MFG Core Infrastructure Fund

(Managed Fund) (Ticker: MCSI)

A low-cost diversified portfolio of 70 – 100 of the world's best Infrastructure companies

Fund Update: 31 March 2021

MFG CORE SERIES

ARSN: 646 028 131
APIR: MGE9182AU

Fund Features

- An actively constructed portfolio of 70 - 100 securities that meet our proprietary definition of infrastructure, rebalanced in a systematic manner
- Highly defensive, inflation-linked exposure
- Investors can buy or sell units on Chi-X like any other listed security or apply and redeem directly with the Responsible Entity

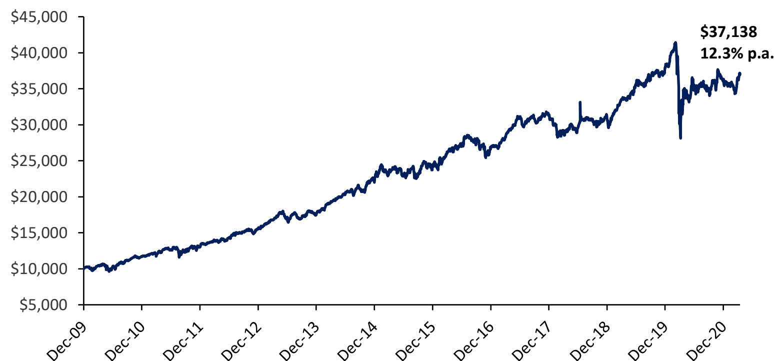
Fund Facts

Portfolio Manager	David Costello
Structure	Global Listed Infrastructure Fund, A$ Hedged
Objective	Achieve attractive risk-adjusted returns over the medium to long term through investment in a diversified exposure to infrastructure securities that meet the Investment Manager's definition of infrastructure.
Inception Date	17 December 2009
Management Fee[1]	0.50% per annum
Buy/Sell Spread[1,2]	0.15%/0.15%
Minimum Investment[2]	AUD$10,000
Fund Size/NAV Price	AUD $431.8 million / $1.5359 per unit
Distribution Frequency	Semi-annually
Chi-X Ticker	MCSI
iNAV tickers	Bloomberg: MCSI AU Equity, MCSIAUIV Index Thomson Reuters: MCSI.CHA, MCSIAUiv.P IRESS: MCSI.CXA, MCSI-AUINAV.NGIF

Visit www.mfgcoreseries.com.au for more information, including: fund performance, unit prices and iNAV, investment insights, PDS & forms

[1]All fees are inclusive of the net effect of GST;
[2]Only applicable to investors who apply for units directly with the Fund

Performance Chart growth of AUD $10,000*



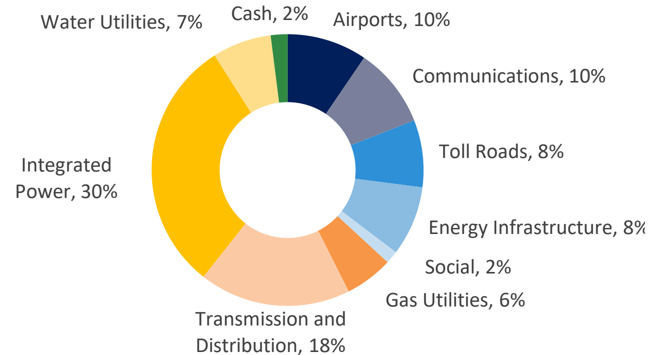
Performance^,*

	Fund (%)	Index (%)**	Excess (%)
1 Month	8.3	5.6	2.7
3 Months	3.1	4.1	-1.0
6 Months	6.5	15.8	-9.3
1 Year	12.7	27.4	-14.7
3 Years (p.a.)	8.3	4.5	3.8
5 Years (p.a.)	6.8	5.7	1.1
7 Years (p.a.)	9.6	6.1	3.5
10 Years (p.a.)	11.6	8.0	3.6
Since Inception (p.a.)	12.3	7.8	4.5

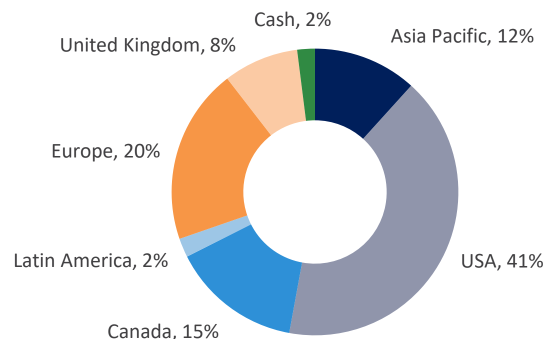
Top 10 Positions

Company	Sector#	%
Cellnex Telecom SA	Communications	3.3
Fortis Inc	Transmission and Distribution	3.0
Enbridge Inc	Energy Infrastructure	2.9
Transurban Group	Toll Roads	2.9
TC Energy Corporation	Energy Infrastructure	2.9
National Grid PLC	Transmission and Distribution	2.9
Vinci SA	Toll Roads	2.7
Sydney Airports	Airports	2.4
American Tower Corporation	Communications	2.2
Aena SME SA	Airports	2.2
	TOTAL:	27.4

Sector Exposure#



Geographical Exposure#



^ The Fund was established on 17 December 2009 as an unregistered managed investment scheme. On 19 November 2020, the Fund's name was changed to MFG Core Infrastructure Fund and on 30 November 2020 the Fund was registered with ASIC as a registered managed investment scheme and became available to retail investors.
* Calculations are based on exit price with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable). Returns denoted in AUD.
** S&P Global Infrastructure Net Total Return Index (A$ Hedged) spliced with UBS Developed Infrastructure and Utilities Net Total Return Index (A$ Hedged). Note: as the UBS Developed Infrastructure and Utilities Net Total Return Index ($A hedged) ceased to be published from 31 May 2015, it was replaced by Magellan on 1 January 2015 with the S&P Global Infrastructure Net Total Return Index (A$ Hedged).
# Sectors are internally defined. Geographical exposure is by domicile of listing. Exposures may not sum to 100% due to rounding.

Fund Commentary

In absolute terms, the portfolio recorded a positive return over the quarter. The key driver of investment performance for the portfolio during the quarter was investors' expectations for inflation and interest rates.

In January and February, the portfolio recorded a negative return, reflecting concerns from investors about potential increases in inflation and consequent increases in prevailing bond rates. The potential increases in inflation and bond rates particularly affected the share prices for regulated utilities, which make up more than 60% of the investment portfolio. Given the regulatory process, whereby increases in inflation and interest rates are typically passed through to consumers, the earnings of regulated utilities should be largely insulated from increases in inflation and bond rates. However, a rise in interest rates can lead to an increase in the discount rate applied by investors, leading to a reduction in value if there is no offsetting increase in cash flows.

In March, comments from central-bank officials, suggesting any increase in inflation was likely to be transient rather than structural, appeared to mollify the concerns of investors about inflation. The share price performance of regulated utilities did well during the month as a result, increasing in local currency terms by an average of approximately 11%. The upshot was the portfolio outperformed for the month.

Our view of regulated utilities during the quarter did not change. We assess utilities as offering reliable, predictable earnings and able to digest moderate inflation and interest rate increases through the regulatory process.

The stocks that contributed the most were the investments in Enbridge and TC Energy Corp of Canada and Vinci of France. Enbridge and TC Energy rose in line with the gain in oil prices over the quarter that made energy the best-performing sector, even though changes in the oil price had little immediate effect on their revenues. Furthermore, TC Energy rose even though President Joe Biden cancelled the Keystone XL oil pipeline project because this move was expected. Vinci, which manages toll roads, rose as the vaccine rollout boosted hopes that travel in Europe might soon return to normal.

Stocks that detracted the most included the investments in Red Eléctrica of Spain, Getlink of France and Transurban. Red Eléctrica, which manages Spain's grid, fell after the utility provided a disappointing investment outlook. Getlink, which operates the Eurotunnel, fell after its full-year result showed that pandemic-related restrictions had shaved 25% off revenue for fiscal 2020. Transurban slid as additional lockdowns were announced in regions in which it operates motorways.

In relative terms, the portfolio underperformed the benchmark index over the quarter. This was due largely to oil prices jumping 20% over the three months. This boosted the oil-price-sensitive stocks that we exclude from our investable universe given the volatility in underlying earnings that comes from commodity-price sensitivity.

Stock story: Severn Trent

Severn Trent is one of the largest regulated water and sewerage companies in the UK, supplying 2.0 billion litres of drinking water and treating 3.2 billion litres of wastewater each day for its 4.6 million customers in the English Midlands and Wales.

The company operates within a transparent and prescriptive regulatory regime, where tariffs are set by the Office of Water Services Regulatory Authority for five-year periods. In accordance with precedent, the regulator fixes tariffs in a manner that allows a standard utility to recover its efficient costs of operations. At the same time, the regulator must ensure that water and sewerage companies can finance their activities; in particular, by securing reasonable returns on their invested capital.

At the review finalised in 2019, the regulator's assessment of a reasonable return on equity for water and sewerage companies was approximately 3.2% p.a., expressed in real (inflation-adjusted) terms – a meagre return, even accounting for the benign risk profile of a utility supplying the most basic of human needs.

Yet closer examination reveals that the regulatory regime can support returns well above what is allowed. For the five years to March 2020 (when the reasonable allowed return was 5.6% p.a.), Severn Trent achieved an average real return on regulatory equity of 8.5% p.a., 2.9% ahead of the regulator's 'baseline' allowance. This outsized return represents the reward for exceptional efficiency and operating performance.

Under the UK's model of incentive regulation, water and sewerage companies can generate excess returns in three ways. The first is by delivering their investment and service package at a lower total cost than the regulator's assessment of what it would cost a notional, efficient utility. The second way is by raising debt at levels below the notional allowance determined by the regulator. The third is by delivering service and environmental improvements under the regulator's 'outcome delivery incentive' framework.

Severn Trent generated excess returns on these parameters during the most recent five-year regulatory period, but it was on the final lever, outcome delivery incentives, that the company excelled.

Through targeted investments in its infrastructure, Severn Trent reduced external sewer flooding events by 48%, cut sewer flooding incidents occurring inside customer homes by 20%, and delivered a 21% reduction in the discharge of pollutants from its treatment plants, securing the company a net reward of 174 million pounds for the five years.[1] In

addition to providing a better experience for the Severn Trent customers, these achievements contributed to restoring the environment, improving the quality of rivers spanning 1,600 kilometres, and enhancing the biodiversity of 244 hectares of land.

With the first year of the current five-year regulatory control period having recently ended, Severn Trent appears poised to again reward investors by delivering improved customer service and a cleaner environment.

In its fiscal third-quarter trading update, the utility noted that it has reduced sewer blockages by 25%, cut pollution incidents by a further 15%, and delivered over 2,200 hectares of enhanced natural environment through its biodiversity program during the year to date. These results prompted management to inform investors to expect net rewards of at least 50 million pounds when the company reports its full-year 2020-2021 results in May.

Sources: Company filings.

[1] Quoted on a pre-tax basis, in real 2012/13 terms, consistent with regulatory convention.

Stock story: Enbridge

Enbridge is North America's leading energy infrastructure company. The Canadian-based company owns liquids pipelines, gas transmission assets, gas distribution networks and renewable generation assets. The company operates the largest liquids pipeline network in North America, transporting about 25% of crude oil produced in the region and serving more than 75% of the region's refineries. Enbridge operates the second-largest gas transmission pipeline network in North America, moving about 20% of the natural gas consumed in the US. In addition, the company operates the largest gas distribution system in North America and owns 1.8 Gigawatts of contracted renewable generation capacity.

About 98% of Enbridge's cash flows are secured by cost-of-service regulation or long-term take-or-pay contracts, which means that less than 2% of the company's cash flow is sensitive to movements in commodity prices. While Enbridge bears volume risk on its cost-of-service regulated pipelines, the company serves some of the most economically advantaged regions and refiners in the world – factors that have delivered consistently high levels of asset use.

Reflecting these helpful characteristics, Enbridge delivered distributable cash flow per share above the mid-point of management's pre-pandemic guidance in 2020, despite the disruption to global energy markets caused by the global health crisis and an oil price war between Saudi Arabia and Russia.

The company has introduced guidance for EBITDA growth of about 6% in 2021, supporting growth in distributable cash flow per share of around 4%. Over the next three years, management expects to deliver growth in distributable cash flow per share of 5% to 7% p.a., with 4% to 5% of annualised growth attributable to the company's C$17 billion secured capital program and a further 1% to 2% of growth generated through cost and productivity levers.

In the longer term, Enbridge will need to navigate the transition to a global economy that is less reliant on fossil fuels – a potentially significant challenge for a business that derived about 97% of group EBITDA from the delivery of crude oil and natural gas last year.

Yet concerns that decarbonisation will erode Enbridge's stable cash flows over the investment horizon appear premature. Virtually all reputable forecasting agencies expect global energy demand to increase to 2040. The International Energy Agency, for instance, forecasts a 7% increase in demand for oil and a 29% increase in demand for natural gas during this period. While much of this demand is likely to emanate from emerging Asian economies, IHS Markit, an energy markets consultancy, forecasts that Canadian oil-sands production will increase by nearly 40% over the next decade, which suggests that demand for Enbridge's liquids pipeline system will remain robust in the medium term.

Enbridge's natural gas transmission and distribution assets are expected to be similarly resilient. Natural gas remains the primary fuel for power generation in the regions served by Enbridge's gas transmission network, a paradigm that is unlikely to change in the medium term, given the long useful lives of electricity-generating fleets and the need to ensure security of supply in an energy market that embeds a growing share of intermittent generation.

The dominance of natural gas as a feedstock for space heating loads in Enbridge's Ontario gas distribution network appears even less likely to be challenged over the investment horizon. Heating a home with natural gas in Ontario is about 60% cheaper than heating with electric appliances, creating a compelling value proposition for households. Moreover, the region's brutal winters see peak demand for natural gas reach levels about three times the existing capacity of the electricity network, implying that full electrification of the system would carry a cost that is unlikely to be accepted by consumers or tolerated by policymakers seeking re-election.

Sources: Company filings.

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