Magellan Global Fund

Fund Update: 31 March 2013

Key Facts

Portfolio Manager
Hamish Douglass

Structure
Global Equity Fund, $AUD unhedged

Inception date
1 July 2007

Management and Administration Fee[1]
1.35%

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

Fund Size
AUD $2,686.9 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	1.9	0.5	1.4
3 Months	10.5	7.3	3.2
6 Months	13.2	10.1	3.1
1 Year	19.8	11.1	8.7
2 Years (p.a.)	19.5	5.6	13.9
3 Years (p.a.)	12.4	4.0	8.4
4 Years (p.a.)	14.0	6.7	7.3
5 Years (p.a.)	9.9	-0.5	10.4
Since Inception (p.a.)	6.8	-3.3	10.1
Since Inception	46.3	-17.5	63.8

[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

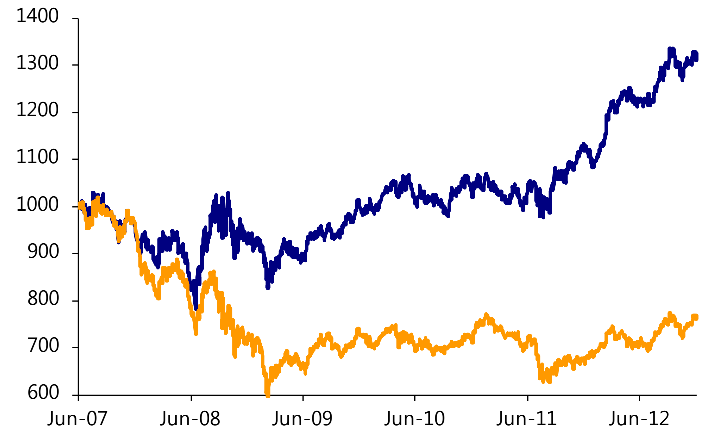
	Sector	% of Fund
Google Inc	Information Technology	6.1
Tesco Plc	Consumer Staples	5.8
Microsoft Corp	Information Technology	5.7
Lowe's	Consumer Discretionary	5.3
eBay Inc	Information Technology	5.2
Yum! Brands Inc	Consumer Discretionary	5.1
Novartis	Health Care	4.8
Target Corp	Consumer Discretionary	4.7
McDonald's Corp	Consumer Discretionary	4.5
Wells Fargo	Financials	4.5

Regional Breakdown

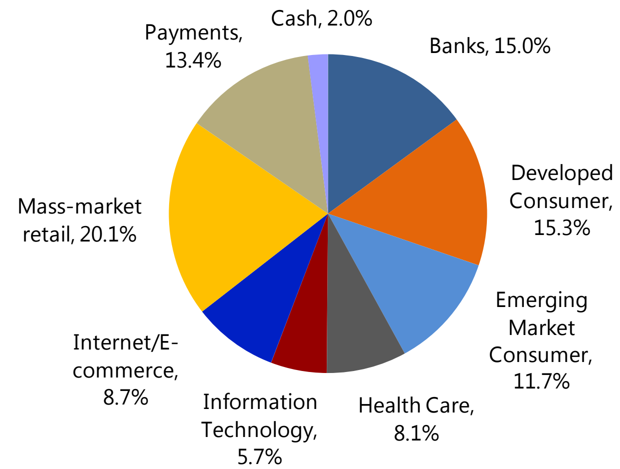
	% of Fund
Multinational[4]	52.8
North America	39.4
United Kingdom	5.8
Australia	0.0
Europe	0.0
Japan	0.0
Asia Ex-Japan	0.0
Cash	2.0
TOTAL	**100**

Performance Chart Growth of AUD $1,000[2]

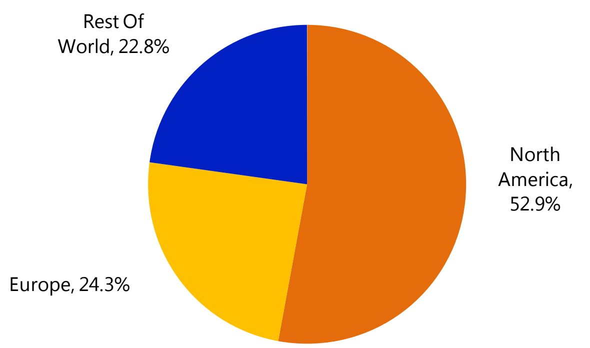
Magellan Global Fund   Index[3]



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

Global markets continued to rally over the quarter as markets re-evaluated the risk of implosion of sovereign credit in Europe and economic data indicated a recovering US economy. Notwithstanding the impasse in Washington over the mandatory expenditure cuts and a way forward to address the longer term fiscal imbalances, the US economy is moving to more stable growth, with labour markets slowly improving, retail sales remaining robust and housing starts continuing to strengthen. In Europe, the ECB has indicated that it will do whatever it takes to ensure the euro survives and it continues to underwrite smooth functioning of the banking system and debt markets. However, this is not sufficient to offset our expectations of years of economic stagnation as governments, banks, households and corporations reduce their debt loads. Indeed, economic data over the quarter revealed contraction in many European countries. Also, the inconclusive Italian election underscores the difficult political road to the structural reforms required across the Eurozone. China is entering a period of slower economic growth as the new administration appears to be intent on re-balancing economy away from the credit driven fixed asset investment and export driven model towards a model more driven by domestic consumption. Lastly, central banks across the world continue to retain their very accommodative low-interest rate policies.

Fund Commentary

As at 31 March 2013, the portfolio consisted of 25 investments, with the top ten holdings representing 52% of the portfolio. During the quarter, the portfolio returned 10.5% net of fees against the benchmark return of 7.3%, resulting in relative outperformance of 3.2%.

Over the quarter, all stocks held within the portfolio produced positive local currency returns. Within the top ten holdings, the three stocks with the strongest returns in local currency were Novartis (+22%), Target Corp (+16%) and McDonalds (+14%) while the three stocks in the top ten holdings with the weakest local currency returns were eBay (+6%), Lowes (+7%) and Microsoft (+8%).

The significant changes to the portfolio during the quarter were the result of active portfolio management regarding relative valuation and opportunity cost. We sold the entire position of General Mills which had appreciated materially since our investment and purchased a new stock, Microsoft which is trading materially below our assessed intrinsic value. The Microsoft position was subsequently increased to the top ten holdings during the quarter.

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 extremely 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.

Within the current macro environment we continue to see value in high quality companies exposed to certain investment themes. Our portfolio has material exposure to the following 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 a 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.

Key Stock in Focus - Target Corporation

Target Corporation is a leading US mass-market discount retailer, with approximately 1,800 stores, online sales via target.com and revenues of $73bn. Target sells general merchandise and groceries, with a strong focus on apparel and home products, and its private label ranges. It has an estimated 2.3% share of US retail sales and ~6% of the more narrowly defined food and general merchandise retail market. (Target in Australia (owned by Wesfarmers) has no relationship with Target US but is modelled on the business and has the rights to use the same bullseye logo.)

Target has been successful in steadily gaining market share in the US by differentiating its offering to appeal to a mid-market, often college-educated customer base who is seeking high quality, on trend merchandise at highly competitive prices. Target has a strongly growing Loyalty discount card, a Target credit card and its Expect More. Pay Less.® brand promise. While its product offering is underpinned by quality basics at low prices, it builds brand equity via limited edition collaborations with celebrities and designers (eg Alexander McQueen, Missoni) as well as seasonal events, which create 'buzz' and fashion credibility.

Target owns 85% of its US stores. While this reduces the return on capital versus leasing, it materially increases its economic moat and sustainability of cash flows and returns. Very recently Target divested its credit card receivables book and will redeploy the $5.8Bn funds received to repay debt and buyback shares on issue. This has further reduced the risks in the business while it continues to earn a large share of the profits from the Target credit card.

With the emergence of online retail, traditional retailers like Target must continue to evolve and meet the challenge. Target is well positioned to compete online given the strength of its brand and strong loyalty boosted by the REDCard program. REDCard, which gives holders a 5% discount on purchases at the checkout, was introduced in recent years to protect the business and leverage the opportunity given its already very loyal customer base. Uptake has been strong and since users shop almost twice as often as other guests and they shop two and a half times more departments per visit, the benefit exceeds the 5% cost. Target's more extensive private label assortment also differentiates its merchandise and reduces price comparison.

In 2011 Target announced its first foray outside of the US, to enter the Canadian market via the purchase of the leasehold interests of the Zellers store portfolio. It closed the stores, renovated most of them and rebranded these Targets. Its first reopenings will occur this quarter, with the aim of having 124 Target stores operating in Canada by year end. Target expects Canada to be earnings accretive by the 4th quarter of 2013 and its growing contribution will help the company to achieve its 2017 goals of $100bn or more in sales, earnings per share of at least $8 and a dividend per share of $3 or more (a compound annual growth rate of 18% from 2012).

With early signs of an upturn in the US consumer environment now appearing, Target should comfortably achieve growth in sales in existing stores of ~2% this year. With modest operating leverage, a further improvement in US sales/store over the next few years and a strong uptick in income and cash flows from the entry of Canada, we believe the outlook for Target is very positive. While TGT has risen 17% since the start of 2013 (3 months) (and much more since we first added it to the portfolio), it remains very attractively priced in our view at 12.5x 2014 PER, a 6.4% free cash flow yield yet delivering, on our estimates, 16% 3 year compound EPS growth.

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