Fund Update: 31 December 2017

Magellan High Conviction Fund

ARSN: 164 285 947

Fund Facts

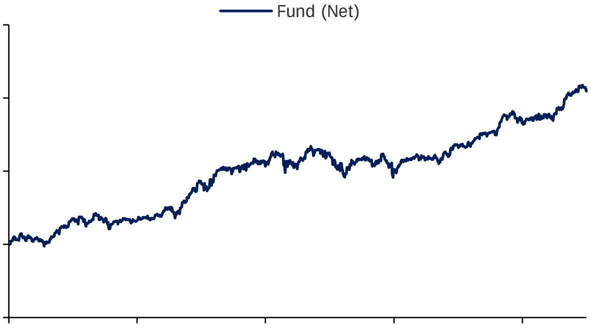
Portfolio Manager	Hamish Douglass
Structure	Global Equity Fund
Inception Date	Magellan High Conviction Fund: 1 July 2013 Magellan High Conviction Fund Class B: 14 November 2017
Management & Administration Fee[1]	Magellan High Conviction Fund: 1.50% per annum Magellan High Conviction Fund Class B: 0.78% per annum
Buy/Sell Spread[1]	0.10%/0.10%
Fund Size[2]	AUD $472.8 million
Distribution Frequency	Annually at 30 June
Performance Fee[1]	Magellan High Conviction Fund: 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.

[1]All fees are inclusive of the net effect of GST
[2]Includes High Conviction Fund 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 46% hedged to AUD†
- Maximum cash position of 50%
- Magellan High Conviction Fund $10,000 minimum initial investment; Magellan High Conviction Fund Class B $100,000 minimum initial investment

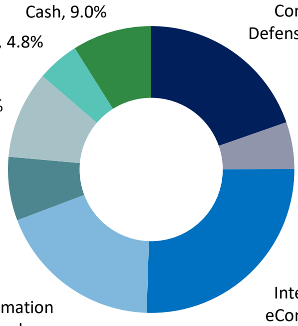
Performance Chart growth of AUD $1,000



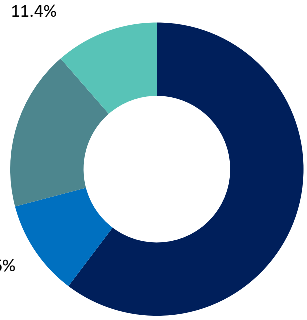
Top 5 Holdings

In alphabetical order	Sector#
Alphabet Inc	Internet & eCommerce
Apple Inc	Information Technology
Facebook Inc-A	Internet & eCommerce
Lowe's Co Inc	Consumer Discretionary
Visa Inc	Payments

Sector Exposure by Source of Revenue#



Geographical Exposure by Source of Revenue#



Fund Performance*

	Magellan High Conviction Fund (%)	Magellan High Conviction Fund Class B (%)	Magellan Global Fund (%)
1 Month	-0.7	-0.7	-1.9
3 Months	8.1	-	6.5
6 Months	11.9	-	8.1
1 Year	23.3	-	14.2
3 Years (% p.a.)	13.2	-	10.9
4 Years (% p.a.)	14.8	-	11.8
Since Inception (% p.a.)	17.2	0.9	

† 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. 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.

Market Commentary

Global stocks set record highs as they rose for a seventh straight quarter in the December quarter as US companies overall posted higher-than-expected earnings, the internet giants surged on strong results and their upbeat outlooks, US Congress slashed the corporate tax rate, the Federal Reserve projected that it would only tighten US monetary policy slowly, and the world's major economies grew in unison for the first time in about a decade. European stocks, however, slid on political uncertainty. Ten of the 11 industry classifications within the MSCI World Index rose in US-dollar terms over the quarter. IT and materials were the best-performing sectors while utilities fell.

US stocks reached unprecedented heights as Amazon, Alphabet and Microsoft were among tech stocks that surged after posting better-than-expected earnings. The biggest rewriting of tax laws since 1986 lowered the corporate tax rate from 35% to 21%. The Fed in December raised the cash rate by 25 basis points to between 1.25% and 1.5% and maintained a projection of three rate increases over 2018. The Fed made its fifth post-crisis rate increase – and third for 2017 – on signs that the US economy is growing at close to capacity. The third reading of GDP showed the US economy expanded 3.2% over the September quarter, a pace not achieved since the first quarter of 2015, while the unemployment rate stayed at a 17-year low of 4.1% in November.

European equities struggled after Chancellor Angela Merkel's Christian Democratic Union of Germany Party was unable to form a coalition after indecisive elections in September, Italy's president in December dissolved parliament and called for elections in March that populist euro-sceptic parties are expected to do well at, and pro-independence parties won a slender majority in elections in Catalonia in December, to leave unresolved the Catalonian drive for independence from Spain.

In Asia, Japanese stocks rose after Japan's Prime Minister Shinzō Abe won a snap general election in October that signalled the country's fiscal and monetary stimulus would continue and Japan's economic expansion reached seven consecutive quarters of growth. In China, stocks rose after the Communist party's 19th congress in October cemented the leadership of Xi Jinping across all levers of the government and a report showed China's economy expanded 6.8% in the September quarter from a year earlier.

Fund Commentary

The portfolio recorded a positive return for the quarter. The largest contributors to performance included the investments in Alphabet and Apple. Alphabet rose after the 32% increase in earnings per share for the third quarter beat consensus by 15%. Alphabet's search business remains dominant globally and this position is enhanced by the shift to mobile. Alphabet is leading the race in artificial intelligence and digital assistants, which presents enormous potential for search monetisation and beyond. In addition, YouTube, Play Store, and Google's cloud businesses are expected to continue to take worthwhile shares of their large global markets for years to come. Apple rose after its higher-than-expected quarterly revenue and profit results showed iPhones remained popular, aided by the 10-year anniversary launch of the iPhone X, and that its services and wearables businesses are performing well.

Over the quarter, the stock that lagged was an investment in Oracle. Oracle slid as guidance for next quarter's cloud-computing sales fell short of estimates. Despite lower-than-expected growth, Oracle has made significant progress transitioning to cloud computing in recent years, particularly in applications, increasing its total addressable market.

Key Stock in Focus – Starbucks

Starbucks – Cafés offering personalised choice that have gone global

Feel like a coffee? At a Starbucks café in the US you could try the Eggnog Latte or the Gingerbread Latte or one of the Frappuccino® cold coffees. If you want a hot chocolate, the choices include the new Toffee Almondmilk or the Snickerdoodle. Prefer a tea? Perhaps you could try the Teavana® Apple Joyful Medley option or the Emperor's Cloud and Mist® Green selection. You can instead opt for a Fizzio™ 'handcrafted' soda. You can grab a bite to eat as well. Whatever you select, your choice is personalised, delivered with a smile in a café with a localised décor that styles itself as a 'neighbourhood gathering place', somewhere to escape home and work. Such is the formula behind the world's largest chain of coffee shops.

From a store in Pike Place Market that overlooks Seattle's waterfront, Starbucks has ballooned into a chain that serves about 90 million customers a week across its 27,339 company-owned and licensed outlets in 75 countries. The company, named after the first mate on the whaler Pequod in Herman Melville's novel Moby Dick, earned revenue of US$22.4 billion in fiscal 2017, up 7% from a year earlier.

The key to the Starbucks juggernaut is the company's success in making people want to come back for the beverages and food in its cafés. To encourage customers to return, Starbucks runs stylish cafés in key locations where people are free to hang around. As eclectic music plays, baristas greet regulars by name and customise their drinks from the vast number of combinations available worldwide. The company is making mobile order and pay widely available to speed up service and it operates the Starbucks Rewards™ loyalty program to give people a financial incentive to order again.

The habitual nature of coffee, Starbucks's loyal customers, their appreciation for Starbuck's as a destination in itself, which limits disruption risk, the company's aggressive focus on expanding its chain, especially in China, its ability to generate healthy same-store-sales growth, a renewed focus on controlling costs, steady product innovation and the prized brand represented by the twin-tailed-siren logo make Starbucks a compelling company from an investor's point of view.

Starbucks has its challenges including that it is part of a competitive industry in which a number of up-starts and established companies are trying to replicate Starbucks' success. The pace of growth slipped in fiscal 2017 when same-store-sales growth only rose 3% compared with 5% in fiscal 2016. However, even allowing for the slower growth rate over the past 12 months, sales growth averaged 10% p.a. over the past four fiscal years while earnings-per-share growth averaged 17% p.a. So the company's operating history is strong and is likely to stay that way.

Growth focus

While Starbucks traces its history to 1971, the pivotal moment occurred 10 years later when Howard Schultz walked into a Starbucks store and tried a cup of Sumatra. Impressed by the operation, Schultz joined a year later to become director of retail operations and marketing. Schultz's vision for Starbucks emerged from a trip to Italy in 1983 when he saw how influential cafés were in Italian community life. In 1984, he convinced the Starbucks founders to mimic the coffeehouse concept and the first Starbucks Caffè Latte was served in Seattle. After leaving Starbucks in 1985 to start an Italian-style coffeehouse named Il Giornale, Schultz returned in 1987 when Il Giornale purchased Starbucks. Total stores at the time numbered 17.

Schultz became chief executive and chair of the revamped Starbucks and infused the chain's cafés with the feel of the Italian coffee bars. While Schultz stepped down as CEO in April of 2017, he remains chairman and owns about 3% of the company that was listed in 1992 when Starbucks had 165 stores.

The company's café chain, which expanded by 2,254 outlets in fiscal 2017, brings in about 90% of the company's revenue while consumer-packaged goods and 'foodservice' (wholesale sales of whole bean and ground coffee etc.) drive the remainder. Away from its cafés, Starbucks's ambitions include gaining a share of the 'at-home coffee' market by selling coffee machines and associated pods, now available from other outlets as well as Starbucks stores. Other revenue comes from ready-to-drink beverages such as Frappuccino® and Starbucks Doubleshot® sold worldwide through channels such as grocery and convenience stores.

Starbucks remains focused on growth, especially in the US and China, and on expanding its profit margins. The company aims to deliver high single-digit revenue growth each year over the long term by driving more volume through existing stores and expanding the global footprint. Its target for earnings-per-share growth is 12% per annum, or better.

Starbucks has robust plans for China, which is its fastest-growing market. It achieved same-store sales of 7% in fiscal 2017 compared with 3% overall and in the US. In fiscal 2018, the company plans to open nearly 600 outlets in China, and recently bought out the partner of its Chinese joint venture that operates around 1,300 stores. When the transaction is completed, the company will control about 2,900 locations in China. As with every Starbucks café, each will offer personalised choice with a smile in a café with localised décor that doubles as a neighbourhood gathering place.