Fund Update: 31 March 2019

MAGELLAN
EXPERTS IN GLOBAL INVESTING

Magellan Global Fund

ARSN: 126 366 961

Fund Facts

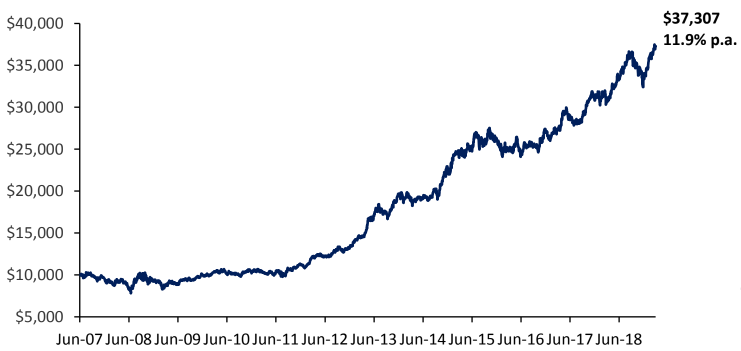
Portfolio Manager	Hamish Douglass
Structure	Global Equity Fund, $AUD unhedged
Inception Date	1 July 2007
Management & Administration Fee[1]	1.35% per annum
Buy/Sell Spread[1]	0.07%/0.07%
Fund Size	AUD $10,383.5 million
Distribution Frequency	Annually at 30 June
Performance Fee[1]	10.0% of the excess return of the units of the Fund above the higher of the Index Relative Hurdle (MSCI World Net Total Return Index (AUD)) and the Absolute Return Hurdle (the yield of 10-year Australian Government Bonds). Additionally, the Performance Fees are subject to a high water mark.

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

Fund Features

- A specialised and focused long-only global equity fund
- Relatively concentrated portfolio of typically 20 to 40 high-quality securities
- Benchmark unaware
- Maximum cash position of 20%
- $10,000 minimum investment amount.

Performance Chart growth of AUD $10,000*



Fund Performance*

	Fund (%)	Index (%)**	Excess (%)
1 Month	3.7	1.5	2.2
3 Months	10.3	11.5	-1.2
6 Months	2.7	-0.8	3.5
1 Year	20.3	12.3	8.0
3 Years (% p.a.)	14.6	13.7	0.9
5 Years (% p.a.)	14.3	12.6	1.7
7 Years (% p.a.)	17.3	15.2	2.1
10 Years (% p.a.)	15.7	12.1	3.6
Since Inception (% p.a.)	11.9	6.1	5.8

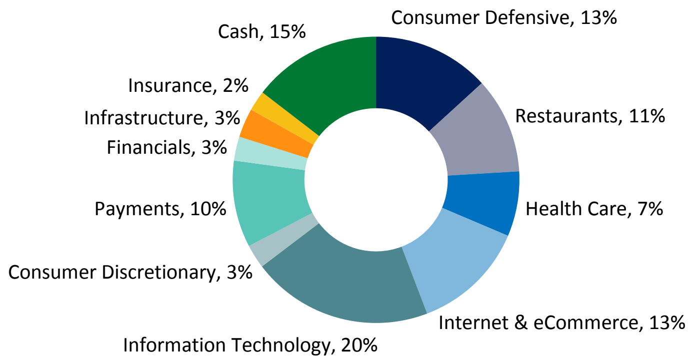
Capital Preservation Measures^

Adverse Markets	3 Years	5 Years	7 Years	10 Years	Since Inception
No of observations	7	17	20	29	43
Outperformance consistency	86%	94%	95%	97%	93%
Down Market Capture	0.7	0.5	0.5	0.4	0.5

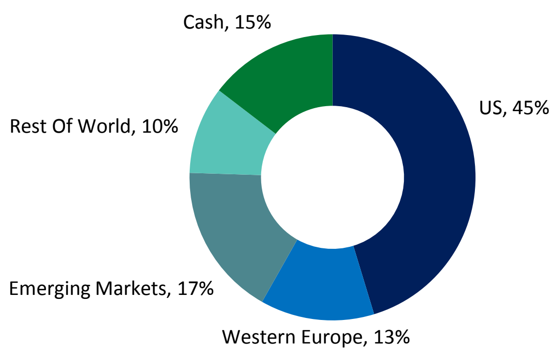
Top 10 Holdings

	Sector#	%
Microsoft Corp	Information Technology	6.8
Alphabet Inc	Internet & eCommerce	6.6
Facebook Inc-A	Internet & eCommerce	6.2
Visa Inc	Payments	5.6
Apple Inc	Information Technology	5.5
Starbucks Corp	Restaurants	5.5
MasterCard Inc	Payments	4.2
SAP SE	Information Technology	4.1
Oracle Corp	Information Technology	4.0
HCA Healthcare Inc	Health Care	4.0
	TOTAL:	52.5

Sector Exposure by Source of Revenue#



Geographical Exposure by Source of Revenue#



* 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. Returns denoted in AUD

** MSCI World Net Total Return Index (AUD)

^ Risk measures are calculated after fees. An adverse market is defined as a negative quarter, rolled monthly, for the MSCI World Net Total Return Index (USD). Down market capture shows if a fund has outperformed a benchmark during periods of market weakness, and if so, by how much.

Sectors are internally defined. Geographical exposure is calculated on a look through basis based on underlying revenue exposure of individual companies held within the portfolio. Exposures may not sum to 100% due to rounding.

Market Commentary

Global stocks staged their best quarterly performance in more than eight years in the three months to March after the Federal Reserve signalled that it no longer held to forecasts it issued in December when it indicated it expected to conduct two rate increases in 2019, the US government delayed increasing tariffs on Chinese imports and reports showed the US economy was expanding at a fast-enough pace. The surge overcame rising doubts over the eurozone economy and uncertainty over the UK's departure from the EU. During the quarter, all 11 sectors rose in US-dollar terms. IT (+20%) and real estate (+16%) rose the most while healthcare (+8.1%) rose the least. The Morgan Stanley Capital International (MSCI) World Index rallied 12%, its best performance since 2010, and surged 11% in Australian currency.

US stocks rose after the Fed repeatedly signalled it didn't expect to pursue the two rate increases it predicted in December that it would enact in 2019. In another shift that was a boost for stocks, the Fed said that by the end of September it would stop reducing its balance sheet that was swollen by three spurts of quantitative easing or asset buying since the financial crisis of 2008. Previously, the Fed said it would reduce its balance sheet to a set timetable. Concerns about trade tensions between China and the US eased after US President Donald Trump said trade talks with China had progressed enough for him to meet Chinese President Xi Jinping to "conclude an agreement". An economic report showed the US economy expanded at an annualised pace of 2.2% in the fourth quarter. In political news, the investigation into Russian interference in the 2016 election headed by Special Counsel Robert Mueller III found that Trump had not colluded with Russia's meddling during the campaign, according to a synopsis that Attorney-General William Barr sent congress. The S&P 500 Index added 13%, its biggest quarterly gain since 2009.

European stocks rose after the European Central Bank indicated it could aid the economy if needed and the central bank announced new cheap loans for banks. Another boost came when the EU granted the UK an extension on its March 29 deadline for leaving the EU so it had more time to work through its divorce. Economic reports showed the eurozone economy is tepid. A key report showed the eurozone economy only grew 0.2% in the fourth quarter, meaning the euro area expanded 1.8% in 2018. The Euro Stoxx 50 Index gained 12%.

In Asia, Japanese stocks rose after a report showed Japan's economy returned to growth in the fourth quarter, when it expanded at an annualised rate of 1.4%. Chinese stocks surged after the People's Bank of China cut reserve requirements for commercial banks to encourage lending, the government applied some fiscal stimulus and trade tensions eased (and on a decision that the MSCI China Index would hold a greater weighting in world indices). Japan's Nikkei 225 Index rose 8.4%. China's CSI 300 Index soared 30%. The MSCI Emerging Markets Index added 10%.

Movements in benchmark indices are in local currency unless stated otherwise.

Fund Commentary

The portfolio recorded a positive return for the March quarter. The biggest contributors included the investments in Facebook, Apple and Microsoft. Facebook surged after higher-than-expected revenue numbers for the fourth quarter of U$16.9 billion showed users and advertisers were sticking with the social media company even though it has been troubled by privacy and other scandals. Apple gained after a sell-off triggered when key suppliers in late 2018 downgraded earnings and cast doubt on demand for Apple products was judged an overreaction. Microsoft rose after releasing quarterly earnings that showed strong growth in cloud revenues.

The two detractors were the investments in Kraft Heinz and Berkshire Hathaway. Kraft Heinz plummeted after the packaged-goods company wrote down the value of underperforming brands by US$15.4 billion, reported earnings that fell short of expectations due to higher costs, and said it was subject to a probe by regulators. Berkshire Hathaway edged down after some of the company's biggest investments lowered revenue expectations.

Stock story: Yum! Brands

Yum! Brands: The force behind the KFC, Pizza Hut and Taco Bell fast-food juggernauts.

In the 1930s, Harland Sanders started cooking for travellers at his service station and motel in Kentucky. In 2017, the company that the honorary Colonel founded sent a chicken sandwich into space to promote KFC outlets, which already attract eight million people a day in the US. In 1958, two brothers borrowed US$600 from their mother and opened a Pizza Hut in Kansas. The chain is now the official pizza sponsor of the NFL and on Super Bowl day this year it sold enough pizzas in the US to cover 41,000 gridiron pitches. In 1962, a Taco Bell opened in California. In 2018, the Mexican-style chain, which publicised its arrival in London by projecting its bell logo over a scaffolded Big Ben and sending out chimes for the under-repair clock, sold 53 million servings of 'nacho fries' in a three-month promotion.

Behind the success of the world's most famous quick-service chicken restaurant, the world's biggest pizza chain and the US's leading Mexican-style franchise sits Yum! Brands. In 2018, the Kentucky-based business generated US$5.7 billion in revenue, mainly from licence fees, from the 48,000 or so KFC, Pizza Hut and Taco Bell restaurants that it franchises, licenses and operates around the world. (These outlets sold about US$49 billion worth of chicken, pizza, tacos and other eatables last year.)

The variety of foods Yum! Brands offers across its three chains mean its outlets can appeal to more customers in different segments than can most single-concept operators – Pizza Hut caters more for restaurant outings while the others are more geared towards takeaway. Another reason for the Yum! Brands success is that 20,500 of its outlets are in fast-growing emerging markets. This number includes 8,200 licensed outlets in China, where 'finger lickin' good' translates into 'eat your fingers off'.

Bold expansion plans and skill at managing franchisees on top of Yum! Brands's marketable and valued brands and worldwide reach mean the company is likely to hold a dominant position in the global fast-food market for years to come. That's what makes it such a promising investment.

Yum! Brands has challenges, of course. Fast food is a competitive industry and Yum! Brands has rivals in every segment. Pizza Hut sales are lagging due to competition from Domino's and Papa John's. It's not easy overseeing such a large business of franchisees either. KFC outlets embarrassingly ran out of chickens in the UK in 2018 when the Yum! Brands supply system failed. The occasional food poisoning issue erupts. A long-lasting challenge that shows no sign of abating is the trend towards healthier eating, which prompted the name change from Kentucky Fried Chicken to KFC as long ago as 1991. Yum! Brands holds a fair bit of debt too.

But Yum! Brands is a solid business with formidable growth opportunities and one that is always striving to appeal to customers and keep franchisees happy. Satisfied patrons and profitable franchisees make for robust returns for the company's investors. The shares of Yum! Brands have set fresh record highs so far in 2019.

Running franchisees

KFC, Pizza Hut and Taco Bell came to be grouped in the same business because soft-drinks giant Pepsi wanted to reduce its reliance on beverages. Accordingly, Pepsi bought Pizza Hut in 1977, Taco Bell the next year and KFC in 1986. In 1997, Pepsi sold (via a listing) its restaurant franchises that went under the name of Tricon before the switch to Yum! Brands in 2002.

Yum! Brands, which has 98% of outlets operating under franchise, sees much growth in the decades ahead. The company's long-term plan is to have 126,000 KFC, Pizza Hut and Taco Bell outlets globally, which would be nearly triple today's number. (The targeted spilt is 60,000 KFC, 48,000 Pizza Hut and 18,000 Taco Bell outlets compared with 23,000, 18,000 and 7,000 outlets respectively today.)

Under a capital-light franchise model that reduces risks associated with higher labour and commodity prices, the success of Yum! Brands is based on sales growth rather than the earnings of outlets. Franchisees can be individual stores or small and larger groups of stores such as Yum China, a US-listed business spun out of Yum! Brands in 2016.

Franchisees rule over their restaurants. They get to set prices, hire staff and manage the supply chain. If successful, franchise operators tend to add more outlets, which boosts the revenue of Yum! Brands. As the franchiser, the role of Yum! Brands consists of day-to-day tasks such as checking on the franchisees. Yum! Brands, for instance, ensures that the décor in the restaurants, the speed of service and the quality of the food meet the required standards.

More-overarching roles include that Yum! supervises menu changes such as Taco Bell's expansion of vegetarian. Others are that Yum! Brands negotiates certain agreements on behalf of franchisees. An example of this includes the recently announced partnership with GrubHub to deliver KFC and Taco Bell in the US. A prominent role is that Yum! Brands in 2018 spent US$131 million to support the brands – the stores paid for another US$1 billion in marketing. Some of what Yum! Brands has spent on marketing in recent years has been directed at the bizarre. KFC, for instance, promotes faux bearskin floor rugs featuring Colonel Sanders's face and markets fire logs that burn with the aroma of KFC fried chicken.

Yum! Brands has a long-term sales growth target of 7% p.a. for systemwide sales, a measure that includes store growth and same-store-sales growth. That's achievable given Yum! Brands's three-pronged strategy to mass market well-known brands enjoyed by millions the world over each day.

Sources: Company filings, Company website and Bloomberg.