entitlement to a dividend equivalent payment. Upon the valid exercise of a deferred right, or deemed exercise, of a deferred right, an eligible employee will be entitled to receive an amount approximately equal to the amount of dividends that would have been paid to the eligible employee had they held the share from the grant date to the date that the deferred rights are exercised.

**Long-Term Remuneration Plans**

Platinum has two inactive long-term Remuneration Plans, being an "Options and Performance Rights Plan" (OPRP) and an "Fund Appreciation Rights Plan" (FARP). There was no allocation under either plan in either the current or prior year.

**Key Management Personnel ("KMP")**

For the purposes of this report, KMP of the consolidated entity in office at any time during the financial year were:

| NAME | POSITION |
|---|---|
| Michael Cole | Chairman and Non-Executive Director |
| Stephen Menzies | Non-Executive Director |
| Anne Loveridge | Non-Executive Director |
| Brigitte Smith | Non-Executive Director (from 31 March 2018) |
| Kerr Neilson | Managing Director |
| Andrew Clifford | Executive Director and Chief Investment Officer (CIO) |
| Elizabeth Norman | Executive Director and Director of Investor Services and Communications |
| Andrew Stannard | Executive (Finance) Director |

In addition, the Company recently announced the appointment of Mr Tim Trumper to the Board, as a Non-Executive Director, with effect from 1 August 2018.

There were no other employees that held a KMP position within the Company or consolidated entity.

**Managing Director and other KMP Remuneration**

*Managing Director Remuneration*

Kerr Neilson continued to waive his ability to receive variable compensation. This has been ratified by the Nomination & Remuneration Committee.

With effect from 1 July 2018, Mr Andrew Clifford assumed the role of CEO in addition to his existing responsibilities as Chief Investment Officer. As a consequence of this change, Mr Clifford will, from 1 July 2018, become eligible for discretionary awards under the CEO Plan (subject to a A$1 million cap), subject to meeting KPIs as set by the Board, in addition to any entitlement under the pre-existing plans.

*Other KMP Remuneration*

Andrew Clifford, Platinum's Chief Investment Officer and Co-Manager of Platinum International Fund, received a variable award that reflected both his significant contribution to the strong absolute and relative investment performance achieved for Platinum's clients as well as his leadership and development of the investment team.

The variable compensation paid to Elizabeth Norman reflected her role as Director of Investor Services and Communications and her leadership and involvement in the development of several initiatives during the year, including the launch of a range of new offshore funds in the Cayman Islands (to support US business initiatives), ongoing work associated with our European business operations, the successful growth of the new Quoted Managed Funds, the deployment of a new website and a substantial expansion of our communications with both advisors and investors.

The variable compensation paid to Andrew Stannard reflected the leadership and strategic input that he provided into various business development opportunities for the business. This included the development of the ASX Quoted Managed Funds, the creation of a new range of Cayman registered funds and working on the operational aspects of our European business. In addition, he led various capital management activities undertaken by the firm, including the partial disposal of the consolidated entity's interest in Platinum Asia Investments Limited.

# Directors' Report – continued



## Remuneration of Executive Key Management Personnel (KMP)

The table below presents the remuneration provided by the consolidated entity to Executive KMP of the consolidated entity, in accordance with accounting standards.

| | CASH SALARY $ | OTHER[1] $ | SUPER-ANNUATION $ | VARIABLE REMUNERA-TION (CASH)[2] $ | VARIABLE REMUNERA-TION (DEFERRED)[3] $ | TOTAL $ | VARIABLE REMUNERA-TION AS A % OF TOTAL REMUNERA-TION[4] |
|---|---|---|---|---|---|---|---|
| **2018** | | | | | | | |
| Kerr Neilson[5] | **450,000** | **(5,384)** | **20,049** | **–** | **–** | **464,665** | **0%** |
| Andrew Clifford | **450,000** | **4,428** | **20,049** | **2,632,000** | **174,000** | **3,280,477** | **86%** |
| Elizabeth Norman | **425,000** | **(3,364)** | **20,049** | **1,300,000** | **163,645** | **1,905,330** | **77%** |
| Andrew Stannard | **425,000** | **(4,151)** | **20,049** | **450,000** | **42,950** | **933,848** | **53%** |
| | **1,750,000** | **(8,471)** | **80,196** | **4,382,000** | **380,595** | **6,584,320** | **72%** |
| 2017 | | | | | | | |
| Kerr Neilson[5] | 450,000 | (18,089) | 19,616 | – | – | 451,527 | 0% |
| Andrew Clifford | 425,000 | (13,206) | 19,616 | – | – | 431,410 | 0% |
| Elizabeth Norman | 400,000 | 9,250 | 19,616 | 1,200,000 | 104,400 | 1,733,266 | 75% |
| Andrew Stannard | 400,000 | 11,009 | 19,616 | 400,000 | 17,400 | 848,025 | 49% |
| | 1,675,000 | (11,036) | 78,464 | 1,600,000 | 121,800 | 3,464,228 | 50% |

(1) "Other" represents the increase/(decrease) in the accounting provision for annual and long service leave. These amounts were not received by the Executive Directors and represent provisions made in the consolidated entity's statement of financial position.

(2) See the "Variable Remuneration Plans" section on pages 33 to 36 for further details. The cash variable remuneration attributable to Andrew Clifford is comprised of awards under the Analyst Plan and Profit Share Plan of $1,000,000 and $1,632,000 respectively. The cash awards made to Elizabeth Norman and Andrew Stannard were made under the General Employee Plan.

(3) The accounting fair value attributed to each deferred award is spread over the five year service period. The accounting valuation of $174,000 attributable to Andrew Clifford represents the current year portion of the 2018 deferred award of $1,000,000. The accounting valuation of $163,645 attributable to Elizabeth Norman represents the current year portion of the 2018 deferred award of $350,000, the 2017 award of $300,000 and the 2016 award of $300,000. The accounting valuation of $42,950 attributable to Andrew Stannard represents the current year portion of the 2018 deferred award of $150,000 and the 2017 award of $100,000.

(4) Fixed remuneration refers to salary, superannuation and provisions or payments made for annual and long service leave. Variable remuneration refers to both cash and deferred components.

(5) The Managing Director, Kerr Neilson, waived his right to receive variable compensation and this has been ratified by the Nomination & Remuneration Committee.

The table below presents supplementary disclosure of the remuneration provided by the consolidated entity to Executive KMP's of the consolidated entity, based of amounts awarded to the individual during the year.

| | CASH SALARY $ | SUPER-ANNUATION $ | VARIABLE-REMUNERA-TION (CASH)[1] $ | VARIABLE-REMUNERA-TION (DEFERRED)[2] $ | TOTAL $ | VARIABLE REMUNERA-TION AS A % OF TOTAL REMUNERA-TION[3] |
|---|---|---|---|---|---|---|
| **2018** | | | | | | |
| Kerr Neilson[4] | **450,000** | **20,049** | **–** | **–** | **470,049** | **0%** |
| Andrew Clifford | **450,000** | **20,049** | **2,632,000** | **1,000,000** | **4,102,049** | **89%** |
| Elizabeth Norman | **425,000** | **20,049** | **1,300,000** | **350,000** | **2,095,049** | **79%** |
| Andrew Stannard | **425,000** | **20,049** | **450,000** | **150,000** | **1,045,049** | **57%** |
| | **1,750,000** | **80,196** | **4,382,000** | **1,500,000** | **7,712,196** | **76%** |
| 2017 | | | | | | |
| Kerr Neilson[4] | 450,000 | 19,616 | – | – | 469,616 | 0% |
| Andrew Clifford | 425,000 | 19,616 | – | – | 444,616 | 0% |
| Elizabeth Norman | 400,000 | 19,616 | 1,200,000 | 300,000 | 1,919,616 | 78% |
| Andrew Stannard | 400,000 | 19,616 | 400,000 | 100,000 | 919,616 | 54% |
| | 1,675,000 | 78,464 | 1,600,000 | 400,000 | 3,753,464 | 53% |

(1) See the "Variable Remuneration Plans" section on pages 33 to 36 for further details. The "variable remuneration (cash)" amount attributable to Andrew Clifford is comprised of awards under the Analyst Plan and Profit Share Plan of $1,000,000 and $1,632,000 respectively. The cash awards made to Elizabeth Norman and Andrew Stannard were made under the General Employee Plan.

(2) The "variable remuneration (deferred)" amount noted above reflects the award amounts attributed to each individual in the current financial year.

(3) Fixed remuneration refers to salary and superannuation. Variable remuneration refers to both cash and deferred components.

(4) The Managing Director, Kerr Neilson, waived his right to receive variable compensation and this has been ratified by the Nomination & Remuneration Committee.

# Directors' Report – continued



## Remuneration of Non-Executive Directors

*Remuneration Policy*

The Company's remuneration policy for Non-Executive Directors is designed to ensure that the Company can attract and retain suitably-qualified and experienced directors.

It is the policy of the Board to remunerate at market rates. Non-Executive Directors received a fixed fee and mandatory superannuation payments. Non-Executive Directors do not receive variable compensation and are not eligible to participate in any variable remuneration plans. The Executive Directors examine the base pay of the Non-Executive Directors annually and may utilise the services of an external advisor to assist with this.

The Executive Directors determine the remuneration of the Non-Executive Directors within the maximum approved shareholder limit. The aggregate amount of remuneration that can be paid to the Non-Executive Directors, which was approved by shareholders at a general meeting in April 2007, is $2 million per annum (including superannuation).

No other retirement benefits (other than mandatory superannuation) are provided to the Non-Executive Directors. There are no termination payments payable on the cessation of office and any Director may retire or resign from the Board, or be removed by a resolution of shareholders. The Constitution of the Company specifies that any change to the maximum amount of remuneration that can be paid to the Non-Executive Directors requires the approval by shareholders.

*Remuneration Structure*

Below is a summary of changes within each of the Board's sub-committees over the last year.

| NAME | AUDIT, RISK & COMPLIANCE COMMITTEE | NOMINATION & REMUNERATION COMMITTEE |
|---|---|---|
| Michael Cole | Member for the full financial year. | Member for the full financial year. |
| Anne Loveridge | Member and Chair for the full financial year. | Member for the full financial year. |
| Stephen Menzies | Member for the full financial year. | Member and Chair for the full financial year. |
| Brigitte Smith | Member since 31 March 2018. | Member since 31 March 2018. |

The following table displays the current Non-Executive Directors and their roles at 30 June 2018:

| | MICHAEL COLE | ANNE LOVERIDGE | STEPHEN MENZIES | BRIGITTE SMITH |
|---|---|---|---|---|
| Board | Chair | Member | Member | Member |
| Audit, Risk & Compliance Committee | Member | Chair | Member | Member |
| Nomination & Remuneration Committee | Member | Member | Chair | Member |

The table below shows how the remuneration is allocated reflecting their roles at 30 June 2018.

| | MICHAEL COLE | ANNE LOVERIDGE | STEPHEN MENZIES | BRIGITTE SMITH |
|---|---|---|---|---|
| Board | $170,000 | $130,000 | $130,000 | $130,000 |
| Audit, Risk & Compliance Committee | $15,000 | $30,000 | $15,000 | $15,000 |
| Nomination & Remuneration Committee | $15,000 | $15,000 | $30,000 | $15,000 |
| **Total** | **$200,000** | **$175,000** | **$175,000** | **$160,000** |

# Directors' Report – continued



**Remuneration of Non-Executive Directors**

The table below presents actual amounts received by the Non-Executive Directors.

| | CASH SALARY $ | SUPER-ANNUATION $ | VARIABLE REMUNERATION (CASH) $ | VARIABLE REMUNERATION (DEFERRED) $ | TOTAL $ |
|---|---|---|---|---|---|
| **2018** | | | | | |
| Michael Cole | **200,000** | **19,000** | **–** | **–** | **219,000** |
| Stephen Menzies | **175,000** | **16,625** | **–** | **–** | **191,625** |
| Anne Loveridge | **175,000** | **16,625** | **–** | **–** | **191,625** |
| Brigitte Smith (from 31 March 2018) | **40,000** | **3,800** | **–** | **–** | **43,800** |
| | **590,000** | **56,050** | **–** | **–** | **646,050** |
| 2017 | | | | | |
| Michael Cole | 200,000 | 19,000 | – | – | 219,000 |
| Stephen Menzies | 160,519 | 15,249 | – | – | 175,768 |
| Anne Loveridge (from 22 September 2016) | 129,308 | 12,284 | – | – | 141,592 |
| Margaret Towers (until 22 September 2016) | 43,750 | 4,156 | – | – | 47,906 |
| Bruce Coleman (until 19 June 2017) | 175,597 | 16,678 | – | – | 192,275 |
| | 709,174 | 67,367 | – | – | 776,541 |

Stephen Menzies is Platinum Investment Management Limited's (PIMLs) nominee on the Board of the offshore UCITS fund, Platinum World Portfolios Plc (PWP) and payments are made directly by PWP. Amounts paid in the current year were Euro 22,032 (equivalent to A$34,257) (2017: Euro 20,000 (equivalent to A$28,908)).

**Managing Director and other Senior Executive employment agreements**

The key aspects of the KMP contracts are outlined below:

- Remuneration and other terms of employment for Non-Executive Directors are formalised in letters of appointment.
- All contracts (both Executive and Non-Executive) include the components of remuneration that are to be paid to KMP and provide for annual review, but do not prescribe how remuneration levels are to be modified from year to year.

- The tenure of all Directors, except for the founder, Mr Kerr Neilson, is subject to approval by shareholders at every third AGM or other general meeting convened for the purposes of election of Directors.
- In the event of termination, all KMP are entitled to receive their statutory leave entitlements and superannuation benefits. In relation to variable remuneration plans, upon termination, where an Executive resigns, variable remuneration is only paid if the Executive is employed at the date of payment. The Board retains discretion to still make variable remuneration payments in certain exceptional circumstances, such as bona-fide retirement.
- All Executive Directors can terminate their appointment by providing three months' notice.
- Non-Executive Directors may resign by written notice to the Chairman and where circumstances permit, it is desirable that reasonable notice of an intention to resign is given to assist the Board in succession planning.

**Link between performance and KMP remuneration paid by the consolidated entity**
Total aggregate variable remuneration paid represents variable remuneration awards and is predominantly based on the investment performance generated for clients. The amount paid in 2018 for aggregate variable remuneration was higher than the preceding four years, primarily on account of the strong investment performance generated for clients over the 1 and 3 year period and the associated allocation under the Profit Share Plan (PSP).

| | **2018** | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| Revenue ($'000) | **353,290** | 333,549 | 344,658 | 360,422 | 319,796 |
| Expenses ($'000) | **84,966** | 62,971 | 62,464 | 58,872 | 58,751 |
| Operating profit after tax ($'000) | **191,594** | 192,647 | 199,870 | 213,499 | 189,867 |
| Basic earnings per share (cents per share) | **32.36** | 31.74 | 34.24 | 36.66 | 32.79 |
| Total dividends (cents per share) | **32** | 30 | 32 | 47 | 34 |
| Total aggregate fixed remuneration paid ($)[1] | **2,510,503** | 2,558,913 | 2,518,991 | 2,362,901 | 2,346,251 |
| Total aggregate variable remuneration paid ($) | **4,762,595** | 1,721,800 | 1,452,200 | 1,125,000 | 2,554,650 |

(1) Total aggregate fixed remuneration paid represents salaries and superannuation (and includes the Director's Fees disclosed and paid to Stephen Menzies for his Directorship of the UCITS funds).

# Directors' Report – continued



### Interests of Non-Executive and Executive Directors in shares

The relevant interest in ordinary shares of the Company that each Director held at balance date was:

| | OPENING BALANCE | ADDITIONS | DISPOSALS | CLOSING BALANCE |
|---|---|---|---|---|
| Michael Cole | 200,000 | 40,000 | – | 240,000 |
| Stephen Menzies | 30,000 | 10,000 | – | 40,000 |
| Anne Loveridge | 6,000 | 16,000 | – | 22,000 |
| Brigitte Smith | – | 41,666 | – | 41,666 |
| Kerr Neilson | 312,074,841 | – | – | 312,074,841 |
| Andrew Clifford[1] | 32,831,449 | – | – | 32,831,449 |
| Elizabeth Norman[2] | 766,748 | – | – | 766,748 |
| Andrew Stannard[3] | – | – | – | – |

(1) Andrew Clifford also has contingent rights to receive up to 165,563 shares pursuant to awards made under the Company's deferred remuneration plan.

(2) Elizabeth Norman also has contingent rights to receive up to 171,227 shares pursuant to awards made under the Company's deferred remuneration plan.

(3) Andrew Stannard also has contingent rights to receive up to 46,387 shares pursuant to awards made under the Company's deferred remuneration plan.

### Directors' interests in contracts

The Directors received remuneration that is ultimately derived from net income arising from Platinum Investment Management Limited's investment management contracts.

### Other related party payments involving KMP

In the current year, the consolidated entity paid $50,000 (2017: $200,000) to OneVue Services Pty Limited for the provision of services associated with the build, customisation and enhancement of the Platinum web-site. OneVue is a related entity of the Chairman of Platinum Asset Management Limited, Mr Michael Cole.

### Shareholders' Approval of the 2017 (prior year) Remuneration Report

A 25% or higher "no" vote on the Remuneration Report at an AGM triggers a reporting obligation on a listed company to explain in its next Annual Report how concerns are being addressed. At the last AGM, the Company's Remuneration Report was carried on a poll and received a vote in favour of 96.85%.

# Auditor's Independence Declaration

As lead auditor for the audit of Platinum Asset Management Limited for the year ended 30 June 2018, I declare that to the best of my knowledge and belief, the only contraventions of:

(a) the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and

(b) any applicable code of professional conduct in relation to the audit;

are as set out below.

A partner in the lead audit engagement office held an immaterial investment for a very short period in one of the entities that Platinum Investment Management Limited controls, Platinum Asia Fund (Quoted Managed Hedge Fund). The partner did not provide any services to Platinum Investment Management Limited, the responsible entity, or the fund. The investment was immediately disposed when the issue was identified.

I do not believe this matter has impacted the objectivity of PricewaterhouseCoopers in relation to the audit.

This matter was identified as part of our on-going quality control system. All reasonable steps were undertaken to ensure that this matter was resolved as soon as possible. I report that this matter has been resolved, and in doing so do not believe that this matter has impacted my objectivity and impartiality for the purpose of this audit.

This declaration is in respect of Platinum Asset Management Limited and the entities it controlled during the period.

**R Balding**
Partner
PricewaterhouseCoopers

Sydney, 23 August 2018

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# Consolidated Statement of Profit or Loss and Other Comprehensive Income

## For the year ended 30 June 2018



| | NOTE | CONSOLIDATED 2018 $'000 | 2017 $'000 |
|---|---|---|---|
| **Revenue** | | | |
| Management fees | | **306,803** | 296,391 |
| Performance fees | | **21,878** | 1,626 |
| Administration fees | | **–** | 14,451 |
| | | **328,681** | 312,468 |
| **Other income** | | | |
| Interest | | **3,744** | 4,341 |
| Distributions and dividends | 5 | **23,272** | 11 |
| Gains on equity investments in associates | 2, 5 | **9,211** | 9,736 |
| (Losses)/gains on financial assets at fair value through profit or loss | 5 | **(12,954)** | 6,779 |
| Foreign exchange gains on overseas bank accounts | | **1,296** | 149 |
| Gains on forward currency contracts | 5 | **40** | 65 |
| Total revenue and other income | | **353,290** | 333,549 |
| **Expenses** | | | |
| Staff | | **49,231** | 34,242 |
| Custody and unit registry | | **13,348** | 11,992 |
| Business development | | **7,429** | 4,080 |
| Share-based payments | 19 | **3,558** | 1,449 |
| Legal, compliance and other professional | | **2,813** | 2,321 |
| Research | | **2,214** | 2,032 |
| Technology | | **1,995** | 1,675 |
| Rent and other occupancy | | **1,661** | 1,862 |
| Mail house, periodic reporting and share registry | | **990** | 1,321 |
| Depreciation | 10 | **724** | 895 |
| Insurance | | **460** | 468 |
| Audit fee | 21 | **444** | 425 |
| Other | | **99** | 209 |
| Total expenses | | **84,966** | 62,971 |
| **Profit before income tax expense** | | **268,324** | 270,578 |
| Income tax expense | 6(a) | **76,730** | 77,931 |
| **Profit after income tax expense for the year** | | **191,594** | 192,647 |

| | NOTE | CONSOLIDATED 2018 $'000 | 2017 $'000 |
|---|---|---|---|
| **Other comprehensive income** | | | |
| Exchange rate translation impact of foreign subsidiaries | 14 | **7** | 406 |
| Other comprehensive income for the year, net of tax | | **7** | 406 |
| **Total comprehensive income for the year** | | **191,601** | 193,053 |
| **Profit after income tax expense for the year is attributable to:** | | | |
| Owners of Platinum Asset Management Limited | | **189,221** | 186,026 |
| Non-controlling interests | | **2,373** | 6,621 |
| | | **191,594** | 192,647 |

| | | **CENTS** | CENTS |
|---|---|---|---|
| Basic earnings per share | 22 | **32.36** | 31.74 |
| Diluted earnings per share | 22 | **32.36** | 31.74 |

**The above consolidated statement of profit or loss and other comprehensive income should be read in conjunction with the accompanying notes.**

# Consolidated Statement of Financial Position

## As at 30 June 2018



| | NOTE | CONSOLIDATED 2018 $'000 | 2017 $'000 |
|---|---|---|---|
| **Assets** | | | |
| **Current assets** | | | |
| Cash and cash equivalents | | **164,337** | 154,263 |
| Term deposits | | **27,876** | 74,876 |
| Trade and other receivables | 9 | **52,557** | 30,199 |
| Income tax receivable | | **3,333** | – |
| Total current assets | | **248,103** | 259,338 |
| **Non-current assets** | | | |
| Equity investments in associates | 2 | **95,920** | 91,692 |
| Financial assets at fair value through profit or loss | 8 | **98,796** | 107 |
| Fixed assets | 10 | **2,986** | 2,829 |
| Total non-current assets | | **197,702** | 94,628 |
| **Total assets** | | **445,805** | 353,966 |
| **Liabilities** | | | |
| **Current liabilities** | | | |
| Trade and other payables | 11 | **24,082** | 6,255 |
| Employee benefits | 12 | **3,249** | 3,261 |
| Income tax payable | | **–** | 7,866 |
| Total current liabilities | | **27,331** | 17,382 |
| **Non-current liabilities** | | | |
| Provisions | 12 | **1,145** | 461 |
| Net deferred tax liabilities | 6(b) | **6,214** | 1,049 |
| Total non-current liabilities | | **7,359** | 1,510 |
| **Total liabilities** | | **34,690** | 18,892 |
| **Net assets** | | **411,115** | 335,074 |

| | NOTE | CONSOLIDATED 2018 $'000 | 2017 $'000 |
|---|---|---|---|
| **Equity** | | | |
| Issued capital | 13 | **731,245** | 742,933 |
| Reserves | 14 | **(582,006)** | (585,818) |
| Retained profits | 15 | **185,940** | 177,959 |
| **Total equity attributable to the owners of Platinum Asset Management Limited** | | **335,179** | 335,074 |
| **Total equity attributable to non-controlling interests:** | | | |
| Non-controlling interests | 4 | **75,936** | – |
| **Total equity** | | **411,115** | 335,074 |

The above consolidated statement of financial position should be read in conjunction with the accompanying notes.

# Consolidated Statement of Changes in Equity

## For the year ended 30 June 2018

| CONSOLIDATED | ISSUED CAPITAL $'000 | RESERVES $'000 | RETAINED PROFITS $'000 | NON-CONTROLLING INTERESTS $'000 | TOTAL EQUITY $'000 |
|---|---|---|---|---|---|
| **Balance at 1 July 2016** | **747,717** | **(587,764)** | **175,522** | **28,736** | **364,211** |
| Profit after income tax expense for the year | – | – | 186,026 | 6,621 | 192,647 |
| *Other comprehensive income* | | | | | |
| Exchange rate translation impact of foreign subsidiaries (Note 14) | – | (595) | – | – | (595) |
| Deconsolidation of Platinum World Portfolios Plc. (Note 14) | – | 1,001 | – | – | 1,001 |
| Total comprehensive income for the year | – | 406 | 186,026 | 6,621 | 193,053 |
| *Transactions with owners in the capacity as owners* | | | | | |
| Treasury shares acquired (Note 13) | (4,784) | – | – | – | (4,784) |
| Share-based payments reserve (Note 14) | – | 1,540 | – | – | 1,540 |
| Dividends paid (Note 16) | – | – | (181,687) | – | (181,687) |
| Decrease in retained earnings on deconsolidation of Platinum World Portfolios Plc. (Note 4) | – | – | (1,902) | (5,604) | (7,506) |
| Decrease in equity on deconsolidation of Platinum World Portfolios Plc. (Note 4) | – | – | – | (29,753) | (29,753) |
| Balance at 30 June 2017 | 742,933 | (585,818) | 177,959 | – | 335,074 |

| CONSOLIDATED | ISSUED CAPITAL $'000 | RESERVES $'000 | RETAINED PROFITS $'000 | NON-CONTROLLING INTERESTS $'000 | TOTAL EQUITY $'000 |
|---|---|---|---|---|---|
| **Balance at 1 July 2017** | **742,933** | **(585,818)** | **177,959** | **–** | **335,074** |
| Profit after income tax expense for the year | – | – | 189,221 | 2,373 | 191,594 |
| Other comprehensive income | – | 7 | – | – | 7 |
| Total comprehensive income for the year | – | 7 | 189,221 | 2,373 | 191,601 |
| *Transactions with owners in the capacity as owners* | | | | | |
| Treasury shares acquired (Note 13) | (11,688) | – | – | – | (11,688) |
| Share-based payments reserve (Note 14) | – | 3,805 | – | – | 3,805 |
| Dividends/Distributions paid (Note 16 and Note 4) | – | – | (181,240) | (16,845) | (198,085) |
| Decrease in retained earnings on deconsolidation of PIXX (Note 4) | – | – | – | (1,357) | (1,357) |
| Transactions with non-controlling interests (Note 4) | – | – | – | 91,765 | 91,765 |
| **Balance at 30 June 2018** | **731,245** | **(582,006)** | **185,940** | **75,936** | **411,115** |

**The above consolidated statement of changes in equity should be read in conjunction with the accompanying notes.**

# Consolidated Statement of Cash Flows

## For the year ended 30 June 2018



| | NOTE | CONSOLIDATED 2018 $'000 | 2017 $'000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Receipts from operating activities | | **328,304** | 311,656 |
| Payments for operating activities | | **(91,242)** | (65,584) |
| Income taxes paid | | **(82,516)** | (80,686) |
| **Net cash from operating activities** | 7 | **154,546** | 165,386 |
| **Cash flows from investing activities** | | | |
| Interest received | | **3,869** | 4,666 |
| Purchase of term deposits | | **(518,250)** | (494,394) |
| Proceeds on maturity of term deposits | | **565,394** | 558,036 |
| Receipts from sale of financial assets and investment in associates | | **36,695** | 37,488 |
| Payments for purchases of financial assets and investment in associates | | **(52,949)** | (91,356) |
| Purchase of units held directly by PIXX (whilst consolidated) and PAXX | | **(64,673)** | – |
| Payments for purchases of fixed assets | 10 | **(881)** | (1,097) |
| Dividends and distributions received | | **1,700** | 488 |
| Less cash released on deconsolidation | | **–** | (36,152) |
| **Net cash (used in) investing activities** | | **(29,095)** | (22,321) |
| **Cash flows from financing activities** | | | |
| Proceeds from units issued (net applications into PIXX (whilst consolidated) and PAXX) and other non-controlling interests | | **64,673** | 73,758 |
| Dividends paid | | **(181,247)** | (181,592) |
| Net cash (used in) financing activities | | **(116,574)** | (107,834) |
| Increase in cash and cash equivalents | | **8,877** | 35,231 |
| Cash and cash equivalents at the beginning of the financial year | | **154,263** | 119,079 |
| Effects of exchange rate changes on cash and cash equivalents | | **1,197** | (47) |
| **Cash and cash equivalents at the end of the financial year** | | **164,337** | 154,263 |

The above consolidated statement of cash flows should be read in conjunction with the accompanying notes.

# Notes to the Financial Statements

## 30 June 2018



### Statement of Compliance

The consolidated financial statements are general purpose financial statements which have been prepared in accordance with Australian Accounting Standards adopted by the Australian Accounting Standards Board (AASB) and the *Corporations Act 2001*. The consolidated financial statements comply with International Financial Reporting Standards (IFRSs) adopted by the International Accounting Standards Board (IASB).

### Basis of Preparation

The consolidated financial statements are presented in Australian Dollars, which is the consolidated entity's functional and presentation currency, with all values rounded to the nearest thousand dollars ('$000), in accordance with *ASIC Corporations (Rounding in Financial/ Directors' Reports) Instrument 2016/191*, unless otherwise stated. The consolidated financial statements have been prepared on a historical cost basis, except for the revaluation of financial assets and liabilities at fair value through profit or loss.

Platinum Investment Management Limited ("PIML") has seeded or invested in many of the products it offers to investors and this has impacted on the accounting treatment adopted in the consolidated financial statements as follows:

| ENTITY | PIML OWNERSHIP INTEREST AT 30 JUNE 2018 | ACCOUNTING TREATMENT ADOPTED IN THESE ACCOUNTS |
|---|---|---|
| Platinum Trust Fund investments | Interest is less than 1% in each Fund. | Fair value accounting applied (see Note 8). |
| Platinum Asia Fund (Quoted Managed Hedge Fund) ("PAXX") | 19.9% | Subsidiary. Consolidation accounting applied (see Note 1).^ |
| Platinum World Portfolios Plc ("PWP") | 13.7% | Investment in associate. Equity accounting applied (see Note 2).* |
| Platinum Asia Investments Limited ("PAI") | 8.3% | Investment in associate. Equity accounting applied (see Note 2).* |

^ PIML has been assessed as exerting control over PAXX, predominantly on the basis of its ownership interest in PAXX, and as a result, the consolidated statement of profit or loss and other comprehensive income includes PAXX's investment income and expenses for the period from 14 September 2017 (launch date) to 30 June 2018 and the consolidated statement of financial position includes PAXX's assets, liabilities and equity as at 30 June 2018. A breakdown of the external (non-PIML/non-controlling) investment in PAXX is disclosed in Note 4. Note 4 also shows the consolidated statement of financial position excluding the impact of the PAXX consolidation.

In September 2017, PIML seeded and exerted control over Platinum International Fund (Quoted Managed Hedge Fund) (ASX ticker: PIXX). As a result of encouraging net fund inflows, during the year, PIML fully disposed of its investment in PIXX and has no holding in PIXX as at 30 June 2018. The consolidated statement of profit or loss and other comprehensive income includes PIXX's investment income and expenses for the period that PIML exerted control over PIXX, which was dependent on PIML's ownership interest in PIXX.

* At 30 June 2018, PIML (and the consolidated entity) was assessed as having significant influence over Platinum Asia Investments Limited ("PAI") and Platinum World Portfolios Plc ("PWP") (Refer to Note 2 for further details).

# Notes to the Financial Statements

## 30 June 2018



As a direct result of the different accounting treatment adopted in these consolidated accounts (as presented in the table on the previous page), management has taken the opportunity to re-order the notes to the financial statements this year. Management has presented the notes in three parts:

**PART A – Notes 1 to 4: Accounting treatment of entities that form part of the Platinum consolidated group**

**PART B – Notes 5 to 22: Operations – Notes that explain the operations of the consolidated entity**

**PART C – Notes 23 to 27: Miscellaneous Notes that are required by the accounting standards**

### Significant accounting policies

The principal accounting policies have been included in the relevant notes to which the policy relates and consistently applied to all financial years presented in these consolidated financial statements.

### Critical accounting judgements, estimates and assumptions

The preparation of the consolidated financial statements require management to make judgements, estimates and assumptions. The areas where assumptions and estimates are significant to the consolidated financial statements are outlined after the relevant accounting policy in the relevant notes. The impact of the treatment of the products that PIML has seeded or invested in, is the most critical accounting judgement, estimate or assumption within these consolidated financial statements.

## PART A – Notes 1 to 4

### Accounting treatment of entities that form part of the Platinum consolidated group

Notes 1 to 4 focus on the accounting treatment adopted in these accounts and contains key information relating to the parent entity, subsidiaries, controlled entities and associates.

### Note 1. Subsidiaries and controlled entities

At 30 June 2018 and 30 June 2017, the Company's subsidiaries and the ownership interests were as follows.

| NAME | PRINCIPAL PLACE OF BUSINESS/ COUNTRY OF INCORPORATION | OWNERSHIP INTEREST **2018 %** | 2017 % |
|---|---|---|---|
| McRae Pty Limited | Australia | **100.0** | 100.0 |
| Platinum Asset Pty Limited | Australia | **100.0** | 100.0 |
| Platinum Investment Management Limited | Australia | **100.0** | 100.0 |
| Platinum Employee Share Trust^ | Australia | **100.0** | 100.0 |
| Platinum Investment Management Australia (PIMA) Corp. | United States | **100.0** | 100.0 |
| Platinum Asia Fund (Quoted Managed Hedge Fund) ("PAXX")* | Australia | **19.9** | n/a |
| Platinum GP Pty Limited** | Australia | **100.0** | n/a |

^ Platinum Employee Share Trust holds PTM shares on behalf of employees selected to participate in the Deferred Remuneration Plan (see Note 19 for further details).

* During the year, the consolidated entity launched and seeded both PIXX and PAXX and as a result of encouraging net fund inflows in PIXX, the consolidated entity fully disposed of its investment in PIXX by 29 January 2018. At 30 June 2018, the consolidated entity's interest in PAXX was 19.9%.

** On 7 February 2018, the Company registered Platinum GP Pty Limited associated with the launch of the US/Cayman Funds. The consolidated entity contributed $1 as capital in order to register and incorporate the entity.

# Notes to the Financial Statements

## 30 June 2018



### Note 1. Subsidiaries and controlled entities – continued

**ACCOUNTING POLICY**

**Principles of consolidation**

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries of Platinum Asset Management Limited ("Company" or "parent entity") as at 30 June 2018 and the results of all subsidiaries for the financial year. Platinum Asset Management Limited and its subsidiaries together are referred to in these consolidated financial statements as the 'consolidated entity' or 'group'.

Subsidiaries are all those entities over which the consolidated entity has control. The consolidated entity controls an entity when the consolidated entity is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the consolidated entity. They are deconsolidated from the date that control ceases.

In preparing the consolidated financial statements, all intercompany transactions, balances and unrealised gains arising within the consolidated entity are eliminated in full.

**Foreign currency translation**

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at balance date exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated statement of profit or loss and other comprehensive income.

The results and financial position of foreign operations that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each financial position presented are translated at the balance date;
- income and expenses included in the consolidated statement of profit or loss and other comprehensive income are translated at average exchange rates (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- all resulting exchange differences are recognised in other comprehensive income in the foreign currency translation reserve.

**Critical accounting judgements, estimates and assumptions**

*Assessment of control:* At 30 June 2018, the consolidated entity was assessed as having control over Platinum Asia Fund (Quoted Managed Hedge Fund) ("PAXX"), primarily on the basis of its ownership interest at 30 June 2018 of 19.9% and because PIML acts as the Investment Manager of PAXX.

## Note 2. Equity investments in associates

At 30 June 2018, the consolidated entity's investment(s) in Platinum Asia Investments Limited ("PAI") and Platinum World Portfolios Plc ("PWP") represent interests in associates which are accounted for using the equity method of accounting. Information relating to this is shown below:

### a. Interests in associates

| ENTITY | EQUITY INTEREST % | | FAIR VALUE $'000 | | CARRYING AMOUNT $'000 | | REASON FOR ASSESSMENT OF SIGNIFICANT INFLUENCE |
|---|---|---|---|---|---|---|---|
| | **2018** | 2017 | **2018** | 2017 | **2018** | 2017 | |
| PAI | **8.3** | 13.9 | **37,800** | 50,750 | **34,972** | 53,612 | Level of ownership interest was 8.3% at 30 June 2018; PIML acts as Investment Manager (IM) in accordance with the Investment Management Agreement; PIML provides performance and exposure reports to the PAI Board. |
| PWP | **13.7** | 14.5 | **63,409** | 39,468 | **60,948** | 38,080 | Level of ownership interest was 13.7% at 30 June 2018; PIML acts as Investment Manager (IM) in accordance with the Investment Management Agreement; the Company provides performance and exposure reports to the PWP Board and Stephen Menzies is a Director of PWP and a Director of Platinum Asset Management Limited. |
| | | | **101,209** | 90,218 | **95,920** | 91,692 | |

# Notes to the Financial Statements

## 30 June 2018



### Note 2. Equity investments in associates – continued

**a. Interests in associates – continued**

PIML disposed of 20 million (or 40% of its) shares in PAI during the year (on 14 December 2017) and that is the reason why the fair value and carrying amount have both decreased. PIML partly disposed of its holding in order to invest in other vehicles, such as PWP.

The fair value of PAI reflects the 30 million shares held multiplied by the PAI closing share price at 30 June 2018 of $1.26 (2017: $1.015).

The fair value of PWP reflects the shares held in the sub-funds multiplied by their respective closing unit prices at 30 June 2018. During the year, PIML purchased units to the value of $19,149,000 in the Japan sub-fund of PWP.

The carrying value reflects the consolidated entity's share of each associate's net assets (see Note 2b for further details).

**b. Share of associates' statement of financial position**

| | **PLATINUM ASIA INVESTMENTS LIMITED $'000** | **GROUP'S SHARE OF ASSOCIATE $'000** | **PLATINUM WORLD PORTFOLIOS $'000** | **GROUP'S SHARE OF ASSOCIATE $'000** |
|---|---|---|---|---|
| **30 June 2018** | | | | |
| Total assets | **432,464** | **36,038** | **446,975** | **61,235** |
| Total liabilities | **12,788** | **1,066** | **2,098** | **287** |
| **Net assets** | **419,676** | **34,972** | **444,877** | **60,948** |

Total group's share of associates' statement of financial position (share of PAI's net assets of $34,972,000 and PWP's net assets of $60,948,000) = $95,920,000.

| | PLATINUM ASIA INVESTMENTS LIMITED $'000 | GROUP'S SHARE OF ASSOCIATE $'000 | PLATINUM WORLD PORTFOLIOS $'000 | GROUP'S SHARE OF ASSOCIATE $'000 |
|---|---|---|---|---|
| 30 June 2017 | | | | |
| Total assets | 397,317 | 55,330 | 265,402 | 38,457 |
| Total liabilities | 12,339 | 1,718 | 2,602 | 377 |
| Net assets | 384,978 | 53,612 | 262,800 | 38,080 |

Total group's share of associates' statement of financial position (share of PAI's net assets of $53,612,000 and PWP's net assets of $38,080,000) = $91,692,000.

## Note 2. Equity investments in associates – continued

### c. Carrying amount of investment using the equity method

| | 2018 $'000 | 2017 $'000 |
|---|---|---|
| Opening balance | **91,692** | 47,746 |
| Initial recognition of PWP as an equity investment on deconsolidation | **–** | 34,210 |
| Partial disposal of PAI | **(21,252)** | – |
| Acquisition of additional PWP units (Japan sub-fund) | **19,149** | |
| Share of associates' profit | **8,031*** | 9,736 |
| Dividends paid | **(1,700)** | – |
| Closing balance (see Note 2a) | **95,920** | 91,692 |

### d. Associate's net income

| | PLATINUM ASIA INVESTMENTS LIMITED $'000 | GROUP'S SHARE OF ASSOCIATE $'000 | PLATINUM WORLD PORTFOLIOS $'000 | GROUP'S SHARE OF ASSOCIATE $'000 |
|---|---|---|---|---|
| **2018** | | | | |
| Total investment income | **79,884** | **6,679** | **37,276** | **5,107** |
| Total expenses | **(6,940)** | **(578)** | **(6,454)** | **(884)** |
| Profit before tax | **72,944** | **6,101** | **30,822** | **4,223** |
| Income tax expense | **(21,466)** | **(1,789)** | **–** | **–** |
| **Profit after tax** | **51,478** | **4,312** | **30,822** | **4,223** |
| Realised equity accounting gain on partial disposal of PAI shares, dividends received and dilution of unitholding throughout the year and foreign currency translation impact | | **1,180** | | **(504)** |
| Realised and unrealised gain on investment in associate | | **5,492** | | **3,719** |

* Is comprised of the Group's share of PAI and PWP profit after tax, of $4,312,000 and $4,223,000 respectively, and the impact of the dilution of unitholding throughout the year and foreign currency translation impact of ($504,000).

# Notes to the Financial Statements

## 30 June 2018



### Note 2. Equity investments in associates – continued

**d. Associate's net income – continued**

| | GROUP'S SHARE OF ASSOCIATES (TOTAL) $'000 |
|---|---|
| Total investment income | **11,786** |
| Total expenses | **(1,462)** |
| Profit before tax | **10,324** |
| Income tax expense | **(1,789)** |
| Profit after tax | **8,535** |
| Realised equity accounting gain on partial disposal of PAI shares, dividends received and dilution of unitholding throughout the year and foreign currency translation impact | **676** |
| Realised and unrealised gain on investment in associates | **9,211** |

| | PLATINUM ASIA INVESTMENTS LIMITED $'000 | GROUP'S SHARE OF ASSOCIATE $'000 | PLATINUM WORLD PORTFOLIOS $'000 | GROUP'S SHARE OF ASSOCIATE $'000 |
|---|---|---|---|---|
| 2017 | | | | |
| Total investment income | 61,040 | 8,503 | 31,158 | 4,514 |
| Total expenses | (5,508) | (767) | (1,600) | (232) |
| Profit before tax | 55,532 | 7,736 | 29,558 | 4,282 |
| Income tax expense | (16,381) | (2,282) | – | – |
| Profit after tax | 39,151 | 5,454 | 29,558 | 4,282 |

| | GROUP'S SHARE OF ASSOCIATES (TOTAL) $'000 |
|---|---|
| Total investment income | 13,017 |
| Total expenses | (999) |
| Profit before tax | 12,018 |
| Income tax expense | (2,282) |
| Profit after tax | 9,736 |

## Note 2. Equity investments in associates – continued

**ACCOUNTING POLICY**

Investments in associates are accounted for using the equity method. The share of profit recognised under the equity method is the consolidated entity's share of the investment in associate's profit or loss based on the ownership interest held. Associates are entities in which the consolidated entity, as a result of its voting rights and other factors, has significant influence, but not control or joint control, over its financial and operating policies.

Investments in associates are carried at the lower of the equity accounted carrying amount and the recoverable amount. When the consolidated entity's share of losses exceeds the carrying amount of the equity accounted investment (including assets that form part of the net investment in the associate), the carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the consolidated entity has obligations in respect of the associate.

Dividends from associates represent a return on the consolidated entity's investment and, as such, are applied as a reduction to the carrying value of the investment. Unrealised gains arising from transactions with equity accounted investments are eliminated against the investment in the associate to the extent of the consolidated entity's interest in the associate. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment. Other movements in associates' reserves are recognised directly in the consolidated entity's consolidated reserves.

**Critical accounting judgements, estimates and assumptions**

*Assessment of significant influence:* At 30 June 2018, the consolidated entity was assessed as having significant influence over Platinum Asia Investments Limited ("PAI") and Platinum World Portfolios Plc ("PWP") as a result of its direct investment and investment management activities and other factors outlined on page 57.

We have conducted an impairment assessment of the carrying amount of the investment in associates, including a look-through of each of the underlying assets and liabilities. Our assessment is that at 30 June 2018, no impairment write-down is required because the carrying value of the investment, with respect to both PAI and PWP, is less than its fair value.

# Notes to the Financial Statements

## 30 June 2018



### Note 3. Parent entity information

Set out below is supplementary information about the parent entity.

*Statement of profit or loss and other comprehensive income*

| | PARENT | |
|---|---|---|
| | **2018 $'000** | 2017 $'000 |
| Profit after income tax | **181,222** | 181,770 |
| Total comprehensive income | **181,222** | 181,770 |

*Statement of financial position*

| | PARENT | |
|---|---|---|
| | **2018 $'000** | 2017 $'000 |
| Total current assets | **111,272** | 127,117 |
| Total assets | **745,095** | 757,605 |
| Total current liabilities | **(538)** | (8,412) |
| Total liabilities | **(538)** | (8,412) |
| Net assets | **744,557** | 749,193 |
| Equity | | |
| Issued capital | **731,245** | 742,933 |
| Capital reserve | **11,666** | 4,596 |
| Retained profits | **1,646** | 1,664 |
| Total equity | **744,557** | 749,193 |

## Note 4. Equity attributable to non-controlling interest(s)

As discussed in Note 1, the 30 June 2018 consolidated statement of financial position includes the assets, liabilities and equity of Platinum Asia Fund (Quoted Managed Hedge Fund) ("PAXX") at 30 June 2018, including its external investment. The external (non-related party) investment in PAXX represents a non-controlling interest in the Platinum consolidated entity. Non-controlling interests also reflect the investment in Platinum International Fund (Quoted Managed Hedge Fund) ("PIXX") up until the date of deconsolidation from the Platinum group, on 18 October 2017. The comparative year discloses the non-controlling interest relating to PWP, which was deconsolidated in the comparative year.

| | **2018 $'000** | 2017 $'000 |
|---|---|---|
| Opening balance | **–** | 28,736 |
| Profit after income tax attributable to non-controlling interests – PIXX | **1,357** | |
| Profit after income tax attributable to non-controlling interests – PAXX/PWP | **1,016** | 6,621 |
| Additional external investment into PAXX | **91,765** | – |
| Deconsolidation of PIXX | **(1,357)** | – |
| Distribution paid to external unitholders of PAXX | **(16,845)** | – |
| Additional external investment into PWP | **–** | 73,758 |
| Deconsolidation of PWP – Equity | **–** | (103,511) |
| Deconsolidation of PWP | **–** | (5,604) |
| | **75,936** | – |

**External equity – PAXX**

External equity represents external investment into PAXX. During the year, net external investment into PAXX totalled A$91,765,000.

**Consolidated statement of financial position – excluding the impact of PAXX and its minority interest share at balance date.**

| | **2018 $'000** | 2017 $'000 |
|---|---|---|
| Total current assets | **226,552** | 259,338 |
| Total assets | **353,024** | 353,966 |
| Total liabilities | **(17,845)** | (18,892) |
| Net assets | **335,179** | 335,074 |
| Equity | | |
| Issued capital | **731,245** | 742,933 |
| Capital reserve | **(582,006)** | (585,818) |
| Retained profits | **185,940** | 177,959 |
| Total equity | **335,179** | 335,074 |

# Notes to the Financial Statements

30 June 2018



## PART B – Notes 5 to 22

### Operations – Notes that explain the operations of the consolidated entity

#### Note 5. Operating segments

The consolidated entity is organised into two main operating segments being:

- funds management: through the generation of management and performance fees from Australian investment vehicles, its US-based investment mandates and Platinum World Portfolios Plc. ("PWP"); and
- investments and other: through the consolidated entity's investment (during the year) in the (a) ASX quoted, Platinum Asia Investments Limited ("PAI"), (b) offshore European-based fund, PWP, (c) unlisted Platinum Trust Funds, and (d) Platinum Asia Fund (Quoted Managed Hedge Fund) ("PAXX") and Platinum International Fund (Quoted Managed Hedge Fund) ("PIXX")[6]. Also included in this category are Australian dollar term deposits as well as any associated interest derived from these.

The segment financial results, segment assets and liabilities are disclosed on the following page(s).

6. Seed investment by the consolidated entity in PIXX was disposed of during the year (when PIXX derived sufficient additional external investment).

## Note 5. Operating segments – continued

| 2018 | FUNDS MANAGEMENT $'000 | INVESTMENTS AND OTHER $'000 | TOTAL $'000 |
|---|---|---|---|
| **Revenue** | | | |
| Management and performance fees | 328,681 | – | 328,681 |
| Interest | 436 | 3,308 | 3,744 |
| Distributions, dividends and gains on forward currency contracts* | – | 23,312 | 23,312 |
| Net (losses) on financial assets and equity in associates^ | – | (3,743) | (3,743) |
| Net foreign exchange gains on overseas bank accounts | – | 1,296 | 1,296 |
| **Total revenue and other income** | 329,117 | 24,173 | 353,290 |
| **Expenses** | (84,681) | (285) | (84,966) |
| **Profit before income tax expense** | 244,436 | 23,888 | 268,324 |
| Income tax expense | (69,013) | (7,717) | (76,730) |
| **Profit after income tax expense** | 175,423 | 16,171 | 191,594 |
| Other comprehensive income | 7 | – | 7 |
| **Total comprehensive income** | 175,430 | 16,171 | 191,601 |
| **Assets** | | | |
| Cash and cash equivalents | 4,837 | 159,500 | 164,337 |
| Financial assets and equity in associates | – | 194,716 | 194,716 |
| Term deposits | – | 27,876 | 27,876 |
| Receivables and other assets | 37,187 | 21,689 | 58,876 |
| **Total assets** | 42,024 | 403,781 | 445,805 |
| **Liabilities** | | | |
| Payables and provisions | 11,631 | 16,845 | 28,476 |
| Tax liabilities | 1,496 | 4,718 | 6,214 |
| **Total liabilities** | 13,127 | 21,563 | 34,690 |
| **Net assets** | 28,897 | 382,218 | 411,115 |

# Notes to the Financial Statements

## 30 June 2018



### Note 5. Operating segments – continued

| 2017 | FUNDS MANAGEMENT $'000 | INVESTMENTS AND OTHER $'000 | TOTAL $'000 |
|---|---|---|---|
| **Revenue** | | | |
| Management, performance and administration fees | 312,468 | – | 312,468 |
| Interest | 343 | 3,998 | 4,341 |
| Distributions, dividends and gains on forward currency contracts* | – | 76 | 76 |
| Net gains on financial assets and equity in associates^ | – | 16,515 | 16,515 |
| Net foreign exchange gains on overseas bank accounts | – | 149 | 149 |
| **Total revenue and other income** | 312,811 | 20,738 | 333,549 |
| **Expenses** | (62,641) | (330) | (62,971) |
| **Profit before income tax expense** | 250,170 | 20,408 | 270,578 |
| Income tax expense | (74,170) | (3,761) | (77,931) |
| **Profit after income tax expense** | 176,000 | 16,647 | 192,647 |
| Other comprehensive income | – | 406 | 406 |
| **Total comprehensive income** | 176,000 | 17,053 | 193,053 |
| **Assets** | | | |
| Cash and cash equivalents | 9,256 | 145,007 | 154,263 |
| Financial assets and equity in associates | – | 91,799 | 91,799 |
| Term deposits | – | 74,876 | 74,876 |
| Receivables and other assets | 32,769 | 259 | 33,028 |
| **Total assets** | 42,025 | 311,941 | 353,966 |
| **Liabilities** | | | |
| Payables and provisions | 9,977 | – | 9,977 |
| Tax liabilities | 7,368 | 1,547 | 8,915 |
| **Total liabilities** | 17,345 | 1,547 | 18,892 |
| **Net assets** | 24,680 | 310,394 | 355,074 |

## Note 5. Operating segments – continued

* The amount in the tables above disclosed as "Distributions, dividends and gains on forward currency contracts" is comprised of:

| | 2018 $'000 | 2017 $'000 |
|---|---|---|
| Distribution received by PAXX from Platinum Asia Fund | 21,551 | – |
| Dividend received by PIML from its investment in PAI | 1,700 | – |
| Distribution received by PIML from its investment in the Platinum Trust Funds | 21 | 11 |
| Distributions and dividends (total as appears in the consolidated statement of profit or loss and other comprehensive income) | 23,272 | 11 |
| Net gains on forward currency contracts | 40 | 65 |
| | 23,312 | 76 |

^ The amount in the tables above disclosed as "Net (losses)/gains on financial assets and equity in associates" is comprised of:

| | 2018 $'000 | 2017 $'000 |
|---|---|---|
| Unrealised losses made by PAXX (ex-distribution) | (15,521) | – |
| PAXXs own/direct realised income generated during the year | 54 | – |
| Realised gains made by PIML on disposal of PIXX units | 1,142 | – |
| Unrealised gains made by PIXX (during period of consolidation) | 1,357 | – |
| (Un)realised gains on Platinum Trust Fund investments/PWP whilst consolidated | 14 | 6,779 |
| (Losses)/gains on financial assets (total as appears in the consolidated statement of profit or loss and other comprehensive income) | (12,954) | 6,779 |
| Gains on equity investment in associates | 9,211 | 9,736 |
| | (3,743) | 16,515 |

The consolidated entity derived management and performance fees from Australian investment vehicles, its "absolute" US performance fee mandates and PWP and also derived investment income from its seed investments, as follows:

| | 2018 $'000 | 2017 $'000 |
|---|---|---|
| Revenue breakdown by geographic region | | |
| Australia | 320,719 | 316,366 |
| Offshore: United States and Ireland | 32,571 | 17,183 |
| | 353,290 | 333,549 |

# Notes to the Financial Statements

## 30 June 2018



### Note 5. Operating segments – continued

**ACCOUNTING POLICY**

Operating segments are presented using the 'management approach', where the information presented is on the same basis as the internal reports provided to the Chief Operating Decision Makers ("CODM"). The CODM refers to the Board of the Company, who are responsible for the allocation of resources to operating segments and assessing their performance. Revenue as disclosed in the consolidated statement of profit or loss and other comprehensive income is measure at the fair value of the consideration received or receivable and is recognised if it meets the criteria below:

- *Management fees:* recognised based on the applicable investment management agreements and recognised as they are earned. The majority of management fees were derived from the Platinum Trust Funds C Class. The management fee for this Class was calculated at 1.35% per annum of each Fund's daily Net Asset Value.
- *Performance fees:* recognised as income at the end of the relevant period to which the performance fee relates, when the consolidated entity's entitlement to the fee becomes certain.
- *Interest income:* recognised in the consolidated statement of profit or loss and other comprehensive income and is based on the effective interest method.
- *Distributions:* recognised when the consolidated entity becomes entitled to the income.
- *Dividend Income:* brought to account on the applicable ex-dividend date.
- *Net gains on financial assets at fair value through profit or loss:* relates to net gains on seeded and other investments, and recognised as and when the fair value of these investments change and if disposed, the proceeds less costs on sale of investments.

## Note 6. Taxation

### (a) Income tax expense

The income tax expense attributable to profit comprises:

| | **2018 $'000** | 2017 $'000 |
|---|---|---|
| Current tax payable | **71,318** | 77,874 |
| Deferred tax – recognition of temporary differences | **5,165** | 54 |
| Deferred tax – credited to share-based payments reserve | **247** | 91 |
| Adjustment recognised for prior periods | **–** | (88) |
| Income tax expense | **76,730** | 77,931 |
| *Numerical reconciliation of income tax expense:* | | |
| Profit before income tax expense | **268,324** | 270,578 |
| Tax at the statutory tax rate of 30% | **80,497** | 81,173 |
| Tax effect amounts which are not deductible/(taxable) in calculating taxable income: | | |
| Tax rate differential on offshore business income | **(3,758)** | (799) |
| Non-taxable losses/(gains) on investments | **447** | (2,830) |
| Other non-deductible expenses | **95** | 6 |
| Franking credits received | **(551)** | – |
| Realised accounting loss on PAI options | **–** | 240 |
| Taxable gains on Controlled Foreign Corporation | **–** | 229 |
| Adjustment recognised for prior periods | **–** | (88) |
| Income tax expense | **76,730** | 77,931 |

# Notes to the Financial Statements

## 30 June 2018



### Note 6. Taxation – continued

**(b) Non-current liabilities – net deferred tax liabilities:**

| | 2018 $'000 | 2017 $'000 |
|---|---|---|
| *Deferred tax liabilities comprises temporary differences attributable to:* | | |
| Unrealised foreign exchange gains/(losses) on cash | **402** | (17) |
| Deferred Remuneration Plan | **3,633** | 1,640 |
| Employee provisions | **(975)** | (978) |
| Unrealised gains on investments | **4,316** | 1,564 |
| Capital expenditure not immediately deductible | **(836)** | (814) |
| Brokerage fee | **–** | (94) |
| Expense accruals | **(326)** | (252) |
| Net deferred tax liabilities | **6,214** | 1,049 |

The net deferred tax liability figure is comprised of $2,137,000 (2017: $2,155,000) of deferred tax assets and $8,351,000 (2017: $3,204,000) of deferred tax liabilities.

It is estimated that most of the non-investment related deferred tax assets will be recovered or settled within 12 months, and are estimated to be $1,301,000 (2017: $1,230,000).

**ACCOUNTING POLICY**

**Current tax**
The income tax expense or benefit for the period is the tax payable on that period's taxable income based on the applicable income tax rate for each jurisdiction, adjusted by the changes in deferred tax assets and liabilities attributable to temporary differences, unused tax losses and the adjustment recognised for prior periods, where applicable.

**Deferred tax**
Deferred tax is accounted for in respect of temporary differences between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the asset can be utilised.

**Tax consolidation**
The Company and its wholly-owned Australian controlled entities are part of a tax consolidated group under Australian tax legislation. The Company is the head entity of the tax-consolidated group.

**Offshore Banking Unit ("OBU") Legislation**
In June 2010, the Australian Taxation Office declared that the consolidated group is an Offshore Banking Unit (OBU) under Australian Taxation Law. This allows the consolidated group to apply a concessional tax rate of 10% to net income it derives from its offshore mandates. The concession was applied from 1 July 2010.

**Critical accounting judgements, estimates and assumptions**
*Recovery of deferred tax assets:* Deferred tax assets are recognised for deductible temporary differences only if the consolidated entity considers it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

## Note 7. Reconciliation of profit after income tax to net cash from operating activities

| | **2018 $'000** | 2017 $'000 |
|---|---|---|
| Profit after income tax expense for the year | **191,594** | 192,647 |
| Adjustments for: | | |
| Prior period tax | **–** | (88) |
| Depreciation expense | **724** | 895 |
| Net (loss) on disposal of fixed assets | **–** | (1) |
| Purchase of shares and transaction costs associated with the Deferred Remuneration Plan | **(11,703)** | (4,791) |
| Share-based payments accounting expense | **3,558** | 1,449 |
| Foreign exchange differences | **(1,138)** | (118) |
| Interest income | **(3,744)** | (4,341) |
| Dividend and distribution income | **(23,272)** | – |
| Loss/(gain) on investments | **3,703** | (16,591) |
| Change in operating assets and liabilities: | | |
| (Increase) in trade and other receivables | **(377)** | (455) |
| (Increase) in income tax receivable | **(3,333)** | – |
| Decrease in deferred tax assets | **18** | 790 |
| (Increase) in prepayments | **(535)** | (163) |
| Increase/(decrease) in trade creditors and GST | **989** | (696) |
| (Decrease) in income tax provision and expense | **(7,757)** | (2,900) |
| Increase/(decrease) in deferred tax liabilities | **5,147** | (645) |
| Increase in employee provisions and payroll tax | **672** | 394 |
| Net cash from operating activities | **154,546** | 165,386 |

# Notes to the Financial Statements

## 30 June 2018



### Note 7. Reconciliation of profit after income tax to net cash from operating activities – continued

**ACCOUNTING POLICY**

In accordance with AASB 107: Statement of Cash Flows, cash includes deposits at call and cash at bank that are used to meet short-term cash requirements. Cash equivalents include short-term deposits of three months or less from the date of acquisition that are readily convertible into cash. Cash and cash equivalents at the end of the financial year, as shown in the consolidated statement of cash flows and are reconciled to the related item in the consolidated statement of financial position.

Under AASB 107, term deposits that have maturities of more than three months from the date of acquisition are not included as part of "cash and cash equivalents" and have been disclosed separately in the consolidated statement of financial position. All term deposits are held with licensed Australian banks.

Payments and proceeds relating to the purchase and maturity of term deposits are classified as "cash flows from investing activities".

Receipts from operating activities include management and performance fees receipts. Payments for operating activities include payments to suppliers and employees.

### Note 8. Non-current assets – financial assets at fair value through profit or loss

| | **2018 $'000** | 2017 $'000 |
|---|---|---|
| Unit trust – held directly by Platinum Asia Fund (Quoted Managed Hedge Fund) ("PAXX")^ | **98,602** | – |
| Platinum Trust Fund investments | **194** | 107 |
| | **98,796** | 107 |

^ **At 30 June 2018, the financial assets of PAXX have been consolidated into the Platinum consolidated entity. As discussed in Note 1, the consolidated entity seeded PAXX and was assessed as having control over PAXX at 30 June 2018, predominantly because PIML had an ownership interest of 19.9% and because PIML acts as the Investment Manager of PAXX.**

## Note 8. Non-current assets – financial assets at fair value through profit or loss – continued

**ACCOUNTING POLICY**

Under AASB 139: *Financial Instruments: Recognition and Measurement*, investments are classified in the consolidated entity's statement of financial position as "financial assets/liabilities at fair value through profit or loss".

The consolidated entity has applied AASB 13: *Fair Value Measurement*. AASB 13 defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market employees at the measurement date".

The standard prescribes that the most representative price within the bid-ask spread should be used for valuation purposes. With respect to the consolidated entity, the last-sale or "last" price is the most representative price within the bid-ask spread, because it represents the price that the unit last changed hands from seller to buyer.

With respect to both investments disclosed in Note 8, the fair value includes the impact of the 30 June distribution.

## Note 9. Current assets – trade and other receivables

| | **2018 $'000** | 2017 $'000 |
|---|---|---|
| Management fees receivable | **27,959** | 28,024 |
| Performance fees receivable | **1,180** | 738 |
| Distribution receivable – PAXX investment in Platinum Asia Fund | **21,551** | – |
| Interest receivable | **138** | 268 |
| Prepayments | **1,693** | 1,158 |
| Sundry debtors | **36** | 11 |
| | **52,557** | 30,199 |

Management and performance fees receivable(s) are received between three to 30 days after balance date.

Interest receivable comprises accrued interest on term deposits and cash accounts. Interest on term deposits is received on maturity.

**ACCOUNTING POLICY**

All receivables are measured at amortised cost, are not discounted, and are recognised when a right to receive payment is established. Any debts that are known to be uncollectible are written off. Trust distributions are recognised when the consolidated entity becomes entitled to the income.

# Notes to the Financial Statements

## 30 June 2018



### Note 10. Non-current assets – fixed assets

| | 2018 $'000 | 2017 $'000 |
|---|---|---|
| Computer equipment – at cost | **1,530** | 1,314 |
| Less: Accumulated depreciation | **(1,204)** | (1,097) |
| | **326** | 217 |
| Software and applications – at cost | **5,775** | 5,205 |
| Less: Accumulated depreciation | **(4,321)** | (3,997) |
| | **1,454** | 1,208 |
| Communications equipment – at cost | **146** | 133 |
| Less: Accumulated depreciation | **(120)** | (112) |
| | **26** | 21 |
| Office premises fit out – at cost | **2,566** | 2,543 |
| Less: Accumulated depreciation | **(1,547)** | (1,293) |
| | **1,019** | 1,250 |
| Furniture and equipment – at cost | **729** | 670 |
| Less: Accumulated depreciation | **(568)** | (537) |
| | **161** | 133 |
| | **2,986** | 2,829 |

**Reconciliations**

Reconciliations of the written down values at the beginning and end of the current and previous financial year are set out below:

| | COMPUTER EQUIPMENT $'000 | SOFTWARE & APPLICATIONS $'000 | COMMUN-ICATIONS EQUIPMENT $'000 | OFFICE PREMISES FIT OUT $'000 | FURNITURE & EQUIPMENT $'000 | TOTAL $'000 |
|---|---|---|---|---|---|---|
| Balance at 1 July 2016 | 178 | 774 | 28 | 1,478 | 170 | 2,628 |
| Additions | 142 | 862 | 8 | 75 | 10 | 1,097 |
| Disposals | – | – | (1) | – | – | (1) |
| Depreciation expense | (103) | (428) | (14) | (303) | (47) | (895) |
| Balance at 30 June 2017 | 217 | 1,208 | 21 | 1,250 | 133 | 2,829 |
| Additions | 216 | 570 | 13 | 23 | 59 | 881 |
| Disposals | – | – | – | – | – | – |
| Depreciation expense | (107) | (324) | (8) | (254) | (31) | (724) |
| **Balance at 30 June 2018** | **326** | **1,454** | **26** | **1,019** | **161** | **2,986** |

## Note 10. Non-current assets – fixed assets – continued

**Reconciliations – continued**

At 30 June 2018, there was software and applications in the course of construction and development of $406,252 (2017: $530,043), which is included as part of the software & applications additions and balance.

**ACCOUNTING POLICY**

Fixed assets are stated at historical cost less depreciation. Fixed assets (other than in-house software and applications in the course of construction and development) are depreciated over their estimated useful lives using the diminishing balance method.

The expected useful lives are as follows:

| | |
|---|---|
| Computer equipment | 4 years |
| Software | 2½ years |
| In-house software and applications | 4 years |
| Communications equipment | 4 – 10 years |
| Office fit out | 3 – 13 years |
| Office furniture and equipment | 5 – 13 years |

The residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each reporting date.

A fixed asset is derecognised upon disposal or when there is no future economic benefit to the consolidated entity. Gains and losses between the carrying amount and the disposal proceeds are taken to profit or loss.

**Critical accounting judgements, estimates and assumptions**

*Estimation of useful lives of assets:* Management exercises judgement in determining the estimated useful lives and related depreciation charges for its fixed assets. The useful lives could change significantly as a result of technical innovations or some other event. The depreciation charge will increase where the useful lives are less than previously estimated.

## Note 11. Current liabilities – trade and other payables

| | **2018 $'000** | 2017 $'000 |
|---|---|---|
| Distribution payable – PAXX to unitholders (excluding PIML's share) | **16,845** | – |
| Trade payables | **4,326** | 3,219 |
| Unclaimed dividends payable to shareholders | **538** | 545 |
| GST payable | **2,373** | 2,491 |
| | **24,082** | 6,255 |

**ACCOUNTING POLICY**

Payables represent amounts owing at balance date. Trade payables relate to services provided to the consolidated entity at balance date, which are unpaid. Due to their general short-term nature, they are measured at amortised cost and are not discounted. The amounts are unsecured and are usually paid within 14 to 30 days of being invoiced.

# Notes to the Financial Statements

## 30 June 2018



### Note 12. Current and non-current liabilities – employee benefits

| | 2018 $'000 | 2017 $'000 |
|---|---|---|
| **Current liabilities** | | |
| Annual leave | **1,337** | 1,364 |
| Long service leave | **1,912** | 1,897 |
| | **3,249** | 3,261 |
| **Non-current liabilities** | | |
| Payroll tax on Deferred Remuneration Plan* | **1,145** | 461 |

* **The payroll tax provision increased because payroll tax is payable on the additional tranches of deferred rights granted during the year.**

**ACCOUNTING POLICY**

Employee benefit liabilities represents accrued wages, salaries, annual and long-service leave entitlements and other incentives (including any provision for estimated staff incentive payments and related on-costs), that are recognised in respect of employee services up to balance date and are measured at the amounts expected to be paid when the liabilities are settled and include related on-costs, such as payroll tax.

**Critical accounting judgements, estimates and assumptions**

With respect to the interim/half-year financial report, in accordance with AASB 137: *Provisions, Contingent Liabilities and Contingent Assets*, management may include a provision at 31 December for staff incentive payments, if the consolidated entity has achieved strong performance for its clients at that point in time, even though the annual assessment period is from 1 April to 31 March.

## Note 13. Equity – Issued capital

| | 2018 SHARES | 2017 SHARES | 2018 $'000 | 2017 $'000 |
|---|---|---|---|---|
| Ordinary shares – fully paid[a] | **586,678,900** | 586,678,900 | **751,355** | 751,355 |
| Treasury shares[b] | **(3,471,866)** | (1,626,026) | **(20,110)** | (8,422) |
| Total issued capital | **583,207,034** | 585,052,874 | **731,245** | 742,933 |

(a) *Ordinary shares:* entitles shareholders to participate in dividends as declared and in the event of winding up of the Company, to participate in the proceeds in proportion to the number of and amounts paid on the ordinary shares held. Ordinary shares entitle the shareholder to one vote per share, either in person or by proxy, at a meeting of the Company's shareholders. All ordinary shares issued have no par value. On 13 September 2016, the Company announced an on-market share buy-back program, in which shares will be bought-back if the Company's shares trade at a discount to its underlying value. No shares have been bought-back.

(b) *Treasury shares:* are shares that have been purchased by the Employee Share Trust, pursuant to the Deferred Remuneration Plan (Refer to Note 19). Treasury shares are held by the Employee Share Trust for future allocation to employees. Details of the balance of treasury shares at the end of the financial year were as follows:

| | 2018 SHARES | 2017 SHARES | 2018 $'000 | 2017 $'000 |
|---|---|---|---|---|
| Opening balance | **1,626,026** | 591,578 | **8,422** | 3,638 |
| Additional shares held by the Employee Share Trust | **1,845,840** | 1,034,448 | **11,688** | 4,784 |
| Shares allocated to employees | **–** | – | **–** | – |
| Balance at the end of the financial year | **3,471,866** | 1,626,026 | **20,110** | 8,422 |

**ACCOUNTING POLICY**

**Ordinary shares**

Ordinary shares are recognised as the amount paid per ordinary share, net of directly attributable issue costs.

**Treasury shares**

Where the consolidated entity purchase shares in the Company, the consideration paid is deducted from total shareholders' equity and the shares treated as treasury shares. Treasury shares are recorded at cost and when restrictions on employee shares are lifted which is dependent on vesting and exercise of the rights, the cost of such shares will be adjusted to the share-based payments reserve.

# Notes to the Financial Statements

## 30 June 2018



### Note 14. Equity – reserves

| | 2018 $'000 | 2017 $'000 |
|---|---|---|
| Foreign currency translation reserve | **121** | 114 |
| Capital reserve | **(588,144)** | (588,144) |
| Share-based payments reserve | **6,017** | 2,212 |
| | **(582,006)** | (585,818) |

**Foreign currency translation reserve**
Exchange differences arising on translation of foreign controlled entities are recognised in other comprehensive income and accumulated as a separate reserve within equity. The balance of the foreign currency translation reserve was $121,000 at 30 June 2018 (30 June 2017: $114,000).

**Capital reserve**
In 2007, in preparation for listing, a restructure was undertaken in which the Company sold or transferred all of its assets, other than its beneficial interest in shares in Platinum Asset Pty Limited and sufficient cash to meet its year to date income tax liability.

The Company then split its issued share capital of 100 shares into 435,181,783 ordinary shares. It then took its beneficial interests in Platinum Investment Management Limited to 100%, through scrip for scrip offers, in consideration for the issue of 125,818,217 ordinary shares in the Company.

As a result of the share split and takeover offers, the Company had 561,000,000 ordinary shares on issue and beneficially held 100% of the issued share capital of Platinum Investment Management Limited. Subsequently, 140,250,000 shares on issue representing 25% of the issued shares of the Company were sold to the public by existing shareholders.

The amount of $588,144,000 was established on listing as a result of the difference between the consideration paid for the purchase of non-controlling interests and the share of net assets acquired in the minority interests.

**Share-based payments reserve**
In June 2016, the consolidated entity established the Deferred Remuneration Plan. The amount in the share-based payments reserve is comprised of the amortisation of the rights granted and any associated future tax deduction.

Please refer to Note 19 for further information.

## Note 14. Equity – reserves – continued

**Movements in reserves:**

Movements in each class of reserve during the current and previous financial year are set out below:

| | SHARE-BASED PAYMENTS $'000 | FOREIGN CURRENCY $'000 | CAPITAL $'000 | TOTAL $'000 |
|---|---|---|---|---|
| Balance at 30 June 2016 | 672 | (292) | (588,144) | (587,764) |
| Exchange rate translation impact of foreign subsidiaries | – | (595) | – | (595) |
| Deconsolidation of controlled entity | – | 1,001 | – | 1,001 |
| Movement in share-based payments reserve | 1,540 | – | – | 1,540 |
| Balance at 30 June 2017 | 2,212 | 114 | (588,144) | (585,818) |
| Exchange rate translation impact of foreign subsidiaries | – | 7 | – | 7 |
| Movement in share-based payments reserve | 3,805 | – | – | 3,805 |
| **Balance at 30 June 2018** | **6,017** | **121** | **(588,144)** | **(582,006)** |

## Note 15. Equity – retained profits

| | **2018 $'000** | 2017 $'000 |
|---|---|---|
| Retained profits at the beginning of the financial year | **177,959** | 175,522 |
| Profit after income tax expense attributable to owners of the Company | **189,221** | 186,026 |
| Deconsolidation of Platinum World Portfolios Plc. ("PWP") | **–** | (1,902) |
| Dividends paid (Note 16) | **(181,240)** | (181,687) |
| Retained profits at the end of the financial year | **185,940** | 177,959 |

# Notes to the Financial Statements

## 30 June 2018



### Note 16. Equity – dividends

**Dividends paid**

Dividends paid during the financial year were as follows:

| | **2018 $'000** | 2017 $'000 |
|---|---|---|
| Final dividend paid for the 2017 financial year (15 cents per share) | **87,758** | – |
| Interim dividend paid for the 2018 financial year (16 cents per share) | **93,482** | – |
| Final dividend paid for the 2016 financial year (16 cents per share) | **–** | 93,774 |
| Interim dividend paid for the 2017 financial year (15 cents per share) | **–** | 87,913 |
| | **181,240** | 181,687 |

**Dividends not recognised at year-end**

Since 30 June 2018, the Directors declared to pay a fully-franked dividend of 16 cents per share, payable out of profits for the 12 months to 30 June 2018. The dividend has not been provided for at 30 June 2018, because the dividend was declared after year-end.

**Franking credits**

| | **2018 $'000** | 2017 $'000 |
|---|---|---|
| Franking credits available at reporting date based on a tax rate of 30% | **77,903** | 72,333 |
| Franking (debits)/credits that will arise from the (refund)/payment of the provision for income tax at the reporting date based on a tax rate of 30% | **(3,333)** | 7,866 |
| Franking credits available for subsequent financial years based on a tax rate of 30% | **74,570** | 80,199 |

**ACCOUNTING POLICY**

A provision is made for the amount of any dividend declared by the Directors before or at the end of the financial year but not distributed at balance date.

## Note 17. Financial risk management

### Financial risk management objectives

The Company's and consolidated entity's activities expose it to both direct and indirect financial risk, including: market risk, credit risk and liquidity risk. Material direct exposure to financial risk occurs through the impact on profit of movements in funds under management ("FUM") and through its direct investments in:

- Platinum Asia Investments Limited ("PAI");
- the offshore European-based fund, Platinum World Portfolios Plc ("PWP"); and
- its investments in Platinum Asia Fund (Quoted Managed Hedge Fund) ("PAXX").

Indirect exposure occurs because PIML is the Investment Manager for various investment vehicles, including:

- investment mandates;
- various unit trusts, namely the Platinum Trust Funds, Platinum Global Fund, PIXX and PAXX;
- its ASX-listed investment companies, Platinum Capital Limited and PAI; and
- PWP.

The consolidated entity does not derive any management fees or performance fees directly from PIXX and PAXX. Management and performance fees are borne at the Platinum International Fund/Platinum Asia Fund level and are paid directly by these Funds to the consolidated entity.

This note mainly discusses the direct exposure to risk of the consolidated entity. The consolidated entity's risk management procedures focus on managing the potential adverse effects on financial performance caused by volatility of financial markets.

### Market risk

The key direct risks associated with the consolidated entity are those driven by investment and market volatility and the resulting impact on FUM or a reduction in the growth of FUM. Reduced FUM will directly impact on management fee income and profit because management fee income is calculated as a percentage of FUM. FUM can be directly impacted by a range of factors including:

(i) Poor investment performance: absolute negative investment performance will reduce FUM and relative under performance to appropriate market benchmarks could reduce the attractiveness of Platinum's investment products to investors, which would impact on the growth of the business. Poor investment performance could also trigger the termination of Investment Mandate arrangements;

(ii) Market volatility: Platinum invests in global markets. It follows that a decline in overseas markets, adverse exchange rate or interest rate movements will all impact on FUM;

# Notes to the Financial Statements

## 30 June 2018



### Note 17. Financial risk management – continued

**Market risk – continued**

(iii) A reduction in the ability to retain and attract investors: that could be caused by a decline in investment performance, but also a range of other factors, such as the high level of competition in the funds management industry;

(iv) A loss of key personnel; and

(v) Investor allocation decisions: investors constantly re-assess and re-allocate their investments on the basis of their own preferences. Investor allocation decisions could operate independently from investment performance, such that funds outflows occur despite positive investment performance.

A decline in investment performance will also directly impact performance share fees and performance fees earned by the consolidated entity. Historically, the amount of performance share fees earned by the consolidated entity has fluctuated significantly from year to year and can be a material source of fee revenue.

For those investment mandates that pay a performance share fee, the fee is based on a proportion of each Mandate's investment performance, and is calculated at the end of each calendar year and is based on absolute (and not relative) return.

Performance fees may be earned by the consolidated entity, if the investment return of a Platinum Trust Fund, Platinum Capital Limited, Platinum Asia Investments Limited, Platinum World Portfolios or applicable mandate exceeds its specified benchmark. Should the actual performance of one or more of these entities be higher than the applicable benchmark or index, a performance fee would be receivable for the financial year. As at 30 June 2018, performance fees of $1,180,270 (2017: $738,524) were receivable.

If global equity markets fell 10% over the course of the year and consequently the consolidated entity's FUM fell in line with global equity markets, it follows that management fees would fall by 10%. If there was a 10% decrease in performance of investment mandates over the course of the year that resulted in an actual negative performance for the Investment Mandate for the year, then no performance fee would be earned (2018: $21,878,000, 2017: $1,626,000).

The above analysis assumes a uniform 10% fall across all global equity markets. This is extremely unlikely as there is a large degree of variation in volatility across markets. For example, it is quite feasible for the Chinese market to grow whilst other Asian markets fall.

To mitigate the impact of adverse investment performance on FUM, the investment manager may employ hedging strategies to manage the impact of adverse market and exchange rate movements on the funds it manages. Market risk may be managed through derivative contracts, including futures, options and swaps. Currency risk may be managed through the use of forward currency contracts.

The following section mainly discusses the direct impact of foreign currency risk, price risk and interest rate risk on the consolidated entity's financial instruments held at 30 June 2018.

## Note 17. Financial risk management – continued

**Foreign currency risk**

The consolidated entity is exposed to foreign currency risk, because:

- it holds US Dollar cash, either directly or through its direct investments;
- it derives management and performance fees from its US Dollar investment mandates; and
- it directly invests in Platinum World Portfolios, Platinum Asia Investments Limited and PAXX.

*US Dollar cash*

At 30 June 2018, the consolidated entity held US$18,525,503 (equivalent to A$25,032,773) in cash (2017: US$2,978,425 (equivalent to A$3,873,618). If the Australian Dollar had been 10% higher/lower against the US Dollar than the prevailing exchange rate used to convert the balance with all other variables held constant, net profit before tax would have been A$2,277,530 lower/A$2,783,989 higher (2017: A$352,189 lower/A$430,464 higher). The increase relative to the prior year relates to the fact that the consolidated entity received additional US dollar cash, because of the performance share fees derived from its US "absolute fee" mandate during the year.

*US Dollar fees*

If the Australian Dollar had been 10% higher/lower against the US Dollar than the prevailing exchange rate used to convert the US mandate and PWP fees, with all other variables held constant, then net profit before tax would have been A$2,496,946 lower/A$3,051,711 higher (2017: A$502,668 lower/A$614,288 higher). The increase relative to the prior year was mainly attributable to the fact that the consolidated entity derived performance share fees from its US "absolute fee" mandate during the year.

*Investment in PWP*

Platinum Investment Management Limited's (PIML's) investment in PWP is denominated in US Dollars. If the Australian Dollar had been 10% higher/lower against the prevailing exchange rate at 30 June 2018, then the consolidated entity's net assets would have been A$5.8m lower/A$7.0m higher (2017: A$3.4m lower/A$4.2m higher) (exchange rate translation effect).

Platinum World Portfolios' investments are denominated in various foreign currencies specific to the investments held in each of the portfolios. The foreign currency with the largest impact on profit before tax, if there was a 10% currency movement at 30 June 2018, was the Hong Kong Dollar (2017: Japanese Yen). A 10% increase/decrease in the Australian Dollar would have caused net profit before tax to be A$2,180,699 lower/A$2,719,894 higher, based on PIML's interest in PWP at 30 June 2018 (2017: A$726,765 lower/A$939,761 higher).

# Notes to the Financial Statements

## 30 June 2018



### Note 17. Financial risk management – continued

**Foreign currency risk – continued**

*Investment in PAI*

Platinum Asia Investments Limited's investments are also denominated in foreign currencies. The foreign currency with the largest impact on profit before tax, if there was a 10% currency movement at 30 June 2018, was the Hong Kong Dollar, which was the currency with the largest exposure in this entity at 30 June 2018. A 10% increase/decrease in the Australian Dollar would have caused the consolidated entity's net profit before tax to be A$1,417,016 lower/A$1,731,890 higher (2017: A$1,579,510 lower/A$1,930,512 higher).

*Investment in PAXX*

PAXX is a feeder fund that invests in Platinum Asia Fund, which invests in undervalued companies across the Asian region-ex Japan. The foreign currency with the largest impact on profit before tax, if there was a 10% currency movement at 30 June 2018, was the Hong Kong Dollar, which was the currency with the largest exposure in PAXX at 30 June 2018. A 10% increase/decrease in the Australian Dollar would have caused the Company's net profit before tax to be A$1,774,000 lower/A$2,168,000 higher (2017: nil).

*Price risk*

At 30 June 2018, the consolidated entity is exposed to indirect price risk through its equity-accounted investments in Platinum Asia Investments Limited and Platinum World Portfolios and its direct investment in PAXX. The impact of price risk is summarised in the table below:

**Entity**

| IMPACT ON NET PROFIT BEFORE TAX OF 10% INCREASE/(DECREASE) IN 30 JUNE NET ASSET VALUES | **2018 $'000 INCREASE/(DECREASE)** | 2017 $'000 INCREASE/(DECREASE) |
|---|---|---|
| PAI | **3,497/(3,497)** | 5,361/(5,361) |
| PWP | **6,094/(6,094)** | 3,808/(3,808) |
| PAXX | **1,964/(1,964)** | – |

The consolidated entity's exposure to price risk for PAI decreased because it disposed of 20,000,000 shares or 40% of its holding during the year.

The consolidated entity's exposure to price risk for PWP mainly increased because it acquired units in PWP during the year.

*Interest rate risk*

At 30 June 2018, cash and term deposits are the only significant assets with potential exposure to interest rate risk held by the consolidated entity. A movement of +/–1% in Australian interest rates occurring on 30 June 2018 will cause the consolidated entity's net profit before tax to be $422,751 higher/lower, based on the impact on its interest-bearing cash balances. An interest rate movement at 30 June 2018 will not impact the profit earned from term deposits, as term deposit interest rates are determined on execution.

## Note 17. Financial risk management – continued

### Credit risk

Credit risk relates to the risk of a counterparty defaulting on a financial obligation resulting in a loss to the consolidated entity (typically "non-equity" financial instruments). Credit risk arises from the financial assets of the consolidated entity that include: cash and term deposits. All term deposits are held with licensed Australian banks that all have a AA– credit rating.

The maximum exposure to direct credit risk at balance date is the carrying amount recognised in the consolidated statement of financial position. No assets are past due or impaired.

Any default in the value of a financial instrument held within any of the entities that Platinum Investment Management Limited acts as Investment Manager, will result in reduced investment performance. There is no direct loss for the consolidated entity other than through the ensuing reduction in FUM, as noted above in the section on "market risk". The Investment Manager employs standard market practices for managing its credit risk exposure.

The credit quality of cash and term deposits held by each entity in the consolidated entity, by counterparty, can be assessed by reference to external credit ratings. At 30 June 2018 and 30 June 2017, the relevant credit ratings were as follows:

| | **2018 $'000** | 2017 $'000 |
|---|---|---|
| **Rating** | | |
| AA– | **167,120** | 225,170 |
| A | **24,886** | 3,770 |
| BBB+ | **207** | 199 |
| | **192,213** | 229,139 |

### Liquidity risk

Liquidity risk is the risk that the consolidated entity will encounter difficulty in meeting obligations associated with its liabilities. The consolidated entity manages liquidity risk by maintaining sufficient cash reserves to cover its liabilities and receiving management fees to meet operating expenses on a regular basis. Management monitors its cash position on a daily basis and prepares forecasts on a weekly basis.

# Notes to the Financial Statements

## 30 June 2018



### Note 17. Financial risk management – continued

**Liquidity risk – continued**

*Remaining contractual maturities*

The following table details the consolidated entity's remaining contractual maturity for its liabilities. The table has been drawn up based on the undiscounted cash flows of liabilities based on the earliest date on which the liabilities are required to be paid.

| 2018 | AT CALL $'000 | WITHIN 30 DAYS $'000 | BETWEEN 1 AND 3 MONTHS $'000 | OVER 3 MONTHS $'000 | TOTAL $'000 |
|---|---|---|---|---|---|
| Distribution payable – PAXX to unitholders | – | 16,845 | – | – | 16,845 |
| Trade payables | – | 4,326 | – | – | 4,326 |
| GST payable | – | 2,373 | – | – | 2,373 |
| Unclaimed dividends payable | 538 | – | – | – | 538 |
| Employee-related provisions | 3,249 | – | – | 1,145 | 4,394 |
| **Total** | 3,787 | 23,544 | – | 1,145 | 28,476 |

| 2017 | AT CALL $'000 | WITHIN 30 DAYS $'000 | BETWEEN 1 AND 3 MONTHS $'000 | OVER 3 MONTHS $'000 | TOTAL $'000 |
|---|---|---|---|---|---|
| Trade payables | – | 3,219 | – | – | 3,219 |
| GST payable | – | 2,491 | – | – | 2,491 |
| Current tax payable | – | – | 7,866 | – | 7,866 |
| Unclaimed dividends payable | 545 | – | – | – | 545 |
| Employee-related provisions | 3,261 | – | – | 461 | 3,722 |
| Total | 3,806 | 5,710 | 7,866 | 461 | 17,843 |

**Financial liabilities at fair value through profit or loss**

The consolidated entity had no financial liabilities at fair value through profit or loss at 30 June 2018 or 30 June 2017.

Accordingly, the consolidated entity does not have a significant direct exposure to liquidity risk.

**Fair value of financial instruments**

Unless otherwise stated, the carrying amounts of financial instruments reflect their fair value.

## Note 17. Financial risk management – continued

**Capital risk management**

*(i) Capital requirements*

The Company has limited capital requirements and generally expects that most, if not all, future profits will continue to be distributed by way of dividends, subject to ongoing capital requirements.

*(ii) External requirements*

Platinum Investment Management Limited is required to hold an Australian Financial Services Licence (AFSL) issued by the Australian Securities and Investments Commission (ASIC). The AFSL authorises Platinum Investment Management Limited to provide investment management services and act as a Responsible Entity of Registered Managed Investment Schemes.

Platinum Investment Management Limited has complied with all externally imposed requirements to hold an AFSL during the financial year.

# Notes to the Financial Statements

## 30 June 2018



### Note 18. Fair value measurement

**Fair value hierarchy**

AASB 13: *Fair Value Measurement* requires the consolidated entity to classify those assets measured at fair value using the following fair value hierarchy model (consistent with the hierarchy model applied to financial assets and liabilities at 30 June 2017):

(i) quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1);

(ii) inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly (as prices) or indirectly (derived from prices) (level 2); and

(iii) inputs for the assets or liabilities that are not based on observable market data (unobservable inputs) (level 3).

The investments in PAI and PWP have not been measured at fair value because they have been classified as equity investments in associates. If these were to be measured at fair value, PAI would be classified as level 1, and PWP as level 2.

The following table analyses within the fair value hierarchy model the consolidated entity's assets and liabilities, measured or disclosed at fair value, using the three level hierarchy model at 30 June 2018 and 30 June 2017. The consolidated entity has no assets or liabilities that are classified as level 3.

| 2018 | LEVEL 1 $'000 | LEVEL 2 $'000 | TOTAL $'000 |
|---|---|---|---|
| *Assets* | | | |
| Unit trust – held directly by Platinum Asia Fund (Quoted Managed Hedge Fund) ("PAXX") | – | **98,602** | **98,602** |
| Platinum Trust Fund investments | – | **194** | **194** |
| | – | **98,796** | **98,796** |
| 2017 | | | |
| *Assets* | | | |
| Platinum Trust Fund investments | – | 107 | 107 |
| | – | 107 | 107 |

**Valuation techniques used to classify assets and liabilities as level 2**

PIML's direct investment in the unit trust investment held directly by PAXX and the Platinum Trust Funds are valued using their respective Net Asset Values (adjusted for the buy-sell spread) of the underlying assets and liabilities and includes the impact of the 30 June distribution. Accordingly, management has assessed the fair value investments as being Level 2 investments.

For the previous corresponding period, PIML's investment in the Platinum Trust Funds were valued based on the quoted redemption price of the Funds (ie: the daily unit price) and were classified as Level 1. They have been re-classified as Level 2 investments for comparative purposes.

## Note 19. Share-based payments

**Deferred Remuneration Plan *(applies to all staff)***

In June 2016, a "Deferred Bonus Plan" (now known as a "Deferred Remuneration Plan") was approved by the Nomination & Remuneration Committee of Platinum Asset Management Limited. The main objective of the Plan is to recognise the contributions made by key employees and to retain their skills within the firm.

| PLAN | DESCRIPTION | VESTING CONDITION |
|---|---|---|
| Deferred Remuneration Plan | Upon vesting and exercise of the deferred rights, employees will receive ordinary shares in the Company.<br>The deferred rights also carry an entitlement to a dividend equivalent payment. Upon the valid exercise of a deferred right, or deemed exercise, of a deferred right, an eligible employee will be entitled to receive an amount approximately equal to the amount of dividends that would have been paid to the eligible employee had they held the share from the grant date to the date that the deferred rights are exercised. | Continuous employment for a period of 4 years from the grant date. |

# Notes to the Financial Statements

## 30 June 2018



### Note 19. Share-based payments – continued

**Deferred Remuneration Plan *(applies to all staff)* – continued**

The number of rights granted and the accounting expense for the current and comparative year is shown below. The Employee Share Trust has purchased an equivalent number of PTM shares and will hold these shares until the vesting date (four years from each grant) and subsequent exercise.

| | **2018 NUMBER OF DEFERRED RIGHTS GRANTED** | 2017 NUMBER OF DEFERRED RIGHTS GRANTED |
|---|---|---|
| Opening balance | **1,626,026** | 591,578 |
| Granted during the year | **1,878,168** | 1,050,656 |
| Cancelled during the year | **(32,328)** | (16,208) |
| **Closing balance** | **3,471,866** | 1,626,026 |

**Accounting expense**

| | **2018 $'000** | 2017 $'000 |
|---|---|---|
| Deferred rights granted in 2018 | **2,144** | – |
| Deferred rights granted in 2017 | **797** | 848 |
| Deferred rights granted in 2016 | **617** | 601 |
| Total share-based payments expense | **3,558** | 1,449 |
| Associated payroll tax expense on additional deferred rights granted during the year | **689** | 262 |
| **Total** | **4,247** | 1,711 |

The increase in the share-based payments expense and the additional payroll tax is attributed to the fact that an increased number of deferred rights were granted in FY18 to key employees as a reward for the increased one and three year returns generated for investors and mandate clients.

## Note 19. Share-based payments – continued

### Deferred Remuneration Plan *(applies to all staff)* – continued

**ACCOUNTING POLICY**

AASB 2: *Share-based Payments* requires an organisation to recognise an expense for equity provided for services rendered by employees. The amount that is recognised as an expense for share-based payments is derived from the fair value of the equity instruments granted. Deferred incentives to be settled in the Company's shares are considered to be a share-based payments award.

The fair value of the equity instruments granted and measured at grant date is recognised over the term of the service period. The accounting expense will commence when there is a "shared understanding" of the terms and conditions of the offer. The service period may commence prior to grant date. In this case, the expense is estimated and trued-up at grant date.

The fair value of the rights granted is recognised in the consolidated financial statements as an expense with a corresponding entry to reserves. The fair value is measured at grant date and amortised on a straight-line basis over the vesting period that the employees become unconditionally entitled to the share. In measuring the fair value, an allowance has been made for the risk or probability of forfeiture, which measures the risk of selected eligible employees leaving Platinum and forfeiting their rights.

At each balance date, the Company reviews the number of deferred rights granted. Adjustments are made to the share-based payments expense, if the number of deferred rights granted has changed (e.g. through forfeitures). The impact of any revision to the original estimate will be recognised in the consolidated statement of profit or loss and other comprehensive income with the corresponding entry to reserves.

The purchase of shares on-market by the Company through an Employee Share Trust for future allocation to key employees is shown in the consolidated statement of financial position as a debit entry to the "treasury shares" account with the corresponding credit entry to "cash".

# Notes to the Financial Statements

## 30 June 2018



### Note 20. Key management personnel disclosures

| | 2018 $'000 | 2017 $'000 |
|---|---|---|
| The aggregate remuneration that the consolidated entity provided Executive and Non-Executive Directors was as follows: | | |
| Cash salary, Directors' fees and short-term incentive cash awards | **6,722** | 3,984 |
| Accounting expense related to the KMP allocation under the Deferred Remuneration Plan^ | **381** | 121 |
| Superannuation | **136** | 146 |
| Decrease in the consolidated entity's annual and long service leave provision | **(8)** | (11) |
| | **7,231** | 4,240 |

The increase in KMP remuneration predominantly related to the increased short-term cash awards paid to those Executive Directors that played a direct role in either increasing the returns for our underlying funds and clients or increasing our product range, both of which have translated to increased FUM.

^ Andrew Clifford, Elizabeth Norman and Andrew Stannard were the only members of KMP to receive an allocation of rights under the Deferred Remuneration Plan. The accounting expense attributable to KMP are based on the allocation of deferred rights as follows:

| | 2018 GRANT | 2017 GRANT | 2016 GRANT | TOTAL |
|---|---|---|---|---|
| Number of rights allocated to KMP during the year | **248,346** | 86,208 | 48,623 | **383,177** |
| Accounting expense attributed to KMP | **$260,998** | $67,391 | $52,201 | $380,590 |

The accounting valuation of $380,590 represents the amount expensed through the income statement in the current year, with respect to grants made in 2016, 2017 and 2018.

## Note 20. Key management personnel disclosures – continued

**Interests of Non-Executive and Executive Directors in shares**

The relevant interest in ordinary shares in the Company that each Director held at balance date was:

| | OPENING BALANCE | ADDITIONS | DISPOSALS | CLOSING BALANCE |
|---|---|---|---|---|
| Michael Cole | 200,000 | 40,000 | – | 240,000 |
| Stephen Menzies | 30,000 | 10,000 | – | 40,000 |
| Anne Loveridge | 6,000 | 16,000 | – | 22,000 |
| Brigitte Smith | – | 41,666 | – | 41,666 |
| Kerr Neilson | 312,074,841 | – | – | 312,074,841 |
| Andrew Clifford | 32,831,449 | – | – | 32,831,449 |
| Elizabeth Norman | 766,748 | – | – | 766,748 |
| Andrew Stannard | – | – | – | – |

# Notes to the Financial Statements

## 30 June 2018



### Note 21. Remuneration of auditors

During the financial year, the following fees were paid or payable for services provided by PricewaterhouseCoopers (the auditor of the Company) and its overseas network firms:

| | **2018 $** | 2017 $ |
|---|---|---|
| *Audit services – PricewaterhouseCoopers* | | |
| Audit and review of the financial statements and AFSL audit | **93,730** | 91,000 |
| *Audit services for managed funds that Platinum Investment Management Limited acts as responsible entity – PricewaterhouseCoopers* | | |
| Audit and review of the financial statements and compliance plan audit | **300,369** | 258,600 |
| *Audit services for managed funds that Platinum Investment Management Limited acts as responsible entity and audit services for Platinum World Portfolios Plc. – overseas PricewaterhouseCoopers firms* | | |
| Audit of financial statements | **50,000** | 74,995 |
| **Total audit services** | **444,099** | 424,595 |
| *Taxation services – PricewaterhouseCoopers* | | |
| Compliance services | **87,090** | 81,481 |
| *Taxation services for managed funds for which Platinum Investment Management Limited acts as responsible entity – PricewaterhouseCoopers* | | |
| Taxation services | **487,580** | 431,976 |
| *Taxation services – overseas PricewaterhouseCoopers firms* | | |
| Foreign tax agent fees | **17,855** | 21,528 |
| PwC US work associated with the start-up of the Cayman Funds | **3,892** | – |
| **Total taxation services** | **596,417** | 534,985 |
| *Other services – PricewaterhouseCoopers* | | |
| Compliance and assurance services | **148,083** | 114,000 |
| Remuneration services (advice on Deferred Remuneration Plan) | **–** | 52,870 |
| **Total other services** | **148,083** | 166,870 |
| Total fees paid and payable to the auditor and its related practices | **1,188,599** | 1,126,450 |

## Note 22. Earnings per share

| | 2018 $'000 | 2017 $'000 |
|---|---|---|
| Profit after income tax attributable to the owners of Platinum Asset Management Limited | **189,221** | 186,026 |
| | **NUMBER** | NUMBER |
| Weighted average number of ordinary shares used in calculating basic and diluted earnings per share | **584,732,213** | 586,052,147 |
| | **CENTS** | CENTS |
| Basic earnings per share | **32.36** | 31.74 |
| Diluted earnings per share | **32.36** | 31.74 |

**ACCOUNTING POLICY**

**Basic earnings per share**
Basic earnings per share is calculated by dividing the profit attributable to the owners of Platinum Asset Management Limited, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year. Treasury shares are excluded from the weighted average number of ordinary shares used to calculate basic (and diluted) earnings per share.

**Diluted earnings per share**
Diluted earnings per share adjusts the weighted average number of shares used to determine basic earnings per share to take into account any options that are "in the money", but not exercised.

# Notes to the Financial Statements

30 June 2018



## PART C – Notes 23 to 27

### Miscellaneous Notes – Miscellaneous Notes that are required by the accounting standards

### Note 23. Related party transactions

**Subsidiaries**

Interests in subsidiaries are set out in Note 1.

**Key management personnel**

Disclosures relating to key management personnel are set out in Note 20 and the Remuneration Report in the Directors' Report.

**Tax consolidation and dividend transactions**

Any tax payable on income and gains from any entity within the tax consolidated group and dividends are sourced from the main operating subsidiary, Platinum Investment Management Limited ("PIML"), and paid out under the Company. Platinum Asset Management Limited is the head entity of the consolidated tax group and is the parent entity, and consequently, is the entity that ultimately pays out dividends to shareholders. The amounts paid are disclosed in the consolidated statement of cash flows.

**Fees received**

Platinum Investment Management Limited provides investment management services to:

(i) its related party unit trusts – the Platinum Trust Funds and Platinum Global Fund;

(ii) its European-based offshore fund, Platinum World Portfolios Plc;

(iii) its two ASX-listed investment companies (LICs), Platinum Capital Limited (PMC) and Platinum Asia Investments Limited (PAI); and

(iv) its two ASX quoted managed funds, Platinum International Fund (Quoted Managed Hedge Fund) (ASX ticker: PIXX) and Platinum Asia Fund (Quoted Managed Hedge Fund) (ASX ticker: PAXX).

Platinum Investment Management Limited is entitled to receive a monthly management fee, either directly or indirectly, from each of these entities and a performance fee based on the relative investment performance of the Platinum Trust Funds, Platinum World Portfolios Plc, Platinum Capital Limited (PMC) and Platinum Asia Investments Limited (PAI). The consolidated entity does not derive any management fees or performance fees directly from PIXX and PAXX. Management and performance fees are borne at the Platinum International Fund/Platinum Asia Fund level and are paid directly by these funds to the consolidated entity. The total related party fees recognised in the statement of profit or loss and other comprehensive income for the period ended 30 June 2018 and 30 June 2017 were as follows:

## Note 23. Related party transactions – continued

| | 30 JUNE 2018 $ | 30 JUNE 2017 $ |
|---|---|---|
| Related party fees | **257,492,273** | 260,263,536 |

Included in these figures, is related party fees receivable, disclosed in the statement of financial position for the year ended 30 June 2018 and 30 June 2017 as follows:

| | 30 JUNE 2018 $ | 30 JUNE 2017 $ |
|---|---|---|
| Related party fees receivable | **23,317,632** | 22,869,423 |

### Investment transactions

During the year, Platinum Investment Management Limited (PIML) invested $11.4 million in PIXX and $22.3 million in PAXX as a seed investment, but as a result of encouraging net fund inflows, PIML redeemed its investment in PIXX during the year. The total net sale proceeds (after brokerage) was $12,545,324.

During the year, PIML sold 20 million of its shares in PAI and generated $24.1 million in net sale proceeds (after brokerage). PIML also received the final 2017 fully-franked dividend of $500,000 and the interim 2018 fully-franked dividend of $1,200,000 from its investment in PAI.

On 3 July 2017, PIML launched performance fee classes for each of its 8 Platinum Trust Funds. PIML seeded each of these Funds with an investment of $10,000 each (or $80,000 in total).

During the year, PIML invested additional US$15,000,000 (equivalent to A$19,160,378) in the Japan sub-fund of PWP.

# Notes to the Financial Statements

## 30 June 2018



### Note 23. Related party transactions – continued

**Investment transactions – continued**

The amounts paid to purchase these investments and proceeds from the sale of these investments are disclosed in the consolidated statement of cash flows and are summarised below.

**30 June 2018**

| ENTITY | PIMLs INTEREST % | FAIR VALUE OF PIMLs INVESTMENT A$'000 | NET SALE PROCEEDS ON DISPOSALS A$'000 | 30 JUNE 2018 DISTRIBUTION RECEIVABLE A$'000 |
|---|---|---|---|---|
| Platinum Asia Investments Limited (ASX ticker: PAI) | **8.3** | **37,800** | **24,150** | **n/a** |
| Platinum World Portfolios (PWP) | **13.7** | **63,410** | **n/a** | **n/a** |
| Platinum Asia Fund (Quoted Managed Hedge Fund) (ASX ticker: PAXX) | **19.9** | **19,641** | **n/a** | **4,816** |
| Platinum Trust Funds | **Less than 1%** | **194** | **n/a** | **21** |

**30 June 2017**

| ENTITY | PIMLs INTEREST % | FAIR VALUE OF PIMLs INVESTMENT A$'000 |
|---|---|---|
| Platinum Asia Investments Limited (ASX ticker: PAI) | 13.9 | 50,750 |
| Platinum World Portfolios (PWP) | 14.5 | 39,468 |
| Platinum Trust Funds | Less than 1% | 107 |

**Other related party transactions**

With respect to PWP, PIML has undertaken to limit the annual expenses of each of PWPs sub-funds through the use of a voluntary expense cap, where total expenses of each sub-fund does not exceed a specified limit (for example: for the base fee class(es), the limit or cap is 1.65% of the Net Asset Value of each sub-fund). At 30 June 2018, the total amount reimbursed/paid or payable by PIML to PWP in respect of expenses for the period was A$8,557 (30 June 2017: $58,683).

The Company allocated additional rights, via two tranches during the year, to eligible employees under the Deferred Remuneration Plan. In the current year, the amount transferred to the Platinum Employee Share Trust was $11,873,050 and the Trust still retains $170,518 of this for future allocation to employees.

On 7 February 2018, the Company registered Platinum GP Pty Limited associated with the launch of the US/Cayman Funds. The Company contributed $1 as capital in order to register and incorporate the entity.

## Note 23. Related party transactions – continued

**Other related party transactions – continued**

In the current year, the consolidated entity paid $50,000 to OneVue Services Pty Limited for the provision of services associated with the enhancement of the Platinum website. OneVue is a related party of the Chairman of Platinum Asset Management Limited, Mr Michael Cole.

**Loan Agreements with related parties**

There were no formal loan agreements executed with related parties at the current and previous reporting date, but there are intercompany receivables and payables.

## Note 24. Disclosure of interests in other entities

**Structured entity disclosures (excluding subsidiaries and associates)**

A structured entity is an entity that is not part of the consolidated entity, despite one or more entities within the consolidated entity purchasing units or shares in the other (structured) entity. The relevant activities of unconsolidated structured entities are directed by the investment manager by means of contractual arrangements, such as an Investment Management Agreement.

At 30 June 2018, the consolidated entity holds an investment that can be described as a structured entity, via Platinum Investment Management Limited ("PIML") holding investments of less than 1% in each of the Platinum Trust Funds, and for FY18, receiving management and performance fees for its role as investment manager.

The following table provides information in relation to this investment:

| | **2018 $'000** | 2017 $'000 |
|---|---|---|
| Net Asset Value attributable to all investors | | |
| Platinum Trust Funds | **18,421,972** | 16,317,146 |
| Maximum exposure (includes PIMLs interest & fees receivable) | | |
| Platinum Trust Funds | **20,879** | 21,754 |

**Guarantees entered into by the parent entity in relation to the debts of its subsidiaries**

There are no guarantees entered into by the parent entity in relation to debts of its subsidiaries, no contingent liabilities and no capital commitments.

**ACCOUNTING POLICY**

The consolidated entity has applied AASB 12: *Disclosure of Interests in Other Entities*. AASB 12 requires disclosure about the nature of, and risks associated with, the consolidated entity's interest in other entities. An interest in an other entity refers to involvement that exposes the entity to variability of returns from the performance of another (excluding subsidiaries and associates). The consolidated entity applies the standard to its interest in the Platinum Trust Funds.

# Notes to the Financial Statements

## 30 June 2018



### Note 25. Commitments

| | 2018 $'000 | 2017 $'000 |
|---|---|---|
| *Lease commitments – operating* | | |
| Committed at the reporting date but not recognised as liabilities, payable: | | |
| Within one year | **1,768** | 2,057 |
| One to five years | **7,796** | 8,924 |
| Greater than five years | **3,422** | 6,404 |
| | **12,986** | 17,385 |

On 23 June 2017, the consolidated entity entered into a new lease over the premises it occupies. The lease is due to expire in January 2025.

The consolidated entity has no commitments for significant capital expenditure.

**ACCOUNTING POLICY**

Platinum Investment Management Limited has entered into a lease agreement for the premises it occupies and pays rent on a monthly basis. Payments made under the operating lease are charged to the consolidated statement of profit or loss and other comprehensive income.

### Note 26. Events after the reporting period

Apart from the dividend declared in August 2018, no other matter or circumstance has arisen since 30 June 2018 that has significantly affected, or may significantly affect the consolidated entity's operations, the results of those operations, or the consolidated entity's state of affairs in future financial years.

## Note 27. Accounting Standards and Interpretations not yet mandatory or early adopted

Australian Accounting Standards and Interpretations that are of relevance to the consolidated entity but are not mandatory and have not been early adopted for the annual reporting period ended 30 June 2018, and the consolidated entity's assessment of the impact of these issued or amended Accounting Standards and Interpretations, most relevant to the consolidated entity, are set out below.

**AASB 16:** ***Leases***

AASB 16 will apply for annual reporting periods commencing 1 January 2019. The standard eliminates the classification of leases as either operating leases or finance leases for a lessee and requires lease assets and lease liabilities to be recognised in the statement of financial position, initially measured at present value of future lease payments. In addition, depreciation of the lease assets and interest on lease liabilities will be recognised in the statement of profit or loss and other comprehensive income and the statement of cash flows will need to separate the total amount of cash paid into a principal portion and interest. This standard has been assessed as increasing the value of the consolidated entity's gross assets and gross liabilities, however the standard has been assessed as not having a material impact on the consolidated entity's net assets, operations or results. The consolidated entity anticipates that the adoption of the standard for annual reporting periods commencing on 1 July 2019 will result in increased disclosure.

**AASB 15:** ***Revenue from contracts with customers and associated amendments***

AASB 15 will apply for annual reporting periods beginning on or after 1 January 2018. AASB 15 will replace AASB 111 and AASB 118. The standard provides a single revenue recognition model based on the transfer of goods and services and the consideration expected to be received in return for that transfer. Revenue recognised by an asset manager will only be recognised to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur in future periods. This means that performance fees will only be recognised once the contractual measurement period is completed. This is consistent with how performance fees are already recognised in the consolidated entity's accounts.
The consolidated entity anticipates that this standard will not have a material impact on the consolidated entity for FY19 or future periods. The consolidated entity expects to adopt this standard for annual reporting periods commencing on 1 July 2018.

# Notes to the Financial Statements

## 30 June 2018



### Note 27. Accounting Standards and Interpretations not yet mandatory or early adopted – continued

**AASB 9: *Financial Instruments (and applicable amendments)***

AASB 9 addresses the classification, measurement and de-recognition of financial assets and financial liabilities. It includes revised rules around hedge accounting and impairment. The standard is applicable for annual reporting periods beginning on or after 1 January 2018.

More specifically AASB 9 replaces the classification and measurement model in AASB 139: *Financial Instruments: recognition and measurement* with a new model that classifies financial assets based on a) the business model within which the assets are managed, and b) whether contractual cash flows under the instrument solely represent the payment of principal and interest. Management has assessed the classification and measurement aspects of AASB 9 on the consolidated financial statements. Management expects on adoption, that all financial assets, will remain classified at fair value through profit or loss resulting in no material impact to the financial performance or position of the consolidated entity.

The hedging and impairment aspects of the new standard have also been assessed as having no material impact, as the consolidated entity does not enter into hedging arrangements and is not impacted by the requirement that credit quality should be used as one of the factors in determining write-downs, because the financial assets and liabilities are carried at fair value through profit or loss (or are classified as equity investments in associates).

The consolidated entity expects to adopt this standard for annual reporting periods commencing on 1 July 2018.

There are no other standards that are not yet effective that are expected to have a material impact on the consolidated entity in the current or future reporting periods and on foreseeable future transactions.

# Directors' Declaration

## 30 June 2018



In the Directors' opinion:

- the attached financial statements and notes comply with the *Corporations Act 2001*, the Accounting Standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements;
- the attached financial statements and notes comply with International Financial Reporting Standards as issued by the International Accounting Standards Board as described under Basis of Preparation to the financial statements;
- the attached financial statements and notes give a true and fair view of the consolidated entity's financial position as at 30 June 2018 and of its performance for the financial year ended on that date; and
- there are reasonable grounds to believe that the Company and consolidated entity will be able to pay its debts as and when they become due and payable.

The Directors have been given the declarations required by section 295A of the *Corporations Act 2001*.

Signed in accordance with a resolution of Directors made pursuant to section 295(5)(a) of the *Corporations Act 2001*.

On behalf of the Directors

**Michael Cole**
Chairman

**Andrew Clifford**
Director

23 August 2018
Sydney

# Independent Auditor's Report

## To the members of Platinum Asset Management Limited



### Report on the Audit of the Financial Report

**Our opinion**

In our opinion:

The accompanying financial report of Platinum Asset Management Limited (the Company) and its controlled entities (together the Group) is in accordance with the *Corporations Act 2001*, including:

(a) giving a true and fair view of the Group's financial position as at 30 June 2018 and of its financial performance for the year then ended

(b) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

*What we have audited*

The Group financial report comprises:

- the consolidated statement of financial position as at 30 June 2018
- the consolidated statement of profit or loss and other comprehensive income for the year then ended
- the consolidated statement of changes in equity for the year then ended
- the consolidated statement of cash flows for the year then ended
- the notes to the consolidated financial statements, which include a summary of significant accounting policies
- the Directors' Declaration.

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**Basis for opinion**

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial report* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

*Independence*

Other than those matters set out in our Independence Declaration dated 23 August 2018, we are independent of the Group in accordance with the auditor independence requirements of the *Corporations Act 2001* and the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

**Our audit approach**

An audit is designed to provide reasonable assurance about whether the financial report is free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial report.

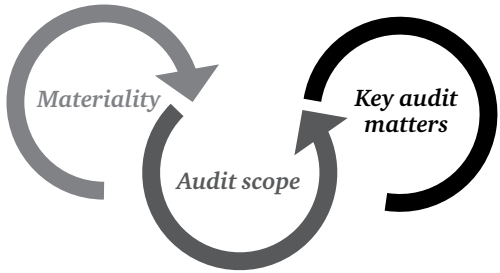
We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial report as a whole, taking into account the geographic and management structure of the Group, its accounting processes and controls and the industry in which it operates.

Our audit approach takes into account work undertaken by key third party service providers relevant to our audit. This includes the administrator which provides custodian and administration services for the trusts that the Group manages.

# Independent Auditor's Report

## To the members of Platinum Asset Management Limited






### MATERIALITY

- For the purpose of our audit we used overall Group materiality of $13.4 million, which represents approximately 5% of the Group's profit before tax.
- We applied this threshold, together with qualitative considerations, to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements on the financial report as a whole.
- We chose Group profit before tax because, in our view, it is the benchmark against which the performance of the Group is most commonly measured.
- We utlised a 5% threshold based on our professional judgement, noting it is within the range of commonly acceptable thresholds.

### AUDIT SCOPE

- Our audit focused on where the Group made subjective judgements; for example, significant accounting estimates involving assumptions and inherently uncertain future events.
- We conducted an audit of the most financially significant entities within the Group being Platinum Investment Management Limited (PIML), Platinum Asset Proprietary Limited (PAPL) and Platinum Asia Fund (Quoted Managed Hedge Fund) (PAXX). This was supplemented by additional risk focused audit procedures over corporate functions, such as cash and treasury.
- In establishing the overall approach to the Group audit, we considered the type of work that needed to be performed by us, as the Group's auditor, or by the component auditors operating under instructions.

### KEY AUDIT MATTERS

- Amongst other relevant topics, we communicated the following key audit matters to the Audit and Risk Committee:
  - Fee Revenue
  - Accounting for investment vehicles.
- These are further described in the *Key audit matters* section of our report.

**Key audit matters**

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial report for the current period. The key audit matters were addressed in the context of our audit of the financial report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. Further, any commentary on the outcomes of a particular audit procedure is made in that context.

| KEY AUDIT MATTER | HOW OUR AUDIT ADDRESSED THE KEY AUDIT MATTER |
|---|---|
| ***Fee Revenue***<br>*Refer to note 1 – Significant accounting policies*<br>Revenue is the Group's most significant account balance in the consolidated statement of profit or loss and other comprehensive income. The Group recognised revenue of $328.7 million comprising the following revenue streams:<br>– Management fees ($306.8 million)<br>– Performance fees ($21.9 million).<br>The terms of these fees are set out in the Group's investment management agreements with mandate clients and trusts.<br>We consider the Group's fee revenue a key audit matter due to the:<br>– Size of the **management fee** balances.<br>– Higher level of risk related to **performance fees** arising from the:<br>• Manual processes undertaken by the Group in calculating, reviewing and recording the fees; and<br>• Complexity of performance fee arrangements which involve the Group assessing the performance of relevant assets against a specified benchmark which is calculated using complex formulae. These benchmarks are agreed between the Group and its clients, and set out in relevant investment management agreements. | To assess the design and operating effectiveness of relevant key controls over recognising fee revenue, we performed the following audit procedures amongst others:<br>– Inspected a sample of reconciliations performed by the Group throughout the year to determine whether the Group's records of assets under its management agreed with the administrator's records<br>– Read the administrator's auditor's report as provided to the Group; and<br>– Assessed our ability to place reliance on the administrator's auditor's report by considering the auditor's independence, experience, competency and the results of their procedures. |

# Independent Auditor's Report

## To the members of Platinum Asset Management Limited



| KEY AUDIT MATTER | HOW OUR AUDIT ADDRESSED THE KEY AUDIT MATTER |
|---|---|
| ***Fee Revenue – continued*** | *Management fees*<br>– To assess the design and operating effectiveness of the third party service providers' relevant controls over the agreeing funds under management (FUM), we inspected the assurance reports provided to the Group by the third party service providers' independent auditors<br>– For management fees received from mandate clients, we tested a sample of fee calculations by agreeing FUM and the fee rate back to the Group's system reports and the relevant investment management agreement respectively.<br>– For management fees received from trusts managed by the Group, we tested a sample of fees recorded by the Group against Net Asset Value data obtained from the third party administrator and fee rates obtained from the Product Disclosure Statements and trust constitutions.<br>*Performance fees*<br>For a sample of performance fees we:<br>– To assess the design and operating effectiveness of the third party service providers' relevant controls over the FUM, we inspected the assurance reports provided to the Group by the third party service providers' independent auditors<br>– We agreed the data used in the fee calculations to the Group's underlying systems, agreed the basis of the calculations to that set out in the relevant client agreements, agreed the benchmark performance to an independent third party source, and recalculated the calculations. We also agreed the performance fees received to the Group's relevant bank statements. |

| KEY AUDIT MATTER | HOW OUR AUDIT ADDRESSED THE KEY AUDIT MATTER |
|---|---|
| ***Accounting for investment vehicles***<br>*Refer to note 1 – Significant accounting policies*<br>During the year, PIML invested in Platinum International Fund (Quoted Managed Hedge Fund) ("PIXX") and Platinum Asia Fund (Quoted Managed Hedge Fund) ("PAXX") as seed investment for the two newly created Quoted Managed Funds.<br><br>We considered this a key audit matter given the judgement required in determining the appropriate classification and accounting for the Group's investments in these entities in accordance with Australian Accounting Standards. This included<br>– The level of influence the Group has over each investment vehicle<br>– The extent of exposure to returns or rights to variable returns from the Group's involvement<br>– The ability for the Group to use its influence to affect the amount of the return from each investment.<br><br>At 30 June 2018, the Group concluded that it controlled PAXX but did not control or influence PIXX. | To assess the classification and accounting treatment of the investment in each vehicle we performed the following audit procedures amongst others:<br>– Inspected the offer documents, constitutions and the Investment Management Agreement between PIML and each investment vehicle to develop an understanding of the scope of powers and decision making authority held by the Group<br>– Assessed the Group's exposure to each investment vehicles' returns by multiplying the expected management and performance fees by the ownership percentage of the Group. |

**Other information**

The directors are responsible for the other information. The other information comprises the information included in the annual report for the year ended 30 June 2018, including the Chairman's report; Managing Director's Letter to Shareholders; Shareholder information and the Directors' Report, but does not include the financial report and our auditor's report thereon.

Our opinion on the financial report does not cover the other information and accordingly we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial report, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial report or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

# Independent Auditor's Report

## To the members of Platinum Asset Management Limited



**Responsibilities of the directors for the financial report**

The directors of the Company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

In preparing the financial report, the directors are responsible for assessing the ability of the Group to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

**Auditor's responsibilities for the audit of the financial report**

Our objectives are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial report.

A further description of our responsibilities for the audit of the financial report is located at the Auditing and Assurance Standards Board website at:

http://www.auasb.gov.au/auditors_responsibilities/ar1.pdf.

This description forms part of our auditor's report.

### Report on the Remuneration Report

**Our opinion on the Remuneration Report**

We have audited the remuneration report included in pages 29 to 44 of the directors' report for the year ended 30 June 2018.

In our opinion, the remuneration report of Platinum Asset Management Limited for the year ended 30 June 2018 complies with section 300A of the *Corporations Act 2001*.

**Responsibilities**

The directors of the Company are responsible for the preparation and presentation of the remuneration report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the remuneration report, based on our audit conducted in accordance with Australian Auditing Standards.

PricewaterhouseCoopers

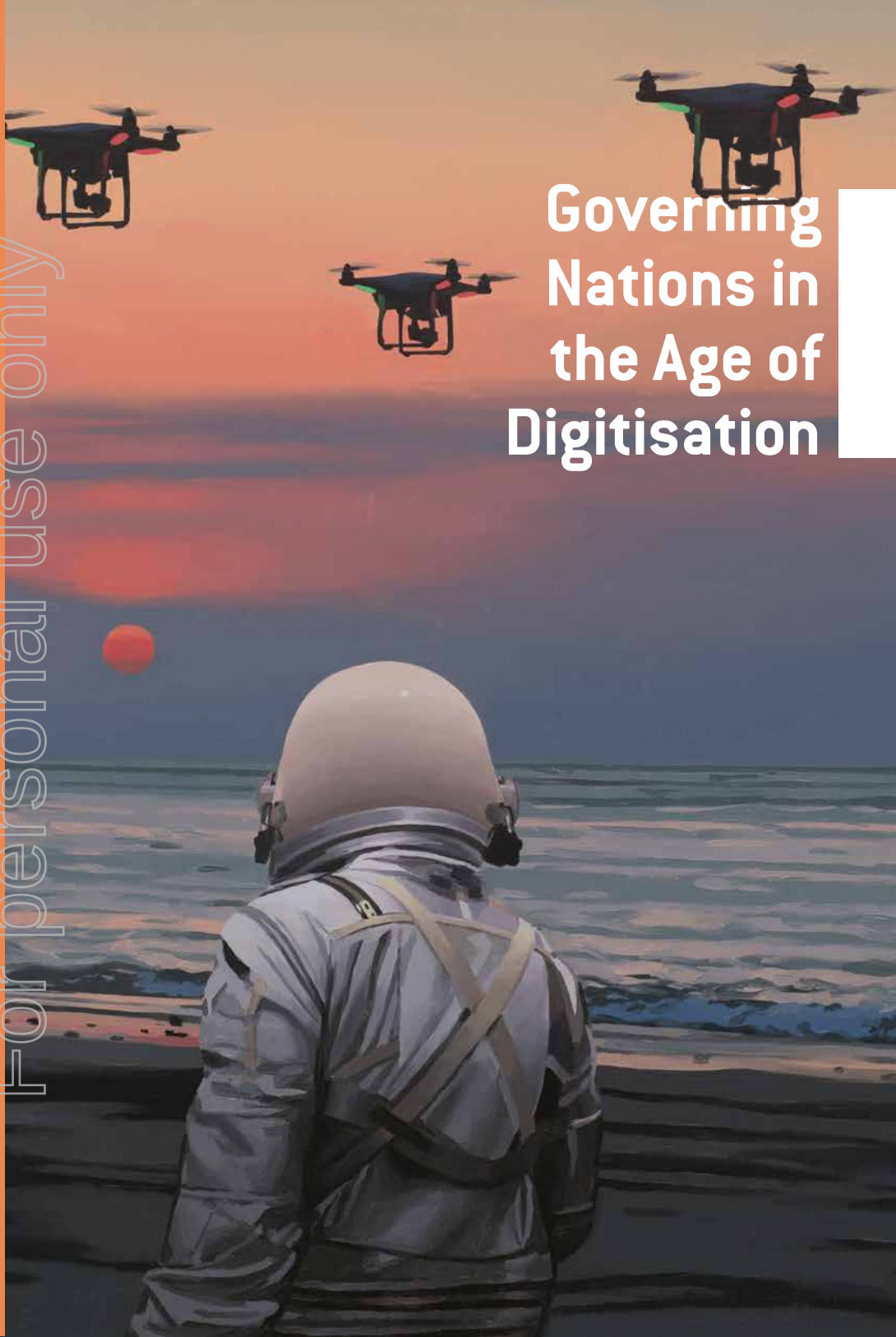
R. Balding

**PricewaterhouseCoopers**

**R Balding**
Partner

Sydney, 23 August 2018

# Governing Nations in the Age of Digitisation



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**Articles**

*The Digital Republic*
By Nathan Heller

Originally published in the print edition of the
December 18 & 25, 2017 issue of The New Yorker.


*Big Data Meets Big Brother*
By Rachel Botsman

Extracted from WHO CAN YOU TRUST by Rachel Botsman,
published by Portfolio Penguin @ £14.99.


**Artwork by**

Scott Listfield
astronautdinosaur.com

**"Simple people suffer in the hands of heavy bureaucracies We must go for inclusiveness, not high end. And we must go for reliability, not complex."**

Kersti Kaljulaid,
President of Estonia

# Preface

Times are challenging for governments around the globe. Populist movements across various countries are pushing for a new political order at home while their heads of state jostle each other to find their place on the world stage. There are trade wars to fight, geopolitical tensions to sooth, and humanitarian crises to diffuse.

And then there is the day-to-day business of running a country: how to tackle unemployment, what infrastructure to build, how to improve health care and education without breaking the budget and while handing out tax cuts... In a world where change is accelerating and growth has become a new creed, citizens are demanding more from their governments, democratically elected or otherwise.

Turning on the news channel on any night of the week, one would without fail feel a sense of tedium and hopelessness at the bickering politicians and a ballooning, yet systematically ineffectual, bureaucracy. This is true not only of our own nation, but also the other traditional beacons of the representative system of government, like the US and the UK. That's why the story of Estonia's digitisation, as vividly told by Nathan Heller from *The New Yorker,* reads like a breath of fresh air.

With a population of just 1.3 million and few big corporates and entrenched interest groups, when Estonia gained independence from the former Soviet Union in 1991 it had a historical opportunity to start afresh as a new nation and build modern institutions almost from scratch. Today, the small Baltic republic is hailed as "the most advanced digital society in the world"[1], a shining exemplar of a forward-thinking government leading a nation in and with information technology. From voting to policing, from health records to tax filings, 99% of public services are now online and linked across a robust digital platform, which also allows the private sector, from banks to pharmacies, to connect their own databases to it.

With the 2007 Russian cyberattack still fresh in memory and being no stranger to the European Union's privacy-focused culture, the Estonians have been both innovative and thoughtful in the design of their digital architecture, carefully balancing privacy and transparency, security and accessibility. X-Road, the data platform that forms the backbone of e-Estonia, employs open-source and distributed systems to minimise the risk of centralised attacks as well as ensuring the traceability of every digital footprint (blockchain technology has been in operational use in various registries since 2012).

1 https://www.wired.co.uk/article/estonia-e-resident
2 https://e-estonia.com/
3 https://theconversation.com/what-australia-can-learn-about-e-government-from-estonia-35091

Creative governance principles and concepts have been equally important to the integrity of e-Estonia: it backs up the entire national database in "data embassies" that are located on foreign soil but are afforded the same protection status as a diplomatic mission; individuals own all the personal information recorded about themselves; and a "once-only" rule that discourages agencies from asking citizens for the same information more than once.

X-Road is said to save more than 800 years of working time annually for the Estonian state and its citizens[2], and going paperless reportedly saves 2% of GDP a year[3]. But the significant efficiency gains and cost savings in both public and private services are not the only benefits of digitisation. Greater transparency and openness can improve the accountability of government.

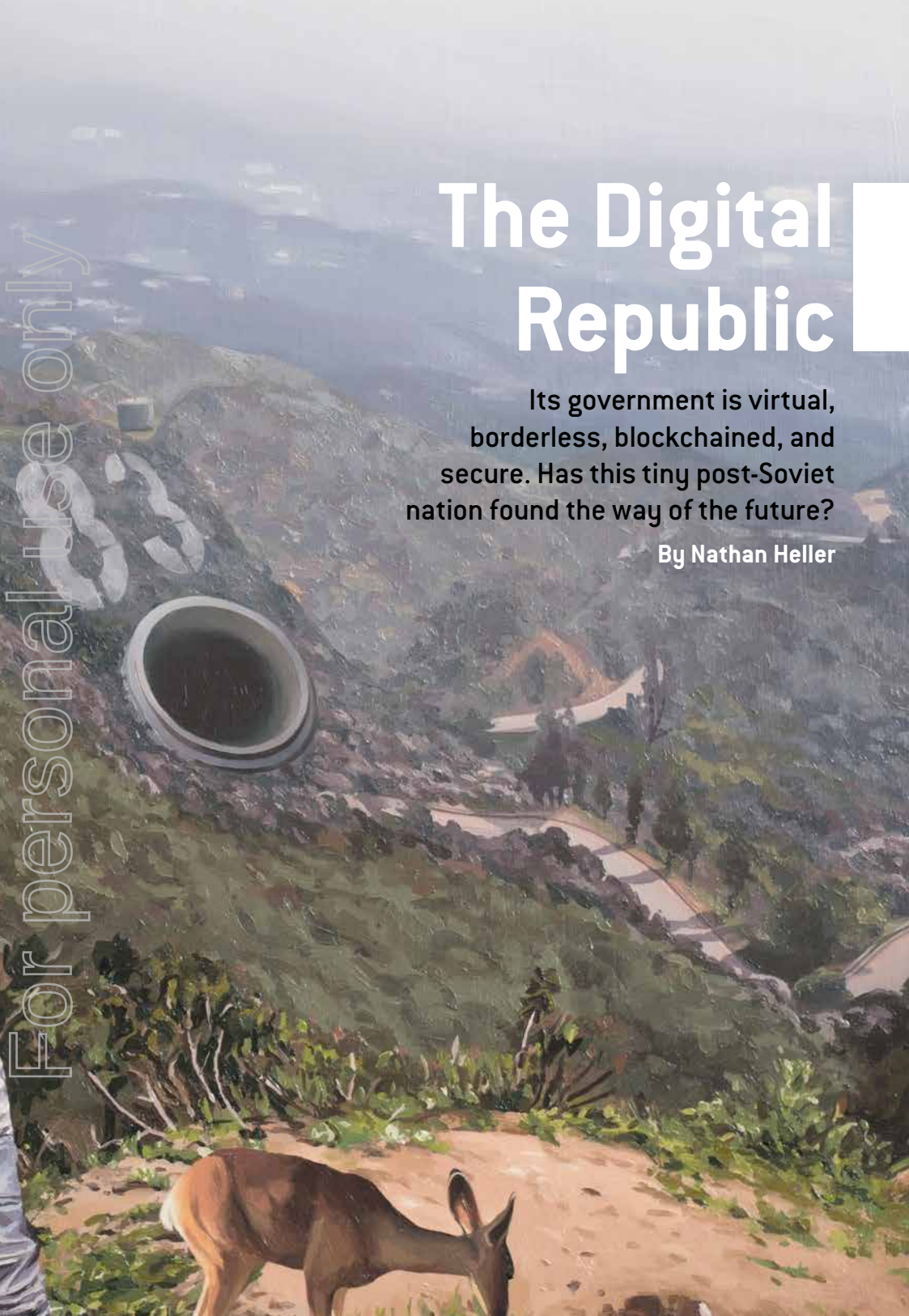
There are also the broader economic benefits – Estonia's investments in technological infrastructure have created a vibrant digital ecosystem that has done a superb job attracting entrepreneurs and fostering innovative start-ups. Skype, Taxify, Transferwise... The success stories are plentiful, and the Estonian government is intent on seeing more entrepreneurialism flourish on its virtual soil through e-Residency, a "transnational digital identity" program. Foreign nationals wishing to take advantage of Estonia's e-services, like opening a European bank account or incorporating a company with EU status, can apply online for a digital ID for the cost of 100 euros without ever setting foot in the country itself.

A remarkable aspect of e-Estonia, as you will sense from Nathan Heller's article, is that there seems to be a virtual cycle of trust underlying its success: the trust that its citizens placed in the Estonian government allowed it to embark on such an audacious and creative undertaking, while the benefits it has delivered reinforced its citizens' trust. The government does not seek to control its citizens with their data; it makes it easier for its people to get on with their lives. It does not coerce businesses to serve the state; but tries to be facilitative and minimise obstruction.

The contrast with China is stark, as you will see from the second feature – an extract from Rachel Botsman's recent book, *Who Can You Trust?*. There, the government is also seeking to harness the power of digital connectivity and big data, and such a "social credit" system will have far-reaching impacts on the trust between the government and its citizens as well as between businesses and citizens. We have over the last year seen numerous reports on the use of facial recognition and other advanced AI technologies by the Chinese government in surveillance and law enforcement – the upsides and the potential Orwellian threats seem equally striking.

One thing is clear – technology is a powerful tool for governments. But as Marten Kaevats, Estonia's national digital adviser, pointed out, it's not about the technology, "It's about the mind-set. It's about the culture. It's about the human relations – what it enables us to do."

**Kerr Neilson,**
Founder and Director,
Platinum Asset Management
August 2018



# The Digital Republic

Its government is virtual, borderless, blockchained, and secure. Has this tiny post-Soviet nation found the way of the future?

By Nathan Heller

Up the Estonian coast, a five-lane highway bends with the path of the sea, then breaks inland, leaving cars to follow a thin road toward the houses at the water's edge. There is a gated community here, but it is not the usual kind. The gate is low – a picket fence – as if to prevent the dunes from riding up into the street. The entrance is blocked by a railroad-crossing arm, not so much to keep out strangers as to make sure they come with intent.

Beyond the gate, there is a schoolhouse, and a few homes line a narrow drive. From Tallinn, Estonia's capital, you arrive dazed: trees trace the highway, and the cars go fast, as if to get in front of something that no one can see.

Within this gated community lives a man, his family, and one vision of the future. Taavi Kotka, who spent four years as Estonia's chief information officer, is one of the leading public faces of a project known as e-Estonia: a coördinated governmental effort to transform the country from a state into a digital society.

E-Estonia is the most ambitious project in technological statecraft today, for it includes all members of the government, and alters citizens' daily lives.

The normal services that government is involved with – legislation, voting, education, justice, health care, banking, taxes, policing, and so on – have been digitally linked across one platform, wiring up the nation. A lawn outside Kotka's large house was being trimmed by a small robot, wheeling itself forward and nibbling the grass.

"Everything here is robots," Kotka said. "Robots here, robots there." He sometimes felt that the lawnmower had a soul. "At parties, it gets *close* to people," he explained.

A curious wind was sucking in a thick fog from the water, and Kotka led me inside. His study was cluttered, with a long table bearing a chessboard and a bowl of foil-wrapped wafer chocolates (a mark of hospitality at Estonian meetings). A four-masted model ship was perched near the window; in the corner was a pile of robot toys.

"We had to set a goal that resonates, large enough for the society to believe in," Kotka went on.

He is tall with thin blond hair that, kept shaggy, almost conceals its recession. He has the liberated confidence, tinged with irony, of a cardplayer who has won a lot of hands and can afford to lose some chips.

It was during Kotka's tenure that the e-Estonian goal reached its fruition. Today, citizens can vote from their laptops and challenge parking tickets from home.

They do so through the "once only" policy, which dictates that no single piece of information should be entered twice.

Instead of having to "prepare" a loan application, applicants have their data – income, debt, savings – pulled from elsewhere in the system. There's nothing to fill out in doctors' waiting rooms, because physicians can access their patients' medical histories.

Estonia's system is keyed to a chip-I.D. card that reduces typically onerous, integrative processes – such as doing taxes – to quick work. "If a couple in love would like to marry, they still have to visit the government location and express their will," Andrus Kaarelson, a director at the Estonian Information Systems Authority, says. But, apart from transfers of physical property, such as buying a house, all bureaucratic processes can be done online.

Estonia is a Baltic country of 1.3 million people and four million hectares, half of which is forest.

Its government presents this digitization as a cost-saving efficiency and an equalizing force.

Digitizing processes reportedly saves the state two per cent of its G.D.P. a year in salaries and expenses.

Since that's the same amount it pays to meet the NATO threshold for protection (Estonia – which has a notably vexed relationship with Russia – has a comparatively small military), its former President Toomas Hendrik Ilves liked to joke that the country got its national security for free.

Other benefits have followed. "If everything is digital, and location-independent, you can run a borderless country," Kotka said.

In 2014, the government launched a digital "residency" program, which allows logged-in foreigners to partake of some Estonian services, such as banking, as if they were living in the country.

Other measures encourage international startups to put down virtual roots; Estonia has the lowest business-tax rates in the European Union, and has become known for liberal regulations around tech research. It is legal to test Level 3 driverless cars (in which a human driver can take control) on all Estonian roads, and the country is planning ahead for Level 5 (cars that take off on their own).

"We believe that innovation happens anyway," Viljar Lubi, Estonia's deputy secretary for economic development, says. "If we close ourselves off, the innovation happens somewhere else."

"It makes it so that, if one country is not performing as well as another country, people are going to the one that is performing better – competitive governance is what I'm calling it," Tim Draper, a venture capitalist at the Silicon Valley firm Draper Fisher Jurvetson and one of Estonia's leading tech boosters, says.

"We're about to go into a very interesting time where a lot of governments can become virtual."

Previously, Estonia's best-known industry was logging, but Skype was built there using mostly local engineers, and countless other startups have sprung from its soil. "It's not an offshore paradise, but you can capitalize a lot of money," Thomas Padovani, a Frenchman who co-founded the digital-ad startup Adcash in Estonia, explains.

"And the administration is light, all the way." A light touch does not mean a restricted one, however, and the guiding influence of government is everywhere.

As an engineer, Kotka said, he found the challenge of helping to construct a digital nation too much to resist. "Imagine that it's your task to build the Golden Gate Bridge," he said excitedly. "You have to change the whole way of thinking about society." So far, Estonia is past halfway there.

One afternoon, I met a woman named Anna Piperal at the e-Estonia Showroom. Piperal is the "e-Estonia ambassador"; the showroom is a permanent exhibit on the glories of digitized Estonia, from Skype to Timbeter, an app designed to count big piles of logs. (Its founder told me that she'd struggled to win over the wary titans of Big Log, who preferred to count the inefficient way.) Piperal has blond hair and an air of brisk, Northern European professionalism. She pulled out her I.D. card; slid it into her laptop, which, like the walls of the room, was faced with blond wood; and typed in her secret code, one of two that went with her I.D. The other code issues her digital signature – a seal that, Estonians point out, is much harder to forge than a scribble.

"This PIN code just starts the whole decryption process," Piperal explained. "I'll start with my personal data from the population registry." She gestured toward a box on the screen. "It has my document numbers, my phone number, my e-mail account. Then there's real estate, the land registry." Elsewhere, a box included all of her employment information; another contained her traffic records and her car insurance. She pointed at the tax box. "I have no tax debts; otherwise, that would be there. And I'm finishing a master's at the Tallinn University of Technology, so here" – she pointed to the education box – "I have my student information. If I buy a ticket, the system can verify, automatically, that I'm a student." She clicked into the education box, and a detailed view came up, listing her previous degrees.

"My cat is in the pet registry," Piperal said proudly, pointing again. "We are done with the vaccines."

Data aren't centrally held, thus reducing the chance of Equifax-level breaches. Instead, the government's data platform, X-Road, links individual servers through end-to-end encrypted pathways, letting information live locally.

Your dentist's practice holds its own data; so does your high school and your bank. When a user requests a piece of information, it is delivered like a boat crossing a canal via locks.

Although X-Road is a government platform, it has become, owing to its ubiquity, the network that many major private firms build on, too. Finland, Estonia's neighbor to the north, recently began using X-Road, which means that certain data – for instance, prescriptions that you're able to pick up at

a local pharmacy – can be linked between the nations. It is easy to imagine a novel internationalism taking shape in this form.

Toomas Ilves, Estonia's former President and a longtime driver of its digitization efforts, is currently a distinguished visiting fellow at Stanford, and says he was shocked at how retrograde U.S. bureaucracy seems even in the heart of Silicon Valley. "It's like the nineteen-fifties – I had to provide an electrical bill to prove I live here!" he exclaimed. "You can get an iPhone X, but, if you have to register your car, forget it."

X-Road is appealing due to its rigorous filtering: Piperal's teachers can enter her grades, but they can't access her financial history, and even a file that's accessible to medical specialists can be sealed off from other doctors if Piperal doesn't want it seen.

"I'll show you a digital health record," she said, to explain. "A doctor from here" – a file from one clinic – "can see the research that this doctor" – she pointed to another – "does." She'd locked a third record, from a female-medicine practice, so that no other doctor would be able to see it.

A tenet of the Estonian system is that an individual owns all information recorded about him or her. Every time a doctor (or a border guard, a police officer, a banker, or a minister) glances at any of Piperal's secure data online, that look is recorded and reported.

Peeping at another person's secure data for no reason is a criminal offense. "In Estonia, we don't have Big Brother; we have Little Brother," a local told me. "You can tell him what to do and maybe also beat him up."

Business and land-registry information is considered public, so Piperal used the system to access the profile of an Estonian politician. "Let's see his land registry," she said, pulling up a list of properties. "You can see there are three land plots he has, and this one is located" – she clicked, and a satellite photograph of a sprawling beach house appeared – "on the sea."

The openness is startling. Finding the business interests of the rich and powerful – a hefty field of journalism in the United States – takes a moment's research, because every business connection or investment captured in any record in Estonia becomes searchable public information. (An online tool even lets citizens map webs of connection, follow-the-money style.) Traffic stops are illegal in the absence of a moving violation, because officers acquire records from a license-plate scan.

Polling-place intimidation is a non-issue if people can vote – and then change their votes, up to the deadline – at home, online. And heat is taken off immigration because, in a borderless society, a resident need not even have visited Estonia in order to work and pay taxes under its dominion.

Soon after becoming the C.I.O., in 2013, Taavi Kotka was charged with an unlikely project: expanding Estonia's population. The motive was predominantly economic. "Countries are like enterprises," he said. "They want to increase the wealth of their own people."

Tallinn, a harbor city with a population just over four hundred thousand, does not seem to be on a path toward outsized growth. Not far from the cobbled streets of the hilly Old Town is a business center, where boxy Soviet structures have been supplanted by stylish buildings of a Scandinavian cast. Otherwise, the capital seems pleasantly preserved in time.

The coastal daylight is bright and thick, and, when a breeze comes off the Baltic, silver-birch leaves shimmer like chimes. "I came home to a great autumn / to a luminous landscape," the Estonian poet Jaan Kaplinski wrote decades ago. This much has not changed.

Kotka, however, thought that it was possible to increase the population just by changing how you thought of what a population was. Consider music, he said. Twenty years ago, you bought a CD and played the album through. Now you listen track by track, on demand.

"If countries are competing not only on physical talent moving to their country but also on how to get the best virtual talent *connected* to their country, it becomes a disruption like the one we have seen in the music industry," he said. "And it's basically a zero-cost project, because we already have this infrastructure for our own people."

The program that resulted is called e-residency, and it permits citizens of another country to become residents of Estonia without ever visiting the place. An e-resident has no leg up at the customs desk, but the program allows individuals to tap into Estonia's digital services from afar.

I applied for Estonian e-residency one recent morning at my apartment, and it took about ten minutes. The application cost a hundred euros, and the hardest part was finding a passport photograph to upload, for my card. After approval, I would pick up my credentials in person, like a passport, at the Estonian Consulate in New York.

This physical task proved to be the main stumbling block, Ott Vatter, the deputy director of e-residency, explained, because consulates were reluctant to expand their workload to include a new document. Mild xenophobia made some Estonians at home wary, too. "Inside Estonia, the mentality is kind of 'What is the gain, and where is the money?' " he said.

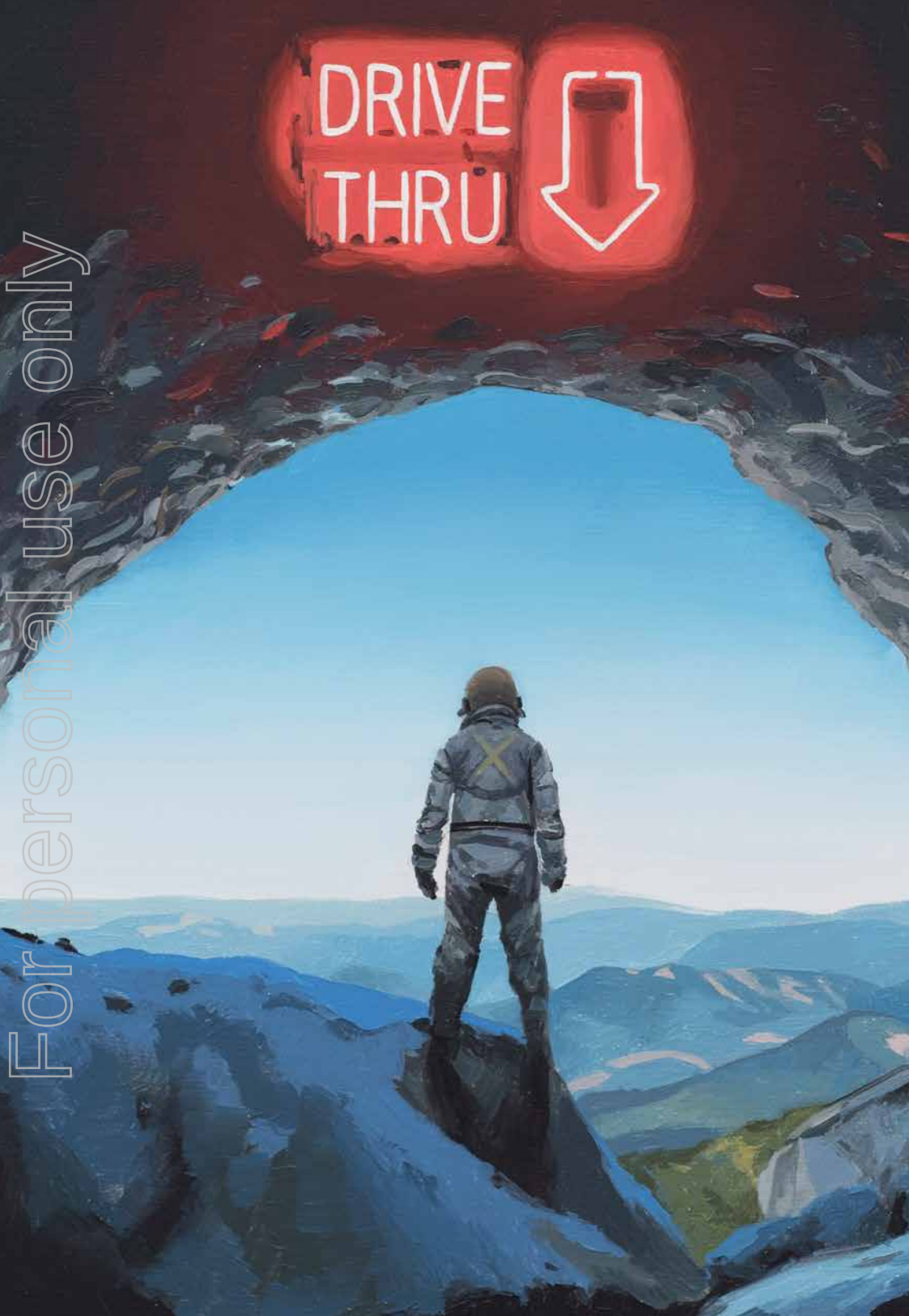
The physical factor still imposes limitations – only thirty-eight consulates have agreed to issue documents, and they are distributed unevenly. (Estonia has only one embassy in all of Africa.) But the office has made special accommodations for several popular locations. Since there's no Estonian consulate in San Francisco, the New York consulate flies personnel to California every three months to batch-process Silicon Valley applicants.

"I had a deal that I did with Funderbeam, in Estonia," Tim Draper, who became Estonia's second e-resident, told me. "We decided to use a 'smart contract' – the first ever in a venture deal!"

Smart contracts are encoded on a digital ledger and, notably, don't require an outside administrative authority. It was an appealing prospect, and Draper, with his market investor's gaze, recognized a new market for élite tech brainpower and capital.

"I thought, Wow! Governments are going to have to compete with each other for us," he said.

So far, twenty-eight thousand people have applied for e-residency, mostly from neighboring countries: Finland and Russia. But Italy and Ukraine follow, and U.K. applications spiked during Brexit.



(Many applicants are footloose entrepreneurs or solo venders who want to be based in the E.U.)

Because eighty-eight per cent of applicants are men, the United Nations has begun seeking applications for female entrepreneurs in India.

"There are so many companies in the world for whom working across borders is a big hassle and a source of expense," Siim Sikkut, Estonia's current C.I.O., says.

Today, in Estonia, the weekly e-residency application rate exceeds the birth rate. "We tried to make more babies, but it's not that easy," he explained.

With so many businesses abroad, Estonia's startup-ism hardly leaves an urban trace. I went to visit one of the places it does show: a co-working space, Lift99, in a complex called the Telliskivi Creative City. The Creative City, a former industrial park, is draped with trees and framed by buildings whose peeling exteriors have turned the yellows of a worn-out sponge. There are murals, outdoor sculptures, and bills for coming shows; the space is shaped by communalism and by the spirit of creative unrule. One art work consists of stacked logs labelled with Tallinn startups: Insly, LeapIN, Photry, and something called 3D Creationist.

The office manager, Elina Kaarneem, greeted me near the entrance. "Please remove your shoes," she said. Lift99, which houses thirty-two companies and five freelancers, had industrial windows, with a two-floor open-plan workspace. Both levels also included smaller rooms named for techies who had done business with Estonia. There was a Zennström Room, after Niklas Zennström, the Swedish entrepreneur who co-founded Skype, in Tallinn. There was a Horowitz Room, for the venture capitalist Ben Horowitz, who has invested in Estonian tech. There was also a Tchaikovsky Room, because the composer had a summer house in Estonia and once said something nice about the place.

"This is not the usual co-working space, because we choose every human," Ragnar Sass, who founded Lift99, exclaimed in the Hemingway Room. Hemingway, too, once said something about Estonia; a version of his pronouncement – "No well-run yacht basin is complete without at least two Estonians" – had been spray-stencilled on the wall, along with his face.

The room was extremely small, with two cushioned benches facing each other. Sass took one; I took the other. "Many times, a miracle can happen if you put talented people in one room," he said as I tried to keep my knees inside my space. Not far from the Hemingway Room, Barack Obama's face was also on a wall.

Obama Rooms are booths for making cell-phone calls, following something he once said about Estonia. ("I should have called the Estonians when we were setting up our health-care Web site.") That had been stencilled on the wall as well.

Some of the companies at Lift99 are local startups, but others are international firms seeking an Estonian foothold. In something called the Draper Room, for Tim Draper, I met an Estonian engineer, Margus Maantoa, who was launching the Tallinn branch of the German motion-control company Trinamic. Maantoa shares the room with other companies, and, to avoid disturbing

them, we went to the Iceland Room. (Iceland was the first country to recognize Estonian independence.) The seats around the table in the Iceland Room were swings.

I took a swing, and Maantoa took another. He said, "I studied engineering and physics in Sweden, and then, seven years ago, I moved back to Estonia because so much is going on." He asked whether I wanted to talk with his boss, Michael Randt, at the Trinamic headquarters, in Hamburg, and I said that I did, so he opened his laptop and set up a conference call on Skype. Randt was sitting at a table, peering down at us as if we were a mug of coffee. Tallinn had a great talent pool, he said: "Software companies are absorbing a lot of this labor, but, when it comes to hardware, there are only a few companies around." He was an e-resident, so opening a Tallinn office was fast.

Maantoa took me upstairs, where he had a laboratory space that looked like a janitor's closet. Between a water heater and two large air ducts, he had set up a desk with a 3-D printer and a robotic motion-control platform. I walked him back to Draper and looked up another startup, an Estonian company called Ööd, which makes one-room, two-hundred-square-foot huts that you can order prefab.

The rooms have floor-to-ceiling windows of one-way glass, climate control, furniture, and lovely wood floors. They come in a truck and are dropped into the countryside.

"Sometimes you want something small, but you don't want to be in a tent," Kaspar Kägu, the head of Ööd sales, explained. "You want a shower in the morning and your coffee and a beautiful landscape. Fifty-two per cent of Estonia is covered by forestland, and we're rather introverted people, so we want to be – uh, *not* near everybody else." People of a more sociable disposition could scatter these box homes on their property, he explained, and rent them out on services like Airbnb.

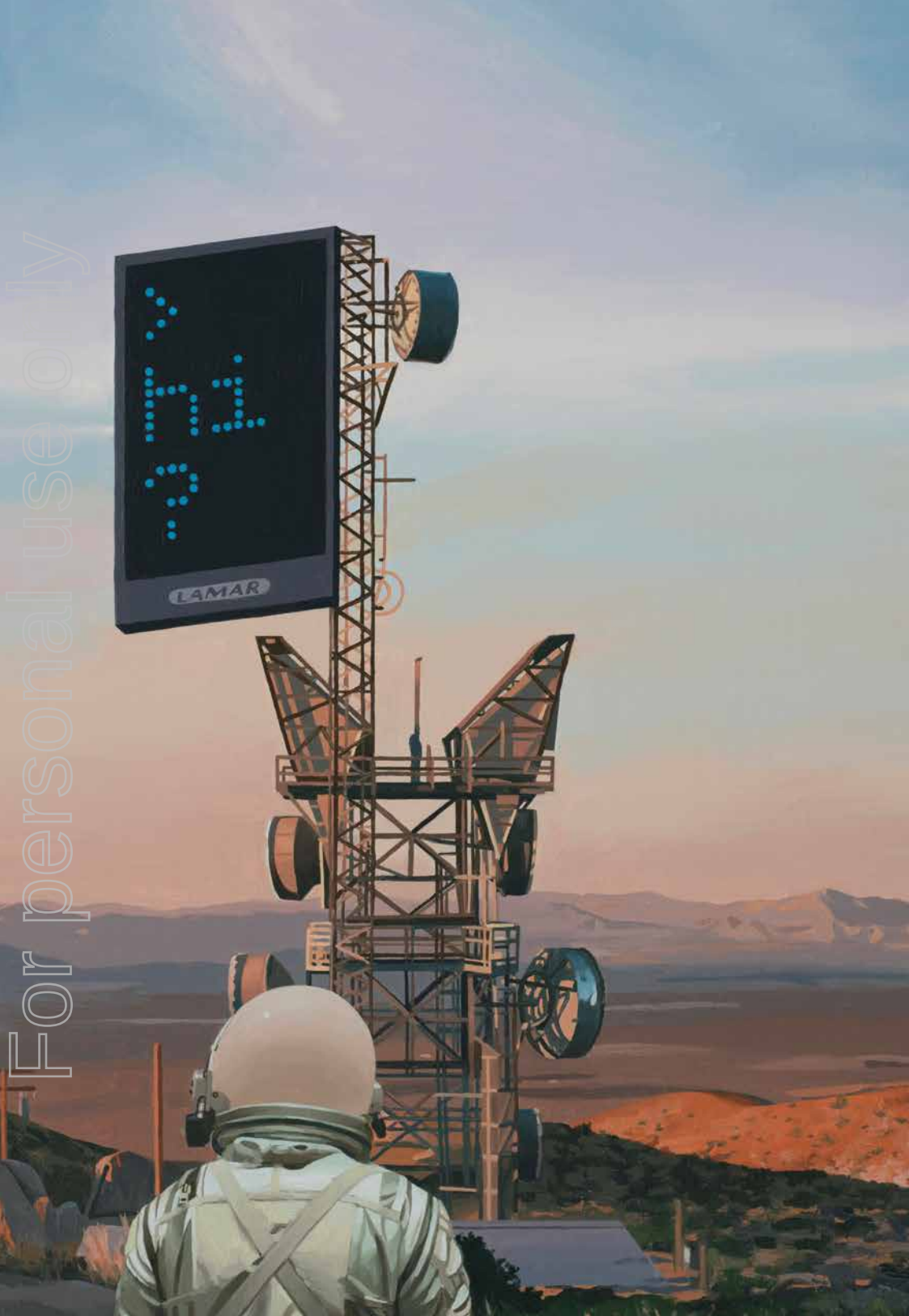
"We like to go to nature – but comfortably," Andreas Tiik, who founded Ööd with his carpenter brother, Jaak, told me. The company had queued preorders from people in Silicon Valley, who also liked the idea, and was tweaking the design for local markets. "We're building a sauna in it," Kägu said.

In the U.S., it is generally assumed that private industry leads innovation. Many ambitious techies I met in Tallinn, though, were leaving industry to go work for the state.

"If someone had asked me, three years ago, if I could imagine myself working for the government, I would have said, 'F--- no,' " Ott Vatter, who had sold his own business, told me. "But I decided that I could go to the U.S. at any point, and work in an average job at a private company. This is so much bigger."

The bigness is partly inherent in the government's appetite for large problems. In Tallinn's courtrooms, judges' benches are fitted with two monitors, for consulting information during the proceedings, and case files are assembled according to the once-only principle. The police make reports directly into the system; forensic specialists at the scene or in the lab do likewise.

Lawyers log on – as do judges, prison wardens, plaintiffs, and defendants, each through his or her portal. The Estonian courts used to be notoriously backlogged, but that is no longer the case.



"No one was able to say whether we should increase the number of courts or increase the number of judges," Timo Mitt, a manager at Netgroup, which the government hired to build the architecture, told me.

Digitizing both streamlined the process and helped identify points of delay. Instead of setting up prisoner transport to trial – fraught with security risks – Estonian courts can teleconference defendants into the courtroom from prison.

For doctors, a remote model has been of even greater use. One afternoon, I stopped at the North Estonia Medical Center, a hospital in the southwest of Tallinn, and met a doctor named Arkadi Popov in an alleyway where ambulances waited in line.

"Welcome to our world," Popov, who leads emergency medical care, said grandly, gesturing with pride toward the chariots of the sick and maimed. "Intensive care!"

In a garage where unused ambulances were parked, he took an iPad Mini from the pocket of his white coat, and opened an "e-ambulance" app, which Estonian paramedics began using in 2015. "This system had some childhood diseases," Popov said, tapping his screen. "But now I can say that it works well."

E-ambulance is keyed onto X-Road, and allows paramedics to access patients' medical records, meaning that the team that arrives for your chest pains will have access to your latest cardiology report and E.C.G.

Since 2011, the hospital has also run a telemedicine system – doctoring at a distance – originally for three islands off its coast. There were few medical experts on the islands, so the E.M.S. accepted volunteer paramedics. "Some of them are hotel administrators, some of them are teachers," Popov said. At a command center at the hospital in Tallinn, a doctor reads data remotely.

"On the screen, she or he can see all the data regarding the patient – physiological parameters, E.C.G.s," he said. "Pulse, blood pressure, temperature. In case of C.P.R., our doctor can see how deep the compression of the chest is, and can give feedback."

The e-ambulance software also allows paramedics to pre-register a patient en route to the hospital, so that tests, treatments, and surgeries can be prepared for the patient's arrival.

To see what that process looks like, I changed into scrubs and a hairnet and visited the hospital's surgery ward. Rita Beljuskina, a nurse anesthetist, led me through a wide hallway lined with steel doors leading to the eighteen operating theatres. Screens above us showed eighteen columns, each marked out with twenty-four hours. Surgeons book their patients into the queue, Beljuskina explained, along with urgency levels and any machinery or personnel they might need. An on-call anesthesiologist schedules them in order to optimize the theatres and the equipment.

"Let me show you how," Beljuskina said, and led me into a room filled with medical equipment and a computer in the corner. She logged on with her own I.D. If she were to glance at any patient's data, she explained, the access would be tagged to her name, and she would get a call inquiring why it was necessary.

The system also scans for drug interactions, so if your otolaryngologist prescribes something that clashes with the pills your cardiologist told you to take, the computer will put up a red flag.

The putative grandfather of Estonia's digital platform is Tarvi Martens, an enigmatic systems architect who today oversees the country's digital-voting program from a stone building in the center of Tallinn's Old Town.

I went to visit him one morning, and was shown into a stateroom with a long conference table and French windows that looked out on the trees. Martens was standing at one window, with his back to me, commander style. For a few moments, he stayed that way; then he whirled around and addressed a timid greeting to the buttons of my shirt.

Martens was wearing a red flannel button-down, baggy jeans, black socks, and the sort of sandals that are sold at drugstores. He had gray stubble, and his hair was stuck down on his forehead in a manner that was somehow both rumpled and flat. This was the busiest time of the year, he said, with the fall election looming. He appeared to run largely on caffeine and nicotine; when he put down a mug of hot coffee, his fingers shook.

For decades, he pointed out, digital technology has been one of Estonia's first recourses for public ailments. A state project in 1970 used computerized data matching to help singles find soul mates, "for the good of the people's economy." In 1997, the government began looking into newer forms of digital documents as a supplement.

"They were talking about chip-equipped bar codes or something," Martens told me, breaking into a nerdy snicker-giggle. "Totally ridiculous." He had been doing work in cybernetics and security as a private-sector contractor, and had an idea. When the cards were released, in 2002, Martens became convinced that they should be both mandatory and cheap.

"Finland started two years earlier with an I.D. card, but it's still a sad story," he said. "Nobody uses it, because they put a hefty price tag on the card, and it's a voluntary document. We sold it for ten euros at first, and what happened? Banks and application providers would say, 'Why should I support this card? Nobody has it.' It was a dead end."

In what may have been the seminal insight of twenty-first-century Estonia, Martens realized that whoever offered the most ubiquitous and secure platform would run the country's digital future – and that it should be an elected leadership, not profit-seeking Big Tech.

"The only thing was to push this card to the people, without them knowing what to do with it, and then say, 'Now people have a card. Let's start some applications,' " he said.

The first "killer application" for the I.D.-card-based system was the one that Martens still works on: i-voting, or casting a secure ballot from your computer. Before the first i-voting period, in 2005, only five thousand people had used their card for anything. More than nine thousand cast an i-vote in that election, however – only two per cent of voters, but proof that online voting was attracting users – and the numbers rose from there. As of 2014, a third of all votes have been cast online.

That year, seven Western researchers published a study of the i-voting system which concluded that it had "serious architectural limitations and procedural gaps." Using an open-source edition of the voting software, the researchers approximated a version of the i-voting setup in their lab and found that it was possible to introduce malware. They were not convinced that the servers were entirely secure, either.

Martens insisted that the study was "ridiculous." The researchers, he said, gathered data with "a lot of assumptions," and misunderstood the safeguards in Estonia's system. You needed both the passwords and the hardware (the chip in your I.D. card or, in the newer "mobile I.D." system, the SIM card in your phone) to log in, blocking most paths of sabotage.

Estonian trust was its own safeguard, too, he told me.

Earlier this fall, when a Czech research team found a vulnerability in the physical chips used in many I.D. cards, Siim Sikkut, the Estonian C.I.O., e-mailed me the finding. His office announced the vulnerability, and the cards were locked for a time. When Sikkut held a small press conference, reporters peppered him with questions: What did the government gain from disclosing the vulnerability? How disastrous *was* it?

Sikkut looked bemused. Many upgrades to phones and computers resolve vulnerabilities that have never even been publicly acknowledged, he said – and think how much data we entrust to those devices.

("There is no government that knows more about you than Google or Facebook," Taavi Kotka says dryly.)

In any case, the transparency seemed to yield a return; a poll conducted after the chip flaw was announced found that trust in the system had fallen by just three per cent.

From time to time, Russian military jets patrolling Estonia's western border switch off their G.P.S. transponders and drift into the country's airspace. What follows is as practiced as a pas de deux at the Bolshoi. NATO troops on the ground scramble an escort. Estonia calls up the Russian Ambassador to complain; Russia cites an obscure error. The dance lets both parties show that they're alert, and have not forgotten the history of place.

Since the eleventh century, Estonian land has been conquered by Russia five times. Yet the country has always been an awkward child of empire, partly owing to its proximity to other powers (and their airwaves) and partly because the Estonian language, which belongs to the same distinct Uralic family as Hungarian and Finnish, is incomprehensible to everyone else. Plus, the greatest threat, these days, may not be physical at all.

In 2007, a Russian cyberattack on Estonia sent everything from the banks to the media into chaos. Estonians today see it as the defining event of their recent history.

The chief outgrowth of the attack is the NATO Coöperative Cyber Defense Center of Excellence, a think tank and training facility. It's on a military base that once housed the Soviet Army. You enter through a gatehouse with gray walls and a pane of mirrored one-way glass.

"Document, please!" the mirror boomed at me when I arrived one morning. I slid my passport through on a tray. The mirror was silent for two full minutes, and I backed into a plastic chair. "You have to wait here!" the mirror boomed back.

Some minutes later, a friendly staffer appeared at the inner doorway and escorted me across a quadrangle trimmed with NATO-member flags and birch trees just fading to gold. Inside a gray stone building, another mirror instructed me to stow my goods and to don a badge. Upstairs, the center's director, Merle Maigre, formerly the national-security adviser to the Estonian President, said that the center's goal was to guide other NATO nations toward vigilance.

"This country is located – just where it is," she said, when I asked about Russia. Since starting, in 2008, the center has done research on digital forensics, cyber-defense strategy, and similar topics. (It publishes the "Tallinn Manual 2.0 on the International Law Applicable to Cyber Operations" and organizes a yearly research conference.)

But it is best known for its training simulations: an eight-hundred-person cyber "live-fire" exercise called Locked Shields was run this year alongside CYBRID, an exercise for defense ministers of the E.U. "This included aspects such as fake news and social media," Maigre said.

Not all of Estonia's digital leadership in the region is as openly rehearsed. Its experts have consulted on Georgia's efforts to set up its own digital registry. Estonia is also building data partnerships with Finland, and trying to export its methods elsewhere across the E.U. "The vision is that I will go to Greece, to a doctor, and be able to get everything," Toomas Ilves explains.

Sandra Roosna, a member of Estonia's E-Governance Academy and the author of the book "eGovernance in Practice," says, "I think we need to give the European Union two years to do cross-border transactions and to recognize each other digitally." Even now, though, the Estonian platform has been adopted by nations as disparate as Moldova and Panama. "It's very popular in countries that want – and not all do – transparency against corruption," Ilves says.

Beyond X-Road, the backbone of Estonia's digital security is a blockchain technology called K.S.I.

A blockchain is like the digital version of a scarf knitted by your grandmother. She uses one ball of yarn, and the result is continuous. Each stitch depends on the one just before it. It's impossible to remove part of the fabric, or to substitute a swatch, without leaving some trace: a few telling knots, or a change in the knit.

In a blockchain system, too, every line is contingent on what came before it. Any breach of the weave leaves a trace, and trying to cover your tracks leaves a trace, too. "Our No. 1 marketing pitch is Mr. Snowden," Martin Ruubel, the president of Guardtime, the Estonian company that developed K.S.I., told me. (The company's biggest customer group is now the U.S. military.)

Popular anxiety tends to focus on data security – who can see my information? – but bits of personal information are rarely truly compromising. The larger threat is data integrity: whether what looks secure has been changed. (It doesn't really matter who knows what your blood type is, but if

someone switches it in a confidential record your next trip to the emergency room could be lethal.)

The average time until discovery of a data breach is two hundred and five days, which is a huge problem if there's no stable point of reference.

"In the Estonian system, you don't have paper originals," Ruubel said. "The question is: Do I know about this problem, and how quickly can I react?"

The blockchain makes every footprint immediately noticeable, regardless of the source. (Ruubel says that there is no possibility of a back door.) To guard secrets, K.S.I. is also able to protect information without "seeing" the information itself. But, to deal with a full-scale cyberattack, other safeguards now exist. Earlier this year, the Estonian government created a server closet in Luxembourg, with a backup of its systems.

A "data embassy" like this one is built on the same body of international law as a physical embassy, so that the servers and their data are Estonian "soil." If Tallinn is compromised, whether digitally or physically, Estonia's locus of control will shift to such mirror sites abroad.

"*If* Russia comes – not when – and if our systems shut down, we will have copies," Piret Hirv, a ministerial adviser, told me. In the event of a sudden invasion, Estonia's elected leaders might scatter as necessary. Then, from cars leaving the capital, from hotel rooms, from seat 3A at thirty thousand feet, they will open their laptops, log into Luxembourg, and – with digital signatures to execute orders and a suite of tamper-resistant services linking global citizens to their government – continue running their country, with no interruption, from the cloud.

The history of nationhood is a history of boundaries marked on land. When, in the fourteenth century, peace arrived after bloodshed among the peoples of Mexico's eastern altiplano, the first task of the Tlaxcaltecs was to set the borders of their territory. In 1813, Ernst Moritz Arndt, a German nationalist poet before there was a Germany to be nationalistic about, embraced the idea of a "Vaterland" of shared history: "Which is the German's fatherland? / So tell me now at last the land! – / As far's the German's accent rings / And hymns to God in heaven sings."

Today, the old fatuities of the nation-state are showing signs of crisis. Formerly imperialist powers have withered into nationalism (as in Brexit) and separatism (Scotland, Catalonia). New powers, such as the Islamic State, have redefined nationhood by ideological acculturation.

It is possible to imagine a future in which nationality is determined not so much by where you live as by what you log on to.

Estonia currently holds the presidency of the European Union Council – a bureaucratic role that mostly entails chairing meetings. (The presidency rotates every six months; in January, it will go to Bulgaria.) This meant that the autumn's E.U. Digital Summit was held in Tallinn, a convergence of audience and expertise not lost on Estonia's leaders. One September morning, a car pulled up in front of the Tallinn Creative Hub, a former power station, and Kersti Kaljulaid, the

President of Estonia, stepped out. She is the country's first female President, and its youngest. Tall and lanky, with chestnut hair in a pixie cut, she wore an asymmetrical dress of Estonian blue and machine gray. Kaljulaid took office last fall, after Estonia's Presidential election yielded no majority winner; parliamentary representatives of all parties plucked her out of deep government as a consensus candidate whom they could all support. She had previously been an E.U. auditor.

"I am President to a digital society," she declared in her address. The leaders of Europe were arrayed in folding chairs, with Angela Merkel, in front, slumped wearily in a red leather jacket. "Simple people suffer in the hands of heavy bureaucracies," Kaljulaid told them. "We must go for inclusiveness, not high end. And we must go for reliability, not complex."

Kaljulaid urged the leaders to consider a transient population. Theresa May had told her people, after Brexit, "If you believe you're a citizen of the world, you're a citizen of nowhere." With May in the audience, Kaljulaid staked out the opposite view. "Our citizens will be global soon," she said. "We have to fly like bees from flower to flower to gather those taxes from citizens working in the morning in France, in the evening in the U.K., living half a year in Estonia and then going to Australia."

Citizens had to remain connected, she said, as the French President, Emmanuel Macron, began nodding vigorously and whispering to an associate. When Kaljulaid finished, Merkel came up to the podium.

"You're so much further than we are," she said. Later, the E.U. member states announced an agreement to work toward digital government and, as the Estonian Prime Minister put it in a statement, "rethink our entire labor market."

Before leaving Tallinn, I booked a meeting with Marten Kaevats, Estonia's national digital adviser. We arranged to meet at a café near the water, but it was closed for a private event. Kaevats looked unperturbed. "Let's go somewhere beautiful!" he said. He led me to an enormous terraced concrete platform blotched with graffiti and weeds.

We climbed a staircase to the second level, as if to a Mayan plateau. Kaevats, who is in his thirties, wore black basketball sneakers, navy trousers, a pin-striped jacket from a different suit, and a white shirt, untucked. The fancy dress was for the digital summit. "I have to introduce the President of Estonia," he said merrily, crabbing a hand through his strawberry-blond hair, which stuck out in several directions. "I don't know what to say!" He fished a box of Marlboro Reds out of his pocket and tented into himself, twitching a lighter.

It was a cloudless morning. Rounded bits of gravel in the concrete caught a glare. The structure was bare and weather-beaten, and we sat on a ledge above a drop facing the harbor. The Soviets built this "Linnahall," originally as a multipurpose venue for sailing-related sports of the Moscow Summer Olympics. It has fallen into disrepair, but there are plans for renovation soon.

For the past year, Kaevats's main pursuit has been self-driving cars. "It basically embeds all the difficult questions of the digital age: privacy, data, safety – everything," he said. It's also an idea accessible to the man and woman (literally) in the street, whose involvement in regulatory standards he wants to encourage.

"What's difficult is the ethical and emotional side," he said. "It's about values. What do we want? Where are the borders? Where are the red lines? These cannot be decisions made only by specialists."

To support that future, he has plumbed the past. Estonian folklore includes a creature known as the *kratt:* an assembly of random objects that the Devil will bring to life for you, in exchange for a drop of blood offered at the conjunction of five roads. The Devil gives the *kratt* a soul, making it the slave of its creator.

"Each and every Estonian, even children, understands this character," Kaevats said. His office now speaks of *kratt* instead of robots and algorithms, and has been using the word to define a new, important nuance in Estonian law.

"Basically, a *kratt* is a robot with representative rights," he explained. "The idea that an algorithm can buy and sell services *on your behalf* is a conceptual upgrade."

In the U.S., where we lack such a distinction, it's a matter of dispute whether, for instance, Facebook is responsible for algorithmic sales to Russian forces of misinformation.

#KrattLaw – Estonia's digital shorthand for a new category of legal entity comprising A.I., algorithms, and robots – will make it possible to hold accountable whoever gave a drop of blood.

"In the U.S. recently, smart toasters and Teddy bears were used to attack Web sites," Kaevats said. "Toasters should not be making attacks!" He squatted and emptied a pocket onto the ledge: cigarettes, lighter, a phone. "Wherever there's a smart device, around it there are other smart devices," he said, arranging the items on the concrete. "This smart street light" – he stood his lighter up – "asks the self-driving car" – he scooted his phone past it – " 'Are you O.K.? Is everything O.K. with you?' " The Marlboro box became a building whose appliances made checks of their own, scanning one another for physical and blockchain breaches. Such checks, device to device, have a distributed effect. To commandeer a self-driving car on a street, a saboteur would, in theory, also have to hack every street lamp and smart toaster that it passed. This "mesh network" of devices, Kaevats said, will roll out starting in 2018.

*Is everything O.K. with you?* It's hard to hear about Estonians' vision for the robots without thinking of the people they're blood-sworn to serve. I stayed with Kaevats on the Linnahall for more than an hour. He lit several cigarettes, and talked excitedly of "building a digital society."

It struck me then how long it had been since anyone in America had spoken of society-building of any kind. It was as if, in the nineties, Estonia and the U.S. had approached a fork in the road to a digital future, and the U.S. had taken one path – personalization, anonymity, information privatization, and competitive efficiency – while Estonia had taken the other. Two decades on, these roads have led to distinct places, not just in digital culture but in public life as well.

Kaevats admitted that he didn't start out as a techie for the state. He used to be a protester, advocating cycling rights. It had been dispiriting work. "I felt as if I was constantly beating my head against a big concrete wall," he said. After eight years, he began to resent the person he'd become: angry, distrustful, and negative, with few victories to show.

"My friends and I made a conscious decision then to say 'Yes' and not 'No' – to be proactive rather than destructive," he explained. He started community organizing ("analog, not digital") and went to school for architecture, with an eye to structural change through urban planning. "I did that for ten years," Kaevats said. Then he found architecture, too, frustrating and slow. The more he learned of Estonia's digital endeavors, the more excited he became. And so he did what seemed the only thing to do: he joined his old foe, the government of Estonia.

Kaevats told me it irked him that so many Westerners saw his country as a tech haven. He thought they were missing the point. "This enthusiasm and optimism around technology is like a value of its own," he complained.

"This gadgetry that I've been ranting about? This is not *important*." He threw up his hands, scattering ash. "It's about the mind-set. It's about the culture. It's about the human relations – what it enables us to *do*."

Seagulls riding the surf breeze screeched. I asked Kaevats what he saw when he looked at the U.S. Two things, he said. First, a technical mess. Data architecture was too centralized. Citizens didn't control their own data; it was sold, instead, by brokers. Basic security was lax. "For example, I can tell you my I.D. number – I don't care," he said. "You have a Social Security number, which is, like, a big secret." He laughed. "This does not work!"

The U.S. had backward notions of protection, he said, and the result was a bigger problem: a systemic loss of community and trust.

"Snowden things and whatnot have done a lot of damage. But they have also proved that these fears are justified.

"To regain this trust takes quite a lot of time," he went on. "There also needs to be a vision from the political side. It needs to be there always – a policy, not politics. But the politicians need to live it, because, in today's world, everything will be public at some point."

We gazed out across the blinding sea. It was nearly midday, and the morning shadows were shrinking to islands at our feet. Kaevats studied his basketball sneakers for a moment, narrowed his eyes under his crown of spiky hair, and lifted his burning cigarette with a smile. "You need to constantly be who you are," he said. ■

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# Big Data Meets Big Brother

The Chinese government plans to launch its Social Credit System in 2020. The aim? To judge the trustworthiness – or otherwise – of its 1.3 billion residents.

By Rachel Botsman

On June 14, 2014, the State Council of China published an ominous-sounding document called "Planning Outline for the Construction of a Social Credit System". In the way of Chinese policy documents, it was a lengthy and rather dry affair, but it contained a radical idea. What if there was a national trust score that rated the kind of citizen you were?

Imagine a world where many of your daily activities were constantly monitored and evaluated: what you buy at the shops and online; where you are at any given time; who your friends are and how you interact with them; how many hours you spend watching content or playing video games; and what bills and taxes you pay (or not).

It's not hard to picture, because most of that already happens, thanks to all those data-collecting behemoths like Google, Facebook and Instagram or health-tracking apps such as Fitbit.

But now imagine a system where all these behaviours are rated as either positive or negative and distilled into a single number, according to rules set by the government. That would create your Citizen Score and it would tell everyone whether or not you were trustworthy. Plus, your rating would be publicly ranked against that of the entire population and used to determine your eligibility for a mortgage or a job, where your children can go to school – or even just your chances of getting a date.

A futuristic vision of Big Brother out of control? No, it's already getting underway in China, where the government is developing the Social Credit System (SCS) to rate the trustworthiness of its 1.3 billion citizens.

The Chinese government is pitching the system as a desirable way to measure and enhance "trust" nationwide and to build a culture of "sincerity".

As the policy states, "It will forge a public opinion environment where keeping trust is glorious. It will strengthen sincerity in government affairs, commercial sincerity, social sincerity and the construction of judicial credibility."

Others are less sanguine about its wider purpose. "It is very ambitious in both depth and scope, including scrutinising individual behaviour and what books people are reading. It's Amazon's consumer tracking with an Orwellian political twist," is how Johan Lagerkvist, a Chinese internet specialist at the Swedish Institute of International Affairs, described the social credit system. Rogier Creemers, a post-doctoral scholar specialising in Chinese law and governance at the Van Vollenhoven Institute at Leiden University, who published a comprehensive translation of the plan, compared it to "Yelp reviews with the nanny state watching over your shoulder".

For now, technically, participating in China's Citizen Scores is voluntary. But by 2020 it will be mandatory. The behaviour of every single citizen and legal person (which includes every company or other entity) in China will be rated and ranked, whether they like it or not.

Prior to its national roll-out in 2020, the Chinese government is taking a watch-and-learn approach.

In this marriage between communist oversight and capitalist can-do, the government has given a licence to eight private companies to come up with systems and algorithms for social credit scores. Predictably, data giants currently run two of the best-known projects.

The first is with China Rapid Finance, a partner of the social-network behemoth Tencent and developer of the messaging app *WeChat* with more than 850 million active users. The other, Sesame Credit, is run by the Ant Financial Services Group (AFSG), an affiliate company of Alibaba. Ant Financial sells insurance products and provides loans to small- to medium-sized businesses. However, the real star of Ant is AliPay, its payments arm that people use not only to buy things online, but also for restaurants, taxis, school fees, cinema tickets and even to transfer money to each other.

Sesame Credit has also teamed up with other data-generating platforms, such as Didi Chuxing, the ride-hailing company that was Uber's main competitor in China before it acquired the American company's Chinese operations in 2016, and Baihe, the country's largest online matchmaking service. It's not hard to see how that all adds up to gargantuan amounts of big data that Sesame Credit can tap into to assess how people behave and rate them accordingly.

So just how are people rated? Individuals on Sesame Credit are measured by a score ranging between 350 and 950 points. Alibaba does not divulge the "complex algorithm" it uses to calculate the number but they do reveal the five factors taken into account. The first is credit history. For example, does the citizen pay their electricity or phone bill on time? Next is fulfilment capacity, which it defines in its guidelines as "a user's ability to fulfil his/her contract obligations". The third factor is personal characteristics, verifying personal information such as someone's mobile phone number and address. But the fourth category, behaviour and preference, is where it gets interesting.

Under this system, something as innocuous as a person's shopping habits become a measure of character. Alibaba admits it judges people by the types of products they buy.

"Someone who plays video games for ten hours a day, for example, would be considered an idle person," says Li Yingyun, Sesame's Technology Director. "Someone who frequently buys diapers would be considered as probably a parent, who on balance is more likely to have a sense of responsibility."

So the system not only investigates behaviour – it shapes it. It "nudges" citizens away from purchases and behaviours the government does not like.

Friends matter, too. The fifth category is interpersonal relationships. What does their choice of online friends and their interactions say about the person being assessed? Sharing what Sesame Credit refers to as "positive energy" online, nice messages about the government or how well the country's economy is doing, will make your score go up.

Alibaba is adamant that, currently, anything negative posted on social media does not affect scores (we don't know if this is true or not because the algorithm is secret). But you can see how this might play out when the government's own citizen score system officially launches in 2020. Even though there is no suggestion yet that any of the eight private companies involved in the ongoing pilot scheme will be ultimately responsible for running the government's own system, it's hard to believe that the government will not want to extract the maximum amount of data for its SCS, from the pilots. If that happens, and continues as the new normal under the government's own SCS it will result in private platforms acting essentially as spy agencies for the government. They may have no choice.

Posting dissenting political opinions or links mentioning Tiananmen Square has never been wise in China, but now it could directly hurt a citizen's rating.



But here's the real kicker: a person's own score will also be affected by what their online friends say and do, beyond their own contact with them. If someone they are connected to online posts a negative comment, their own score will also be dragged down.

So why have millions of people already signed up to what amounts to a trial run for a publicly endorsed government surveillance system? There may be darker, unstated reasons – fear of reprisals, for instance, for those who don't put their hand up – but there is also a lure, in the form of rewards and "special privileges" for those citizens who prove themselves to be "trustworthy" on Sesame Credit.

If their score reaches 600, they can take out a Just Spend loan of up to 5,000 yuan (around £565) to use to shop online, as long as it's on an Alibaba site. Reach 650 points, they may rent a car without leaving a deposit. They are also entitled to faster check-in at hotels and use of the VIP check-in at Beijing Capital International Airport. Those with more than 666 points can get a cash loan of up to 50,000 yuan (£5,700), obviously from Ant Financial Services. Get above 700 and they can apply for Singapore travel without supporting documents such as an employee letter. And at 750, they get fast-tracked application to a coveted pan-European Schengen visa. "I think the best way to understand the system is as a sort of bastard love child of a loyalty scheme," says Creemers.

Higher scores have already become a status symbol, with almost 100,000 people bragging about their scores on Weibo (the Chinese equivalent of Twitter) within months of launch.

A citizen's score can even affect their odds of getting a date, or a marriage partner, because the higher their Sesame rating, the more prominent their dating profile is on Baihe.

Sesame Credit already offers tips to help individuals improve their ranking, including warning about the downsides of friending someone who has a low score. This might lead to the rise of score advisers, who will share tips on how to gain points, or reputation consultants willing to offer expert advice on how to strategically improve a ranking or get off the trust-breaking blacklist.

Indeed, the government's Social Credit System is basically a big data gamified version of the Communist Party's surveillance methods; the disquieting *dang'an*.

The regime kept a dossier on every individual that tracked political and personal transgressions. A citizen's *dang'an* followed them for life, from schools to jobs. People started reporting on friends and even family members, raising suspicion and lowering social trust in China. The same thing will happen with digital dossiers. People will have an incentive to say to their friends and family, "Don't post that. I don't want you to hurt your score but I also don't want you to hurt mine."

We're also bound to see the birth of reputation black markets selling under-the-counter ways to boost trustworthiness. In the same way that Facebook Likes and Twitter followers can be bought, individuals will pay to manipulate their score. What about keeping the system secure? Hackers (some even state-backed) could change or steal the digitally stored information.

The new system reflects a cunning paradigm shift. As we've noted, instead of trying to enforce stability or conformity with a big stick and a good dose of top-down fear, the government is attempting to make obedience feel like gaming. It is a method of social control dressed up in some points-reward system. It's gamified obedience.

In a trendy neighbourhood in downtown Beijing, the BBC news services hit the streets in October 2015 to ask people about their Sesame Credit ratings. Most spoke about the upsides. But then, who would publicly criticise the system? Ding, your score might go down.

Alarmingly, few people understood that a bad score could hurt them in the future. Even more concerning was how many people had no idea that they were being rated.

Currently, Sesame Credit does not directly penalise people for being "untrustworthy" – it's more effective to lock people in with treats for good behaviour. But Hu Tao, Sesame Credit's chief manager, warns people that the system is designed so that "untrustworthy people can't rent a car, can't borrow money or even can't find a job". She has even disclosed that Sesame Credit has approached China's Education Bureau about sharing a list of its students who cheated on national examinations, in order to make them pay into the future for their dishonesty.

Penalties are set to change dramatically when the government system becomes mandatory in 2020. Indeed, on September 25, 2016, the State Council General Office updated its policy entitled "Warning and Punishment Mechanisms for Persons Subject to Enforcement for Trust-Breaking".

The overriding principle is simple: "If trust is broken in one place, restrictions are imposed everywhere," the policy document states.

For instance, people with low ratings will have slower internet speeds; restricted access to restaurants, nightclubs or golf courses; and the removal of the right to travel freely abroad with, I quote, "restrictive control on consumption within holiday areas or travel businesses".

Scores will influence a person's rental applications, their ability to get insurance or a loan and even social-security benefits. Citizens with low scores will not be hired by certain employers and will be forbidden from obtaining some jobs, including in the civil service, journalism and legal fields, where of course you must be deemed trustworthy.

Low-rating citizens will also be restricted when it comes to enrolling themselves or their children in high-paying private schools. I am not fabricating this list of punishments. It's the reality Chinese citizens will face.

As the government document states, the social credit system will "allow the trustworthy to roam everywhere under heaven while making it hard for the discredited to take a single step".

According to Luciano Floridi, a professor of philosophy and ethics of information at the University of Oxford and the director of research at the Oxford Internet Institute, there have been three critical "de-centering shifts" that have altered our view in self-understanding: Copernicus's model of the Earth orbiting the Sun; Darwin's theory of natural selection; and Freud's claim that our daily actions are controlled by the unconscious mind.

Floridi believes we are now entering the fourth shift, as what we do online and offline merge into an onlife. He asserts that, as our society increasingly becomes an infosphere, a mixture of physical and virtual experiences, we are acquiring an onlife personality – different from who we innately are in the "real world" alone.

We see this writ large on Facebook, where people present an edited or idealised portrait of their lives.

Think about your Uber experiences. Are you just a little bit nicer to the driver because you know you will be rated? But Uber ratings are nothing compared to Peeple, an app launched in March 2016, which is like a Yelp for humans. It allows you to assign ratings and reviews to everyone you know – your spouse, neighbour, boss and even your ex.

A profile displays a "Peeple Number", a score based on all the feedback and recommendations you receive. Worryingly, once your name is in the Peeple system, it's there for good. You can't opt out.

Peeple has forbidden certain bad behaviours including mentioning private health conditions, making profanities or being sexist (however you objectively assess that). But there are few rules on how people are graded or standards about transparency.

China's trust system might be voluntary as yet, but it's already having consequences.

In February 2017, the country's Supreme People's Court announced that 6.15 million of its citizens had been banned from taking flights over the past four years for social misdeeds.

The ban is being pointed to as a step toward blacklisting in the SCS. "We have signed a memorandum... [with over] 44 government departments in order to limit 'discredited' people on multiple levels," says Meng Xiang, head of the executive department of the Supreme Court. Another 1.65 million blacklisted people cannot take trains.

Where these systems really descend into nightmarish territory is that the trust algorithms used are unfairly reductive. They don't take into account context.

For instance, one person might miss paying a bill or a fine because they were in hospital; another may simply be a freeloader. And therein lies the challenge facing all of us in the digital world, and not just the Chinese.

If life-determining algorithms are here to stay, we need to figure out how they can embrace the nuances, inconsistencies and contradictions inherent in human beings and how they can reflect real life.

You could see China's so-called trust plan as Orwell's *1984* meets Pavlov's dogs. Act like a good citizen, be rewarded and be made to think you're having fun. It's worth remembering, however, that personal scoring systems have been present in the west for decades.

More than 70 years ago, two men called Bill Fair and Earl Isaac invented credit scores. Today, companies use FICO scores to determine many financial decisions, including the interest rate on our mortgage or whether we should be given a loan.

For the majority of Chinese people, they have never had credit scores and so they can't get credit. "Many people don't own houses, cars or credit cards in China, so that kind of information isn't available to measure," explains Wen Quan, an influential blogger who writes about technology and finance. "The central bank has the financial data from 800 million people, but only 320 million have a traditional credit history." According to the Chinese Ministry of Commerce, the annual economic loss caused by lack of credit information is more than 600 billion yuan (£68bn).

China's lack of a national credit system is why the government is adamant that Citizen Scores are long overdue and badly needed to fix what they refer to as a "trust deficit".

In a poorly regulated market, the sale of counterfeit and substandard products is a massive problem.

According to the Organization for Economic Co-operation and Development (OECD), 63 per cent of all fake goods, from watches to handbags to baby food, originate from China.

"The level of micro corruption is enormous," Creemers says. "So if this particular scheme results in more effective oversight and accountability, it will likely be warmly welcomed."

The government also argues that the system is a way to bring in those people left out of traditional credit systems, such as students and low-income households. Professor Wang Shuqin from the Office of Philosophy and Social Science at Capital Normal University in China recently won the bid to help the government develop the system that she refers to as "China's Social Faithful System". Without such a mechanism, doing business in China is risky, she stresses, as about half of the signed contracts are not kept. "Given the speed of the digital economy it's crucial that people can quickly verify each other's credit worthiness," she says.

"The behaviour of the majority is determined by their world of thoughts. A person who believes in socialist core values is behaving more decently." She regards the "moral standards" the system assesses, as well as financial data, as a bonus.

Indeed, the State Council's aim is to raise the "honest mentality and credit levels of the entire society" in order to improve "the overall competitiveness of the country". Is it possible that the SCS is in fact a more desirably transparent approach to surveillance in a country that has a long history of watching its citizens?

"As a Chinese person, knowing that everything I do online is being tracked, would I rather be aware of the details of what is being monitored and use this information to teach myself how to abide by the rules?" says Rasul Majid, a Chinese blogger based in Shanghai who writes about behavioural design and gaming psychology. "Or would I rather live in ignorance and hope/wish/dream that personal privacy still exists and that our ruling bodies respect us enough not to take advantage?"

Put simply, Majid thinks the system gives him a tiny bit more control over his data.

When I tell westerners about the Social Credit System in China, their responses are fervent and visceral. Yet we already rate restaurants, movies, books and even doctors. Facebook, meanwhile, is now capable of identifying you in pictures without seeing your face; it only needs your clothes, hair and body type to tag you in an image with 83 per cent accuracy.

In 2015, the OECD published a study revealing that in the US there are at least 24.9 connected devices per 100 inhabitants. All kinds of companies scrutinise the "big data" emitted from these devices to understand our lives and desires, and to predict our actions in ways that we couldn't even predict ourselves.

Governments around the world are already in the business of monitoring and rating. In the US, the National Security Agency (NSA) is not the only official digital eye following the movements of its citizens. In 2015, the US Transportation Security Administration proposed the idea of expanding the PreCheck background checks to include social-media records, location data and purchase history. The idea was scrapped after heavy criticism, but that doesn't mean it's dead.

We already live in a world of predictive algorithms that determine if we are a threat, a risk, a good citizen and even if we are trustworthy. We're getting closer to the Chinese system – the expansion of credit scoring into life scoring – even if we don't know we are.

So are we heading for a future where we will all be branded online and data-mined?

It's certainly trending that way. Barring some kind of mass citizen revolt to wrench back privacy, we are entering an age where an individual's actions will be judged by standards they can't control and where that judgement can't be erased.

The consequences are not only troubling; they're permanent. Forget the right to delete or to be forgotten, to be young and foolish.

While it might be too late to stop this new era, we do have choices and rights we can exert now. For one thing, we need to be able rate the raters.

In his book *The Inevitable*, Kevin Kelly describes a future where the watchers and the watched will transparently track each other. "Our central choice now is whether this surveillance is a secret, one-way panopticon – or a mutual, transparent kind of 'coveillance' that involves watching the watchers," he writes.

Our trust should start with individuals within government (or whoever is controlling the system). We need trustworthy mechanisms to make sure ratings and data are used responsibly and with our permission. To trust the system, we need to reduce the unknowns. That means taking steps to reduce the opacity of the algorithms. The argument against mandatory disclosures is that if you know what happens under the hood, the system could become rigged or hacked.

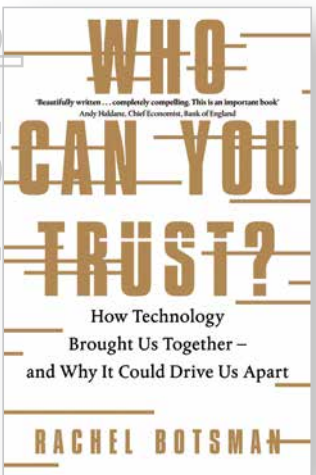
But if humans are being reduced to a rating that could significantly impact their lives, there must be transparency in how the scoring works.

In China, certain citizens, such as government officials, will likely be deemed above the system. What will be the public reaction when their unfavourable actions don't affect their score? We could see a Panama Papers 3.0 for reputation fraud.

It is still too early to know how a culture of constant monitoring plus rating will turn out. What will happen when these systems, charting the social, moral and financial history of an entire population, come into full force? How much further will privacy and freedom of speech (long under siege in China) be eroded? Who will decide which way the system goes? These are questions we all need to consider, and soon. Today China, tomorrow a place near you.

The real questions about the future of trust are not technological or economic; they are ethical.

If we are not vigilant, distributed trust could become networked shame. Life will become an endless popularity contest, with us all vying for the highest rating that only a few can attain. ■




Extracted from WHO CAN YOU TRUST by Rachel Botsman, published by Portfolio Penguin @ £14.99.


Since this piece was written, The People's Bank of China delayed the licences to the eight companies conducting social credit pilots. The government's plans to launch the Social Credit System in 2020 remain unchanged.

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