Fund Update: 30 September 2017

Magellan Global Fund

ARSN: 126 366 961

Fund Facts

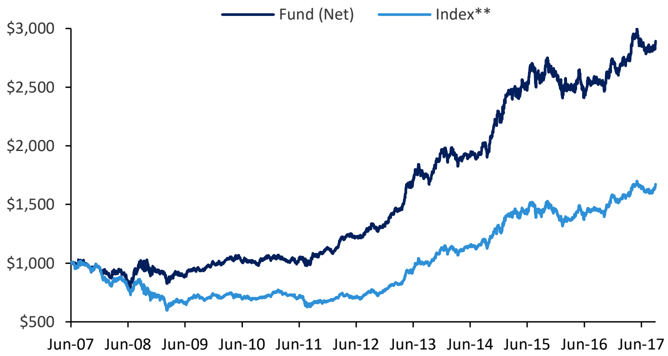
Portfolio Manager	Hamish Douglass
Structure	Global Equity Fund, $AUD unhedged
Inception Date	1 July 2007
Management & Administration Fee[1]	1.35% per annum
Buy/Sell Spread[1]	0.10%/0.10%
Fund Size	AUD $9,065.1 million
Distribution Frequency	Annually at 30 June
Performance Fee[1]	10.0% of the excess return 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 $1,000*



Fund Performance*

	Fund (%)	Index (%)**	Excess (%)
1 Month	1.7	3.4	-1.7
3 Months	1.5	2.5	-1.0
6 Months	5.8	6.0	-0.2
1 Year	13.7	15.2	-1.5
3 Years (% p.a.)	12.6	11.7	0.9
5 Years (% p.a.)	17.5	17.4	0.1
7 Years (% p.a.)	16.6	13.4	3.2
10 Years (% p.a.)	11.4	5.5	5.9
Since Inception (% p.a.)	10.9	5.1	5.8

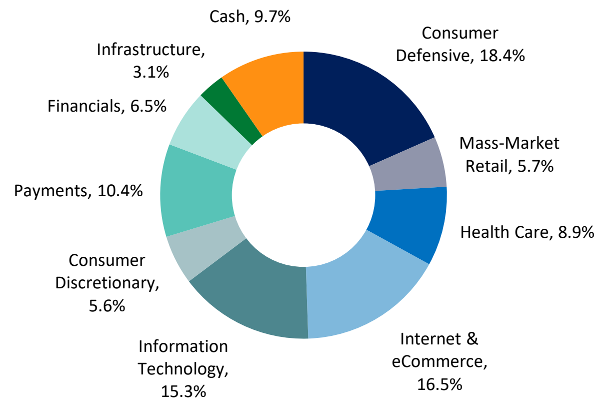
Capital Preservation Measures^

Adverse Markets	3 Years	5 Years	7 Years	Since Inception
No of observations	10	11	19	37
Outperformance consistency	100%	100%	100%	95%
Down Market Capture	0.3	0.3	0.2	0.5

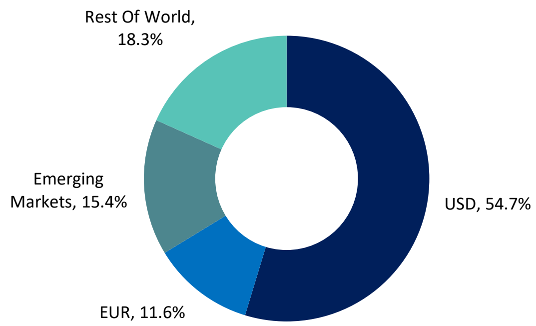
Top 10 Holdings

	Sector#	%
Apple Inc	Information Technology	7.3
Alphabet Inc	Internet & eCommerce	6.5
Facebook Inc-A	Internet & eCommerce	5.9
Lowe's Co Inc	Consumer Discretionary	5.6
Visa Inc	Payments	5.5
Starbucks Corp	Consumer Defensive	4.3
Microsoft Corp	Information Technology	4.2
eBay Inc	Internet & eCommerce	4.2
Wells Fargo & Co	Financials	3.9
Kraft Heinz Co	Consumer Defensive	3.8
	TOTAL:	51.2

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 before fees. An adverse market is defined as a negative quarter, rolled monthly, for the MSCI World Net TR Index in 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.

Market Commentary

Global stocks set record highs as they rose for a sixth straight quarter in the September quarter after US companies posted better-than-expected earnings for the second quarter, reports showed the world's major economies were growing in unison for the first time in a decade, the Federal Reserve reiterated that monetary policy would likely only be tightened gradually and Angela Merkel won a fourth term as chancellor of Germany.

In the US, 73% of S&P 500 companies reported 'positive' earnings-per-share surprises for the second quarter while 'blended earnings growth' reached 10.3%, according to FactSet, as the tech giants shone. In news on the economy, the third reading on second-quarter GDP showed the US economy expanded at an annualised rate of 3.1% over the three months to June, the fastest pace in two years, while the jobless rate stayed around 16-year lows.

In Europe, stocks rose on Merkel's victory and upbeat economic reports such as the one showing the eurozone economy expanded 0.6% in the second quarter, to be 2.3% higher than 12 months earlier.

In other news, Japan's economy grew 1% in the second quarter, its sixth consecutive quarterly expansion, and Prime Minister Shinzō Abe in September called a snap election for October that polls show him winning. In China, the latest readings on industrial production, retail sales and investment disappointed though its economy expanded at a faster-than-expected pace of 6.9% in the 12 months to June.

Ten of the 11 industry classifications within the MSCI World rose in US-dollar terms over the quarter. Energy and materials were the best performers while consumer staples fell.

Fund Commentary

The portfolio recorded a positive return in the quarter. At a stock level, the best performers included investments in PayPal, Visa and Mastercard. PayPal gained after better-than-expected earnings, which delivered 26% growth in total payments volumes including 50% in mobile transactions. Visa rose after its earnings topped analyst expectations for the third straight quarter, aided by outperformance of Visa Europe relative to the expectations held at the time of the acquisition. Mastercard rallied after second-quarter revenue hit a record as volumes and transactions on its network rose.

Stocks that lagged included investments in Kraft Heinz, Starbucks and HCA. Kraft Heinz slid after second-quarter revenue fell more than expected though cost-cutting boosted profit beyond analyst estimates. Starbucks fell amid cautious market commentary as to the outlook for growth in retail traffic and store footprint and the company slightly reduced its annual profit forecast. HCA fell amid uncertainty as to whether or not the ACA repeal bill would be passed given expiration of the budget reconciliation in the month of September.

Key Stock in Focus – Kraft Heinz

KraftHeinz

Kraft Heinz – A leaner consumer brands giant looking to expand

3G Capital is a Brazilian-based private-equity firm with an almost-unparalleled record of improving businesses. The company is now a major shareholder of Kraft Heinz, which it manages. It is intent on making the world's fifth-largest food and beverage group more efficient and even bigger.

3G's owners first built their reputations for enhancing household-name businesses largely through improving and expanding brewing companies. They started with ownership of the Brazilian brewer Brahma in 1989 and by 2016 had formed the world's biggest brewer in Anheuser-Busch InBev, which sells about one in three beers worldwide through brands such as Budweiser, Corona and Stella Artois.

In recent times, 3G expanded into the consumer-packaged-goods industry. In 2013, 3G joined with Berkshire Hathaway to buy HJ Heinz for US$23 billion, which it took private and ran more efficiently. Two years later came an even bigger creation: 3G and Berkshire Hathaway spent US$50 billion to purchase the listed Kraft Foods and merge it with the more-profitable Heinz. 3G owns 24% and Berkshire Hathaway 27% of the group that recorded US$26.5 billion in sales in 2016.

The core strategy of Kraft Heinz is to expand profit margins on its global brands while using the cash generated from these businesses to expand its presence in the consumer-packaged-goods sector, an industry ripe for consolidation.

This dual strategy – improving the profitability of existing lines while looking to expand through takeovers – means that Kraft Heinz is partially insulated from the angst plaguing consumer brands in the age of e-commerce and healthier lifestyles. If the Amazons of the world and better diets reduce the demand for competing brands, these companies may become more attractive takeover targets for Kraft Heinz. As such, Kraft Heinz appears to be entering a future where its products will become more profitable and where it will add more profitable lines. The company's outlook, in short, is for higher earnings in coming years.

Even with 3G in charge, Kraft Heinz has challenges. One problem is that 3G's reputation for using cost-cutting to improve businesses often stokes opposition to its bids, especially from the targets as was shown with Kraft Heinz's failed bid for Unilever this year. The US$143 billion bid for the Anglo-Dutch food and personal care company was abandoned at launch because Unilever painted it as unfriendly.

Another challenge for Kraft Heinz is boosting sales when the consumer-packaged-goods industry's revenue is susceptible to being substituted for private labels and to being overlooked by people who prefer natural and organic foods. Even considering these risks, though, the 3G-led drive to improve profitability and its expansion ambitions make Kraft Heinz an attractive risk-reward proposition for investors.

Long history

HJ Heinz's history goes back to 1869 when Henry John Heinz started selling homegrown horseradish in Pennsylvania. By the time 3G took control of Heinz in 2013, the company was one of the world's most recognised brands. But Heinz was struggling to grow sales.

Kraft's history starts with the entangled story of three US entrepreneurs – James Kraft who started a cheese business in Chicago in 1903, Charles Post who founded a cereal company in Michigan in 1895, and Oscar Mayer who began a meat business in Detroit in 1883. By 2015, Kraft boasted more than 70 major consumer brands including Kool-Aid and Lifesavers and its products were found in nearly all US homes. It too faced challenges at the time.

The merger brought together a company that has eight brands, including Maxwell House, Philadelphia cheese and Planters nuts and the Kraft and Heinz brands, that earn more than US$1 billion in revenue each year.

3G boasts that it is a "strong meritocracy" in that employees must perform or they are out – others would describe the investment firm as a "ruthless meritocracy". Whatever description is more apt, since assembling Kraft Heinz two years ago, 3G has reduced the company's workforce by about 13,000 down to 42,000 workers and closed several plants including iconic ones. On a pro forma basis (assuming Kraft and Heinz were combined from the start of 2014), sales have declined by 9% but operating profits have increased 40% over the past two years, because profit margins have expanded by half to about 28%, well above industry averages of about 16%.

It's this 3G ability to improve the businesses it takes control of plus the potential for takeovers within the consumer-packaged-goods industry that make Kraft Heinz a stock to watch.