

## Investment Managers Report

Dear Investor,

I am pleased to write to you as an investor in the Magellan Infrastructure Fund (the 'Fund').

For the six month period ended 31 December 2009, the Fund showed a positive return of 24.5%. This was 8.9% better than the benchmark index for the Fund, the UBS Global Infrastructure & Utilities Net Total Return Index (A\$ hedged), which increased by 15.6%.

The period saw a strong recovery in the share prices of many of the stocks held by the Fund. In particular, the Fund's holdings in the toll road sector were beneficiaries of this trend reflecting their solid, ongoing operational performance over recent periods.

Corporate actions were also a feature of the portfolio stocks during the last six months. The takeover of Macquarie Communications Infrastructure Group (MCG) by the Canada Pension Plan Investment Board was completed during the period, a conditional non-binding offer was made for Transurban Group (and rejected by Transurban Group) and the merger of Cintra and Ferrovial was finalised in December 2009. We believe that the Fund could benefit from further corporate actions over the medium term as pension funds seek to acquire high quality, inflation protected assets at attractive prices.

### PORTFOLIO SUMMARY

As at 31 December 2009, the portfolio consisted of 24 stocks. The composition of the Fund by sector at 30 June 2009 and 31 December 2009 was as follows.

	Portfolio Weight (%)	
	30 June 2009	31 December 2009
Toll Roads – Urban	33.8	35.3
Toll Roads – Inter-Urban	12.6	12.5
Airports and Ports	8.2	13.0
Utilities	22.8	27.2
Communications Infrastructure	4.2	0.0
Other	6.6	4.6
Cash	11.8	7.4
<b>Total</b>	<b>100.0</b>	<b>100.0</b>

The weighting of both utilities and airports and ports increased during the period with the increase achieved by a reduction in both communications infrastructure (as a result of the MCG takeover) and cash holdings.

Toll roads continue to dominate the portfolio, making up almost half the Fund. Intra-urban toll roads make up almost three-quarters of our toll road holdings, as we assess intra-urban roads as being less exposed to economic conditions.

### LONG TERM FUNDAMENTALS DRIVE VALUE

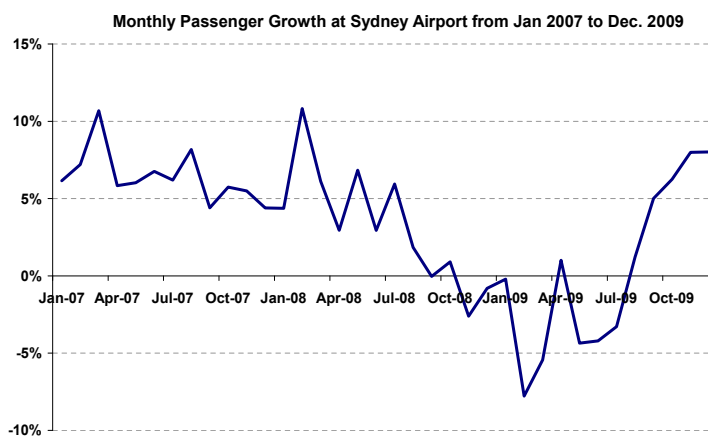
Our investment philosophy is to invest in infrastructure assets where, based on an analysis of fundamental characteristics, we assess a value significantly above the share price. We believe that over time, the share price will reflect the fundamentals affecting the underlying assets. The Fund has made a significant allocation to toll roads and airports and we detail below our views in respect of the impact of fundamentals these key segments of the infrastructure market.

## 1. AIRPORTS

Airports typically offer investors the opportunity to invest in a business which has an effective monopoly over the aviation transport in a particular region. Airports derive revenue by charging passengers a fee for using the airport and by participating in the profits generated from commerce that takes place in the airport (e.g. car parks and retail shops both generate profit from their airport activities and the airport is able to share in this profit).

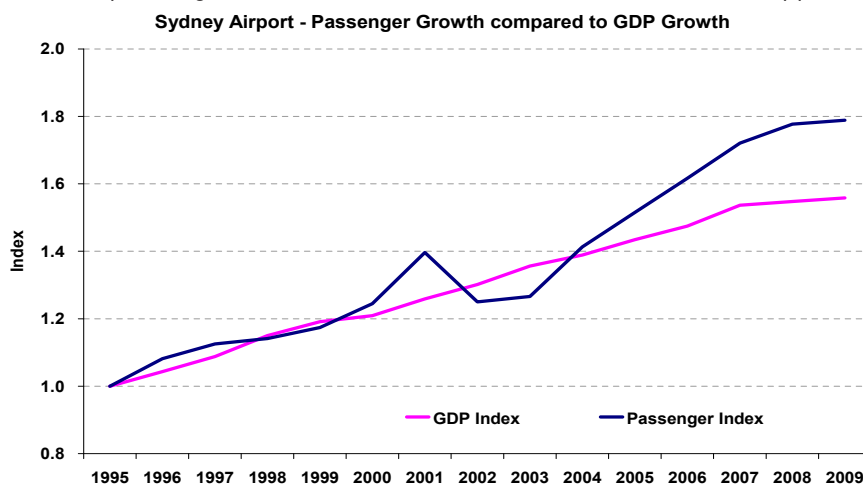
However, in the short-term, an economic recession can affect an airport in two ways: firstly, a decline in economic activity can lead to a reduction in the number of people flying; and secondly, a decline in the amount of money passengers spend in an airport. However, these are short term impacts and, over the long-term, passenger growth can be expected to revert to trend as operating conditions improve.

The following charts will illustrate this phenomenon at Sydney Airport. While Sydney Airport suffered a decline in passenger volumes over 2008 and 2009, the latter half of 2009 witnessed robust growth in passenger volumes. We note that notwithstanding a challenging environment, proactive management of operating costs and a well diversified revenue base enabled it to achieve positive EBITDA results right through this period.



*Monthly passenger growth is measured compared to the same month in the prior year  
Source: Sydney Airport, Macquarie Airports*

As the chart below shows, over the long-term the shorter-term declines in passenger numbers experienced by Sydney Airport as a result of transient conditions have been more than made up by subsequent passenger growth as operating conditions improved. This is symptomatic of many airports around the world and illustrates why short-term share price declines in response to difficult operating conditions can lead to an attractive investment opportunity.



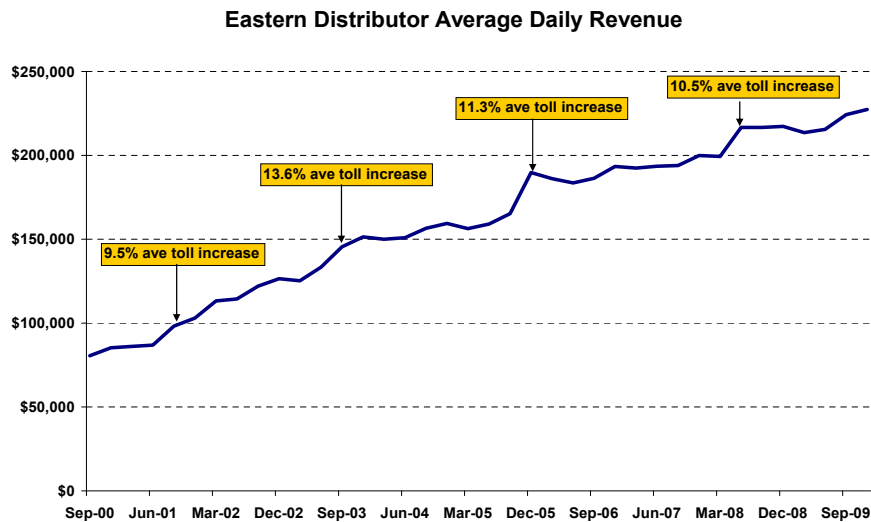
*Source: Sydney Airport, Macquarie Airports, Bloomberg*

The Fund reduced its exposure to the airport sector from 8% of the investment portfolio at 30 June 2008 to 1% at 31 December 2008 but we have now restored the sector to 10% of the Portfolio as investment opportunities we consider to be attractive have become available.

## 2. TOLL ROADS

While the revenue derived by a toll road grows in line with the level of traffic and the prevailing level of tolls, operating expenses are generally a small proportion of total revenues and the requirement for capital expenditure is limited. Hence, the factors that most affect the value of a toll road are the level of traffic using the road and the level of tolls.

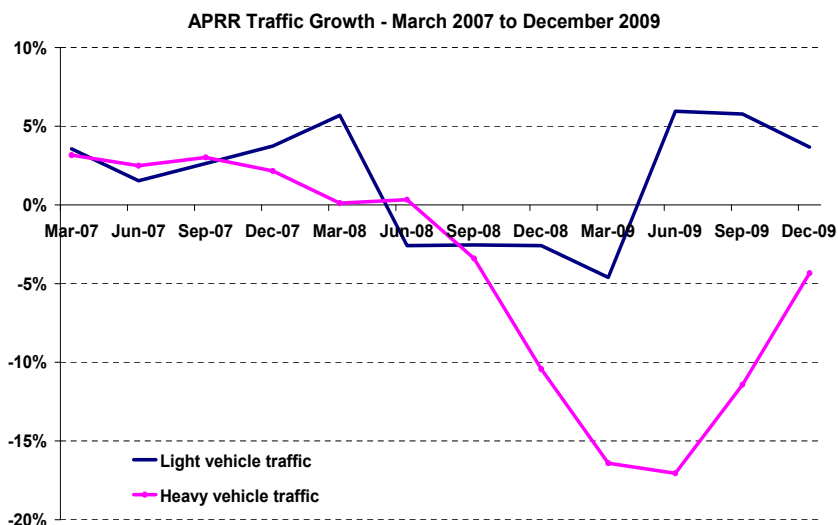
Generally, toll roads have a legally binding agreement with the appropriate government entity that allows them to increase tolls in line with inflation. While typically an increase in price for a good or service can be expected to lead to a reduction in demand, history suggests that an increase in tolls has minimal effect on the level of traffic. For example, as the following graph illustrates the Eastern Distributor in Sydney has increased tolls four times since commencing operations in 2000, increasing tolls by more than 65% of the opening level, and despite this traffic has continued to grow.



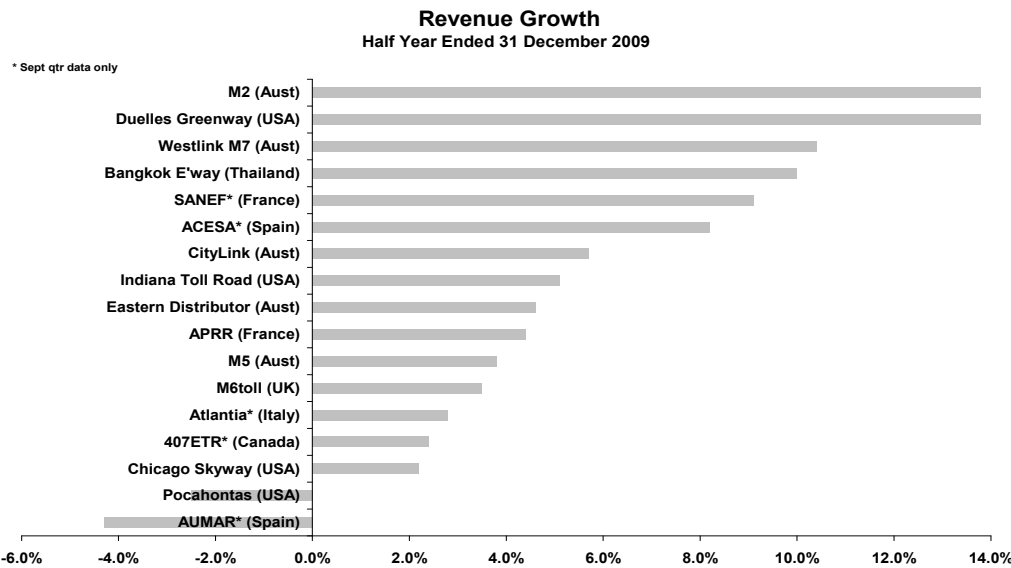
But the Eastern Distributor is an intra-urban road with a low proportion of heavy vehicles – generally around 5%. Intra-urban roads carry traffic within an urban area. Traffic on such roads is dominated by privately owned vehicles rather than commercial vehicles.

In contrast, inter-urban toll roads, as commonly found in Europe, connect two separate urban areas and usually have 15% to 20% heavy vehicles which are used to transport goods and for other commercial purposes. Commercial traffic is more likely than privately owned vehicle traffic to decline in response to an economic downturn. Accordingly, inter-urban roads have more volatile traffic patterns than intra-urban roads. However, in the long-run they generally face attractive traffic dynamics.

As the following graph for French toll road company, APRR, illustrates, recent poor economic conditions had a more significant impact on heavy vehicle usage of the toll road.



Despite the economic downturn, to this point the majority of toll roads we review have continued to grow revenue with toll increases often offsetting falls in traffic. The following chart shows the revenue growth over the half year to 31 December 2009 achieved by a range of toll roads.



At 31 December 2009, toll roads made up 48% of the Fund's investments. The majority of this was invested in intra-urban toll roads as we believe the high proportion of privately owned vehicle traffic on such roads makes their earnings more predictable. It is our view that the long-term prospects for toll roads remain strong and that, at current prices, many listed toll roads offer a compelling investment opportunity.

Our broad investment philosophy and approach has changed little since we launched the fund in mid 2007. We remain focused on assembling a portfolio of what we regard to be outstanding infrastructure companies. We aim to invest in infrastructure companies that possess attractive fundamentals at prices that are at a material discount to our assessment of intrinsic value. The core driver of the Fund – investing in materially mispriced, high quality infrastructure assets with the expectation of holding those assets for 3 to 5 years – has not changed.

Yours Sincerely,



Gerald Stack  
Portfolio Manager - Magellan Infrastructure Fund  
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