

Magellan Global Fund

ARSN: 126 366 961

Fund Facts

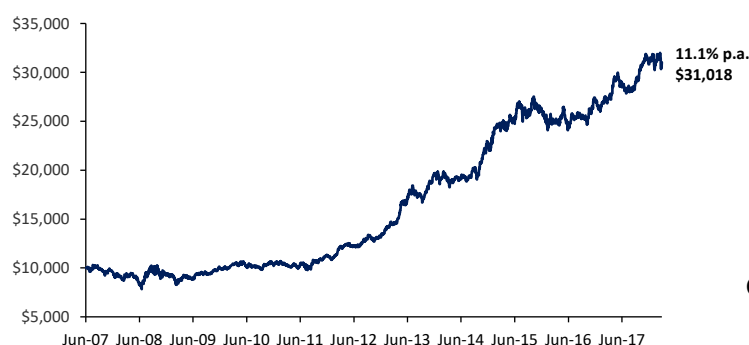
Portfolio Manager	Hamish Douglass
Structure	Global Equity Fund, \$AUD unhedged
Inception Date	1 July 2007
Management & Administration Fee ¹	1.35% per annum
Buy/Sell Spread ¹	0.10%/0.10%
Fund Size	AUD \$9,449.1 million
Distribution Frequency	Annually at 30 June
Performance Fee ¹	10.0% of the excess return 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.

¹All 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	-1.5	-0.6	-0.9
3 Months	0.7	0.7	0.0
6 Months	7.2	6.5	0.7
1 Year	13.5	13.0	0.5
3 Years (% p.a.)	8.0	7.8	0.2
5 Years (% p.a.)	16.2	16.6	-0.4
7 Years (% p.a.)	17.1	13.4	3.7
10 Years (% p.a.)	13.0	7.8	5.2
Since Inception (% p.a.)	11.1	5.5	5.6

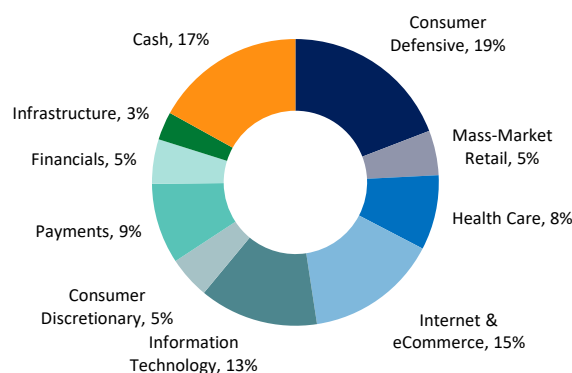
Capital Preservation Measures[^]

Adverse Markets	3 Years	5 Years	7 Years	10 Years	Since Inception
No of observations	9	12	20	34	38
Outperformance consistency	100%	100%	100%	97%	95%
Down Market Capture	0.5	0.3	0.2	0.5	0.5

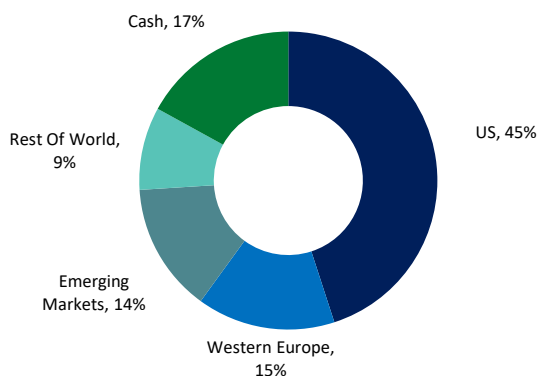
Top 10 Holdings

	Sector [#]	%
Alphabet Inc	Internet & eCommerce	6.6
Facebook Inc-A	Internet & eCommerce	5.6
Visa Inc	Payments	5.3
Starbucks Corp	Consumer Defensive	4.9
Apple Inc	Information Technology	4.8
Lowe's Co Inc	Consumer Discretionary	4.7
Wells Fargo & Co	Financials	4.4
Kraft Heinz Co	Consumer Defensive	4.0
HCA Holdings Inc	Health Care	4.0
MasterCard Inc	Payments	3.8
TOTAL:		48.1

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 Total Return Index (AUD). 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 fell for the first quarter in eight in the March quarter after US President Donald Trump imposed import restrictions that could lead to trade wars (especially with China), concerns mounted that US inflation might accelerate enough to prompt the Federal Reserve to tighten monetary policy more quickly than expected, worries gripped that regulators would crack down on US technology companies, and populist parties dominated in Italy's election. During the quarter, nine of the 11 sectors in the MSCI World Index fell in US-dollar terms. Telecoms (-5.9%) and energy (-5.4%) fell most while information technology fared best (+3.4%).

US stocks slid as concerns mounted about trade wars, the stability of the Trump administration, inflation and tech regulation. The White House imposed tariffs on steel (25%) and aluminium (10%), prompting Trump's top economic adviser Gary Cohn to resign, and targeted China with at least US\$50 billion worth of tariffs. After a report showed accelerating wages growth, investors fretted that fiscal stimulus in the form of corporate tax cuts and extra spending would prompt the Fed to raise the cash rate more than three times in 2018. In March, the Fed raised the US cash rate by 25 basis points to between 1.5% and 1.75%, its highest range since the global financial crisis began, but still flagged only another two rate increases this year. The clouds over tech stocks included concerns about data privacy, and moves by the EU to tax their revenues. Over the quarter, economic reports showed consumer prices rose a higher-than-expected 2.2% in the 12 months to February, the jobless rate stayed at a 17-year low of 4.1% for a fifth consecutive month in February and the US economy expanded a revised 2.9% in the fourth quarter. The S&P 500 Index fell 1.2%.

European stocks fell amid political uncertainty even though economic readings were positive. Investors were concerned about the shape and direction of Italy's next government after eurosceptic and anti-establishment parties won 55% of the popular vote in elections that left the debt-heavy country with a hung parliament. Reports out over the quarter showed the eurozone economy expanded 0.6% in the fourth quarter, consumer prices rose 1.1% in the 12 months to February and industrial production rose 2.7% in January from a year earlier. The Euro Stoxx 50 Index lost 4.1%.

In Asia, Japanese stocks sagged as a cronyism scandal enveloping Prime Minister Shinzō Abe could see him lose a party leadership election this September. Over the quarter, a report showed Japan's economy, after expanding at an annualised rate of 0.5% in the fourth quarter, had notched eight consecutive quarters of growth, the longest such stretch in 28 years. In China, parliament abolished the term limits on the presidency that were installed in 1982, effectively making Xi Jinping ruler for as long as he wishes. Japan's Nikkei 225 Index slumped 6.6% while China's CSI 300 Index fell 3.3%.

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

Fund Commentary

The portfolio recorded a positive return for the quarter. Stocks that performed best included the investments in Mastercard, Visa and HCA Healthcare. Mastercard and Visa gained after the payments companies revealed that fourth-quarter earnings beat estimates – in Mastercard's case, for instance, adjusted earnings per share surged 33% – due to higher consumer spending, and the companies boosted forecasts for 2018. HCA surged after the hospital chain reported a higher-than-expected profit for the fourth quarter on higher revenue and better control of expenses, said it would enjoy a lower effective tax rate of 25%, announced it would pay its first-ever quarterly dividend, and disclosed a US\$10.5 billion investment plan over the next three years.

Stocks that lagged included the investments in Kraft Heinz, Wells Fargo and Facebook. Kraft Heinz dropped after disappointing sales figures in the fourth quarter showed the plight of the US packaged-food industry and margin improvement was below expectations. Wells Fargo slid after the Federal Reserve took the unusual step of banning the bank from expanding its assets until the lender can show it has resolved its "widespread consumer abuses and compliance breakdowns". Facebook slumped after news broke that the data of about 50 million users was improperly gained by a UK company and used to target voters in the US elections of 2016 triggered investigations in the UK and US that pointed to stiffer regulation of tech companies. (In April, the number of users whose data was improperly gained was boosted to 87 million.)

HCA

Hospital Corporation of AmericaSM

HCA Healthcare - The largest US hospital chain is hard to disrupt

Investors have long expected Jeff Bezos's Amazon to move to disrupt the notoriously expensive US healthcare industry in the same way the company has upended retail. Bezos exceeded expectations this year when, in his first foray into healthcare in what is an attempt to reduce Amazon's medical costs, he teamed with investment legend Warren Buffett and the biggest bank in the US.

On January 30, Amazon, Buffett's Berkshire Hathaway and JPMorgan Chase announced they would set up a venture to provide their combined one million workers with "simplified, high-quality and transparent healthcare at reasonable cost".¹

Even though these companies employ relatively few people, stocks for health insurers (or payers in the industry jargon) and other health supply-chain intermediaries dived on the news that such a formidable trio intends to curtail the "ballooning costs of healthcare" that "act as a hungry tapeworm on the American economy," in the words of Buffett.² Among the stocks that plunged that day – some by as much as 9%³ – were health insurers such as Anthem and MetLife and pharmacy-benefit companies such as CVS Health and Express Scripts, which negotiate prescription drug programs for commercial health plans.

But many segments of healthcare were immune to the announcement. Hospital operators were one such subset.⁴ Most of the hospital providers rose slightly that day because running a hospital is such a complex labour-intensive business that few people expect an outside company, no matter how armed with nous, technology and financial muscle, to disrupt these businesses.

Hospitals are hard to run because health and medicine are multifaceted and regulatory requirements are strict. Hospitals require much capital to establish and medical costs are difficult to control, especially as technology improves. They need skilled and expensive staff. Surgeons, who aren't hospital employees, are demanding. Yet they must be kept happy so they conduct their operations at the hospitals seeking their business. Listed hospital operators have the added challenge that about 80% of the market is catered for by not-for-profit ventures and about 50% of these lose money.

From an investor's point of view, the pick of the listed US hospital chains is the largest; HCA Healthcare, which provides about 5% of the country's hospital services. HCA earned revenue of US\$43.6 billion in fiscal 2017 from 46,638 beds in 179 hospitals (including six in the UK), 120 free-standing

surgery centres and about 250 'urgent-care' (after-hours GP) clinics.

HCA is well placed to benefit from rising demand for healthcare as the ageing of the US population increases the incidence of chronic disease. The company's facilities, which each year cater to 26 million patient episodes, eight million emergency visits and 220,000 baby deliveries, have the biggest or second-biggest market shares in 19 of the 20 states where they are found. About half of HCA's hospitals and two-thirds of its beds are in the fastest-growing parts of the US's fastest-growing states.

HCA's other advantages include that it has built the infrastructure to cater for difficult surgeries by the 37,000 doctors who use its facilities. This enables the company to charge high fees and benefit from higher-margin procedures while positioning itself as the hospital of choice in each locality. The company reinvests a sizeable portion of profits to improve standards and expand – it is adding another 100 or so free-standing emergency and urgent-care clinics over the next 12 months. The company enjoys economies of scale and the three parts of its network circulate patients into the other parts of its network. Being part of a well-managed chain gives HCA's facilities strong bargaining positions when dealing with the commercial payers in the health industry, which allows HCA to enjoy industry-leading profit margins. Over time, HCA's expected revenue and profit growth should reward its investors.

While HCA is a low-risk investment from a disruption point of view, it faces other risks that must be monitored. Some are event driven – hurricanes and floods centred on Florida, Georgia, South Carolina and Texas, states where HCA has about half its hospitals, cost the company about US\$140 million in lost revenue in the third quarter of fiscal 2017. The overarching risk, however, is that much uncertainty surrounds the government regulation and funding of the US health system. President Donald Trump and the Republican Party more broadly are undermining the Affordable Health Care for America Act that was passed by former president Barack Obama in 2009 (and thus dubbed 'Obamacare') by making regulatory changes that don't require passing new laws. HCA's advantageous chain of hospitals and other facilities, and the fact that HCA is not dependent on government funding like its peers and is relatively insulated if Obamacare is repealed, mean the company can withstand such uncertainty better than many other healthcare stocks.

More growth and higher fees

In 1968, not long after the US federal government began universal health coverage for the aged and stepped up aid for the poor, HCA began its existence as Hospital Corporation of America after two doctors and two businessmen founded the company to own and operate the Park View Hospital in Nashville, Tennessee. A year later, the company was listed.

The 1970s and 1980s were decades of rapid growth that culminated in the number of hospitals under HCA's control and ownership peaking at 463 in 1987. Then followed management buyouts in 1988 and 2010 (thus two delistings), a merger in 1990, a partial sale in 2010 (of HCA's rural hospitals), and a relisting in 2011.

From an investor point of view, HCA has a sound strategy for enhancing profits in years to come that is based on boosting revenue while controlling costs. Among key strategic goals, the company aims to achieve industry-leading patient outcomes – HCA's hospitals are highly rated for quality on such measures as infection control and admission rates – and is seeking to expand its reach in existing markets. Other goals include enticing the best doctors who can do complex surgeries and to expand prudently in coming years, including via takeovers. To that end, earlier this year, HCA announced it would spend US\$10.5 billion to expand in existing markets over the next three years.

HCA's revenue growth in terms of volume is underpinned by the ageing of the US population, Obamacare's success in widening insurance coverage across the US, and the nine-year economic expansion underway in the US that means more people can pay for healthcare. On a more micro level, HCA seeks to boost revenue by maximising bed usage while minimising hospital stays for each patient. The company is honing its ability to meet the surgery needs of emergency cases and the demand for outpatient surgery. HCA is focused on reducing patient bad debt and lowering the percentage of uninsured patients who are treated free. HCA's strong balance sheet means the company is in prime position to buy hospitals from distressed peers and turn them around operationally. Any acquisitions will provide another fillip for HCA's growth outlook.

In terms of its existing network, HCA's success in boosting revenue by raising prices comes down to three attributes. First, the high quality of HCA's hospitals allows the company to charge higher fees than the non-profit hospitals it competes against in each region. Another is that HCA's size and location in a region give insurers few options when it comes to suggesting alternative private hospital care. Lastly, HCA performs complex procedures at higher cost and superior margins than competitors.

These attributes and advantages mean that HCA is poised to consolidate its position as the largest listed US hospital provider, no matter what Amazon and other disrupters might get up to in healthcare.

¹ Amazon, Berkshire Hathaway and JPMorgan Chase media statement. 'Amazon, Berkshire Hathaway and JPMorgan Chase & Co to partner on US employee healthcare.' 30 January 2018. [berkshirehathaway.com/news/jan3018.pdf](https://www.berkshirehathaway.com/news/jan3018.pdf)

² Amazon, Berkshire Hathaway and JPMorgan Chase media statement. Op cit.

³ MetLife fell 8.6% on 30 January 2018. About US\$30 billion was wiped off the market cap of the 10 largest health insurance and pharmacy stocks within two hours of the announcement from Amazon, Berkshire Hathaway and JP Morgan Chase. Source: Bloomberg

⁴ On 30 January 2018, the stock prices of biggest hospital providers in the US mostly rose. HCA Healthcare rose 3.9%, Universal Health Services added 1.9%, Tenet Healthcare rose 2.5%, Community Health Systems fell 0.2% and LifePoint Health added 2.7%.