Magellan Global Fund

Fund Update: 31 December 2012

Key Facts

Portfolio Manager
Hamish Douglass

Structure
Global Equity Fund, $AUD unhedged

Inception date
1 July 2007

Management and Administration Fee
1.35%

Buy/Sell Spread[1]
0.10%/0.10%

Fund Size
AUD $2,092.0 million

Performance Fee[1]
10.0% of excess return over the higher of the Index Relative hurdle and the Absolute Return Hurdle (Australian Government 10-year bond yield). Additionally, the Performance Fees are subject to a high water mark.

[1]All fees are inclusive of the net effect of GST

AUD Performance[2]

	Fund %	Index %[3]	Excess Return %
1 Month	0.8	2.4	-1.6
3 Months	2.5	2.7	-0.2
6 Months	8.2	8.0	0.2
1 Year	18.3	14.4	3.9
2 Years (p.a.)	14.0	3.9	10.1
3 Years (p.a.)	10.0	1.9	8.1
4 Years (p.a.)	9.1	1.6	7.5
5 Years (p.a.)	6.7	-4.4	11.1
Since Inception (p.a.)	5.2	-4.7	9.9
Since Inception	32.5	-23.1	55.6

[2]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) Fund Inception 1 July 2007.
[3]MSCI World Net Total Return Index ($AUD)

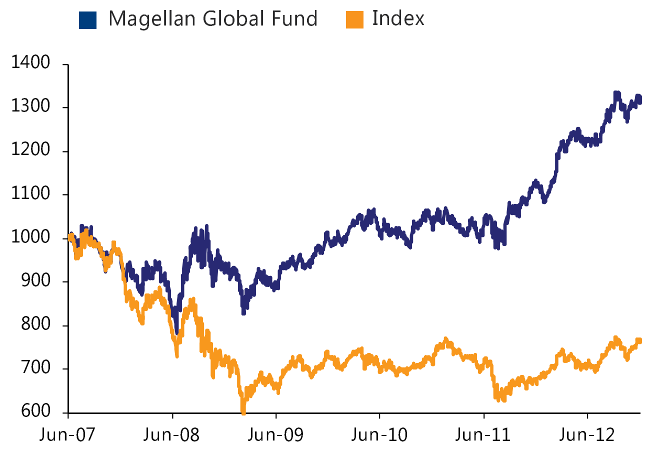
Top 10 Holdings

	Sector	% of Fund
Google Inc	Information Technology	6.6
Novartis	Health Care	6.2
Tesco Plc	Consumer Staples	6.1
Lowe's	Consumer Discretionary	5.6
Yum! Brands Inc	Consumer Discretionary	5.3
Danone	Consumer Staples	4.7
eBay Inc	Information Technology	4.5
McDonald's Corp	Consumer Discretionary	4.5
Visa Inc	Information Technology	4.4
Wal-Mart Stores Inc.	Consumer Staples	4.4

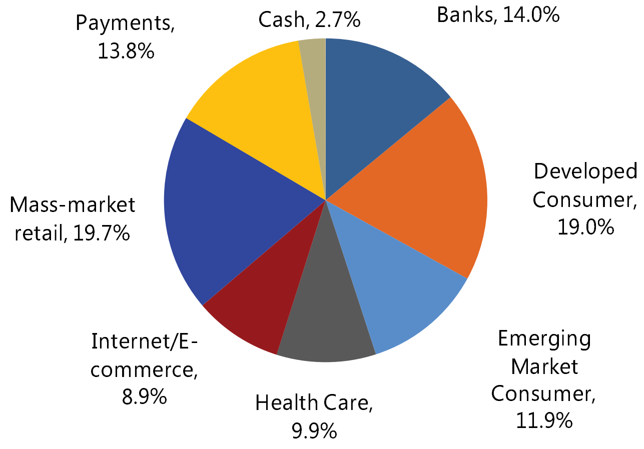
Regional Breakdown

	% of Fund
Multinational[4]	55.6
North America	35.6
United Kingdom	6.1
Australia	0.0
Europe	0.0
Japan	0.0
Asia Ex-Japan	0.0
Cash	2.7
TOTAL	**100**

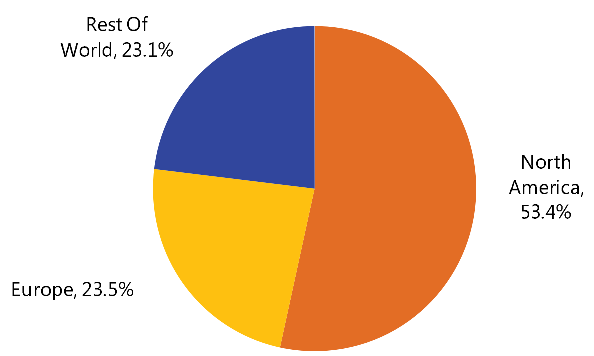
Performance Chart Growth of AUD $1,000 (net of fees)



Industry Exposure by Source of Revenues[5]



Geographical Exposure by Source of Revenues[5]



[4]Multinational: Greater than 50% of revenues outside home country.

[5]Calculated on a look through basis based on underlying revenue exposure of individual companies held within the portfolio.

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Market Commentary

The December quarter saw more stable to rising markets globally. The key drivers were the announcement of further policy measures by the US Federal Reserve, increased confidence that the US will address the "fiscal cliff" and some further progress in Europe. In December, the Federal Reserve announced its intention to purchase at least USD $45 billion of longer dated treasuries each month and its intention to maintain the Federal Funds rate at an exceptionally low level until the US unemployment rate falls below 6.5% but with the proviso that forward inflation expectations do not exceed 2.5%. This followed the announcement by the Federal Reserve in September of its intention to purchase US$40 billion per month of mortgage backed securities until the economy recovers.

In Europe, the Outright Monetary Transaction programme announced by the ECB during the September quarter contributed to the decline in sovereign bond yields for the most affected countries in Europe. In December, the EU Finance ministers announced the Single Supervisory Mechanism (SSM), where the ECB will directly supervise up to 200 Eurozone lenders from early 2014, covering those banks with more than €30 billion in assets; those that have assets equal to or more than 20% of their nation's GDP; or operate in two or more countries. The regulatory and policy framework underpinning the EU banks is critical to breaking the negative feedback loop between sovereigns and their banking systems. While we see this as a positive development there remains significant uncertainty emanating from Europe's ongoing sovereign debt woes. Finally, the successful buy back of €30 billion of Greek government debt has enabled Greece to access the next tranche of EU funding and has resulted in a material decline in Greek bond yields.

Fund Commentary

As at 31 December 2012, the portfolio consisted of 24 investments, with the top ten holdings representing 52% of the portfolio. During the quarter, the portfolio returned +2.5% net of fees against the benchmark return of +2.7%, resulting in underperformance of -0.2%. For the year ended 31 December 2012, the portfolio has returned +18.3% net of fees against the benchmark return of +14.4%, resulting in outperformance of +3.9%.

Over the quarter, within the top ten holdings, the three stocks with the strongest returns in local currency were Lowe's (+18%), Visa Inc (+13%) and eBay (+5%) while the three stocks in the top ten holdings with the weakest local currency returns were Wal-Mart (-7%), Google (-6%) and McDonald's (-3%).

During the quarter, investment exposures to the Developed Consumer were reduced from 22% to 19% (Kraft Foods Group was completely sold down whilst a position in Unilever was trimmed), Mass-market retail increased from 18% to 20%, Banks (specifically US financial institutions) increased from 13% to 14%, Emerging Market Consumer exposures increased from 11% to 12%, Internet/E-commerce decreased from 10% to 9%, while Payments and Health Care exposures remained stable at 14% and 10% respectively.

The portfolio remains fully invested, reflective of our comfort with the current macroeconomic environment and subsequent view that it remains an attractive time to be investing in a select portfolio of high quality multinational companies.

Outlook

We remain focused on prudent portfolio construction with emphasis on the avoidance of aggregation of risk within the portfolio. We feel comfortable with the overall portfolio and believe it is likely to exhibit substantially less downside risk than the market in the event that global markets deteriorate materially.

The portfolio continues to be exposed to the following major investment themes:

- Emerging market consumption growth via investments in multinational consumer franchises.
- The move to a cashless society. There continues to be a strong secular shift from spending via cash and cheque to cashless forms of payments, such as credit cards, debit cards, electronic funds transfer and mobile payments.
- Internet/e-commerce convergence. There are a number of internet enabled businesses that have very attractive investment characteristics with increasing competitive advantages.
- US housing Recovery. A recovery in new housing construction should drive a strong cyclical recovery in companies exposed to US housing and also provide a strong boost to the overall economy.
- US interest rates normalising over the next 3-5 years as the US economy recovers, the Federal Reserve increases the federal deposit rate and begins to reduce the size of its balance sheet.

Key Stock in Focus - McDonald's Corporation

McDonald's is the world's biggest fast food chain, with more than 34,500 McDonald's restaurants worldwide. Over 80% of these restaurants are operated by others, often entrepreneurs, under franchise or licence agreements with the company operating the balance. The business is managed in distinct geographic regions. The U.S. and Europe segments account for about 43% and 37% of operating profits respectively, while the Asia Pacific, Middle East, and Africa markets produce another 19%. McDonald's in Latin America and Canada, less corporate costs, accounts for the balance. Its most important profit markets are the US, France, UK, Germany, Russia, Australia and Japan.

Since 2003 McDonald's has experienced a renaissance as it has re-energised its operations, focussing on maximising the sales from its existing stores and thus improving returns on its capital, rather than emphasising the rollout of new stores. The results of its efforts have been superb, with, as an example, sales per US store rising from $1.6m to $2.5m currently and returns on invested capital across the group almost doubling from 12.7% in 2003 to 23.5% in 2011. Some of the most significant factors behind this were the introduction of breakfast and McCafe, the expansion of the menu to offer a much broader array of menu items and proteins, extension of trading hours to 24hr, addition of drive-thrus where possible, and the upgrading and modernising of store assets.

McDonald's has a tremendous economic moat. It has a significant relative scale advantage over any other player in the segment, owns much of its real estate, which is positioned in prime locations, and has phenomenal worldwide brand recognition.

In 2012, the company, its franchisees, and affiliates should generate roughly $88 billion of systemwide sales globally, from ~$50b in 2004. This compares to about $43B in YUM's systems sales (across 3 brands), $15B by Burger King (and Hungry Jack's) and an estimated $18bn by Subway. Its size gives it buying power when negotiating with suppliers of food and paper inputs and also provides incredible advertising muscle.

The McDonald's brand speaks for itself, especially in one of its most innovative and stronghold markets like Australia. It consistently rates as a top 10 Global brand in major Brand Value surveys such as Interbrand. Importantly, we believe the shift in strategic focus since 2003 has served to strengthen the brand and rebuild its consumer perception.

Due to its perceived image as a restaurant chain serving mass produced and unhealthy food, it is often criticized for promoting obesity. Thus it is trying to change its image by using more natural/healthy ingredients, displaying the calorie content, expanding choice and portion sizes, advertising commercials emphasising the freshness of raw materials and remodeling its restaurants to make them look upscale in order to attract more health-conscious consumers.

After growing at break-neck speed right through the GFC, mainly through an ability to deliver strong growth in sales per store, coupled with some modest growth in store numbers, 2012 has seen the business slow materially. Its long-term financial targets are for average annual System-wide sales and revenue growth of 3% to 5%; average annual operating income growth of 6% to 7%; and annual returns on incremental invested capital in the high teens. These targets exclude the impact of foreign currency translation. It is delivering outcomes well in excess of these and we believe the recent period of weaker results has opened up the gap between the stock's pricing and long term value once again.

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