

Magellan High Conviction Fund

ARSN: 164 285 947

Fund Facts

Portfolio Manager	Hamish Douglass and Chris Wheldon
Structure	Global Equity Fund
Inception Date	Magellan High Conviction Fund Class A: 1 July 2013 Magellan High Conviction Fund Class B: 15 November 2017
Management Fee ¹	Magellan High Conviction Fund Class A: 1.50% per annum Magellan High Conviction Fund Class B: 0.78% per annum
Buy/Sell Spread ¹	0.07%/0.07%
Fund Size ²	AUD \$682.3 million
Distribution Frequency	Annually at 30 June
Performance Fee ¹	Magellan High Conviction Fund Class A: 10.0% of the excess return of the units of the Fund above the Absolute Return performance hurdle (10% per annum). Magellan High Conviction Fund Class B: 20% of the excess return of Class B Units above the Absolute Return performance hurdle (10% per annum). The performance fee for Class B Units is subject to a cap of 2.22% per annum. Performance fees are subject to a high water mark.

¹All fees are inclusive of the net effect of GST

²Includes High Conviction Fund Class A and High Conviction Fund Class B units

Fund Features

- Unconstrained, long-only, highly concentrated
- High quality global equity strategy
- High individual stock exposure – 8 to 12 stocks
- Ability to actively hedge currency exposures, currently 53% hedged to AUD[†]
- Maximum cash position of 50%
- \$10,000 minimum initial investment.

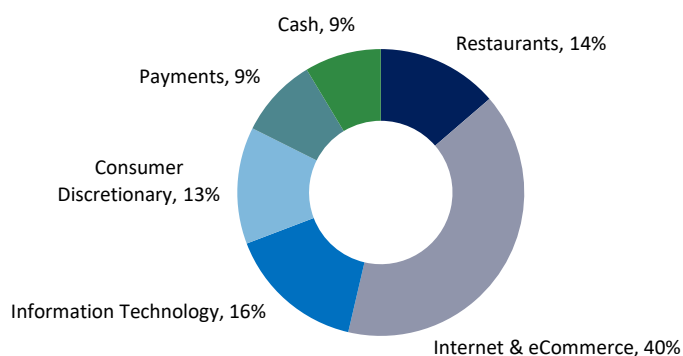
Performance Chart growth of AUD \$10,000



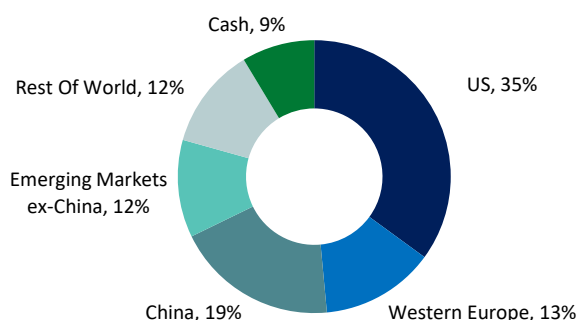
Top 5 Holdings

In alphabetical order	Sector [#]
Alibaba Group Holding Ltd	Internet & eCommerce
Alphabet Inc	Internet & eCommerce
Facebook Inc-A	Internet & eCommerce
Microsoft Corp	Information Technology
Visa Inc	Payments

Sector Exposure by Source of Revenue[#]



Geographical Exposure by Source of Revenue[#]



Fund Performance*

	Magellan High Conviction Fund - Class A (%)	Magellan High Conviction Fund - Class B (%)	Magellan Global Fund (%)	Magellan Global Fund (Hedged) (%)
1 Month	0.8	0.8	-0.9	2.3
3 Months	10.2	9.7	3.1	6.4
6 Months	11.4	11.1	8.2	7.9
1 Year	29.6	29.2	28.1	26.9
3 Years (% p.a.)	18.2	-	17.1	15.6
5 Years (% p.a.)	14.2	-	13.9	11.6
Since Inception (% p.a.)	16.8	15.1	-	-

[†] The Fund is currently exercising its ability to hedge some of the capital component of the foreign currency exposure of the Fund arising from investments in overseas markets back to Australian dollars.

* 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 2013. Magellan High Conviction Class B inception 15 November 2017. Returns denoted in AUD.

[#] 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 rose for a fourth consecutive quarter in the three months to December after the Federal Reserve cut its key rate for the third time in four months to help the US economy extend its growth record well into 2020, China and the US eased up on their trade war, US companies on average reported better-than-expected earnings for the September quarter and the UK election victory for the Conservative party settled that the country would leave the EU and meant the UK avoided the radical policies proposed by Labour. During the quarter, all 11 sectors rose in US-dollar terms. Information technology (+14%) rose the most while real estate (+1.2%) rose the least. The Morgan Stanley Capital International World Index gained 8.6% in US dollars and 4.2% in Australian currency.

US stocks rose to record highs over the quarter. In October, the Fed reduced its key lending rate by a quarter point to between 1.5% and 1.75% and signalled no more imminent reductions. Financial research and data company FactSet said that for the third quarter 75% of S&P 500 companies reported earnings per share above estimates, a 'beat rate' that is above the five-year average of 72%. In December, Chinese and US trade officials justified optimism when they came to a 'phase one' pact on trade that de-escalated a tariff war, notwithstanding that tensions between Beijing and Washington rose when US Congress in November passed almost unanimously a bill compelling Washington to support the protesters in Hong Kong. Economic news released during the quarter was largely upbeat. Reports showed the US economy expanded at 2.1% in the third quarter, US factory production rebounded by 1.1% in November to post its biggest monthly increase in two years, and the jobless rate fell to a 50-year low of 3.5% in September and November. In political news, almost all Democrat lawmakers in the House of Representatives voted to impeach President Donald Trump for abuse of power and obstructing Congress but failed to gain any Republican support during the two votes. Lawmakers in December passed spending measures that avoided a government shutdown as numbers released in October showed the US federal deficit widened to a seven-year high of US\$984 billion in fiscal 2019, the fourth straight annual increase. The S&P 500 Index advanced 8.5%.

European stocks reached record highs on the UK election victory for the Conservatives and signs emerged the eurozone economy had stabilised. In the UK, parliament passed the measures required to ensure the country leaves the EU on January 31. In economic news, the eurozone's GDP rose 0.2% in the third quarter although industrial production fell 0.5% in October from September. The Euro Stoxx 50 Index added 4.9%.

In other markets, Japan's Nikkei 225 Index surged 8.7% on hopes that a fiscal package would help an economy that grew at an annualised rate of just 0.2% in the third quarter. China's CSI 300 Index gained 7.4% as concerns about the economy prompted China's central bank to cut its short-term lending rate for the first time in four years. The S&P/ASX 200 Accumulation Index rose 0.7% as recent rate cuts helped revive the housing market. The MSCI Emerging Markets Index rallied 11.4%.

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

Fund Commentary

The portfolio recorded a positive return in the quarter. The biggest contributors included the investments in Alibaba and Facebook. Alibaba surged after the Chinese conglomerate reported a 40% jump in revenue for the third quarter, its Singles Day online retail promotion reaped a record 268 billion yuan (US\$38.3 billion), and the company raised US\$11 billion via an IPO in Hong Kong. Facebook gained after the social-media company reported higher-than-expected revenue and steady user growth for the third quarter.

All stocks in the portfolio rose in the quarter in US dollars though two stocks, Yum! Brands and Starbucks, detracted in Australian dollars due to the appreciation of the Australian dollar over the period.

Stock story: SAP



Who hasn't heard of 'real-time computing'? It's the achievement that became prevalent in the 1970s that meant computers could process to a deadline rather than be queued for batch processing at a later time. Among those that exploited the development was a German company called *Anwendungen und Produkte in der Datenverarbeitung* that was started in 1972 by five men who foresaw the value that business would place on technology.

Systems Applications and Products in Data Processing, as the name translates into English, or, better still, SAP, has come a long way since its founders, spearheaded by current chairman Hasso Plattner, developed software for real-time data processing that could be sold to many businesses as their central system.

SAP, based in Walldorf near Frankfurt, which earned 25 billion euros in revenue in fiscal 2018, is now one of the world's leading providers of software for businesses. The company's 'enterprise resource planning' software forms the nerve centres of businesses because it runs core 'back office' processes. SAP software manages analytics, customers, financials, human resources, payrolls and supply chains and brings in more than 80% of revenue. A recent focus of SAP's has been to steer clients to cloud-based software. So successful is SAP, the company's software is used by more than 425,000 customers in more than 25 industries and over 180 countries.

Nearly 50 years after its founding, SAP is well positioned for the future for five reasons. The first is that the company enjoys entrenched market positions in core enterprise applications and business intelligence software, especially among large companies in developed countries. These companies are likely to stay with SAP – the company enjoys low annual customer attrition rates – because switching costs are high. Businesses can't easily change software providers because it is tightly coupled with their business processes, often through customisation, and switching to a different software provider is risky and costly.

A second advantage is that SAP software products are world-beaters. They have been honed over time so they can work across departments within a company, throughout industries and in any location. A third advantage is that SAP has built a global sales and support network that few can match. Another plus is that the company enjoys economies of scale in research and development.

Lastly, SAP is well positioned to benefit from the accelerating uptake in cloud computing. These reasons help SAP generate significant excess returns and regular dividends for shareholders. The company, first listed in 1988, is likely to keep its shareholders happy for a while yet.

Challenges remain, of course. SAP faces strong competitors such as Oracle, Workday and Salesforce.com. The company has expanded its cloud portfolio largely through acquisition rather than organically. Executive turnover has been high recently. This was highlighted when CEO Bill McDermott resigned unexpectedly in October after 10 years in the role during which time he effected the drive into cloud computing. (McDermott was replaced by two co-CEOs, which is not an uncommon practice at SAP.)

But SAP didn't become Europe's most valuable tech company by market value without reason. The company has sustainable competitive advantages in growing IT segments that position it well to deliver for investors in coming years.

The cloud spree

SAP enters 2020 with myriad goals. The company wants to push its users onto its next-generation enterprise-resources planning software (called S/4HANA), expand the adoption of its broader software suite, triple its cloud business by 2023 and expand margins. On the latter point, the company is hoping to increase its operating margin, which stood at more than 30% in the second quarter of fiscal 2019, by 100 basis points a year until 2023.

To jumpstart the formation of a formidable cloud business, SAP has spent more than US\$25 billion buying cloud-related companies since 2011. Companies bought include the first target, human-resources-based SuccessFactors for US\$3.4 billion, expense-management firm Concur Technologies of the US for US\$8.3 billion in 2014 and US\$2.4 billion on sales-performance management provider Callidus Software in 2018. The most controversial purchase was the US\$8 billion acquisition in 2019 of Qualtrics International, a US firm that sells customer 'experience-management' software, which SAP hopes will augment its back-office software as well as help it compete with the likes of Salesforce.com.

While SAP faces a challenge in integrating these assets, SAP's cloud computing business is thriving judged on sales numbers – revenue rose 38% (before currency impact) last year to five billion euros. An added impetus for future sales is that in October SAP announced a new three-year partnership with Microsoft. In this arrangement, the company started in 1975 by Bill Gates and Paul Allen becomes a SAP preferred hyperscale partner and will resell SAP Cloud Platform alongside its Azure portfolio.

The tie-up is appropriate in the sense that it links two computing pioneers founded in the 1970s that are still giants of the IT world today.

Sources: Company filings and website, Bloomberg and others were noted.