

Magellan Infrastructure Fund (Unhedged)

ARSN: 164 285 830

Fund Facts

Portfolio Manager	Gerald Stack
Structure	Global Listed Infrastructure Fund, A\$ Unhedged
Inception Date	1 July 2013
Management Fee ¹	1.06% per annum
Buy/Sell Spread ¹	0.15%/0.15%
Fund Size	AUD \$1,092.5 million
Distribution Frequency	Semi-annually
Performance Fee ¹	10.0% of the excess return of the units of the Fund above the higher of the Index Relative Hurdle (S&P Global Infrastructure Net Total Return Index (A\$)) 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

- Benchmark-unaware exposure to global listed infrastructure
- Conservative definition of core infrastructure
- Relatively concentrated portfolio of typically 20 to 40 investments
- Typical cash exposure between 0% - 20%
- \$10,000 minimum investment amount.

3 Year Rolling Returns (measured monthly)[^]

Against Global Infrastructure Benchmark ⁺	Last 12 Months	Last 36 Months	Last 60 Months	Since Inception (61 Months)
Average excess return (% p.a.)	2.3	2.4	2.8	2.8
Outperformance consistency	100%	92%	95%	95%

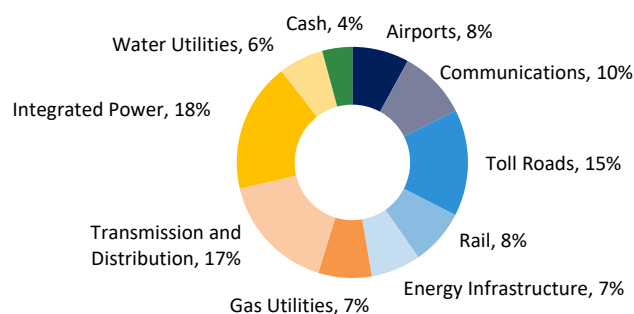
Fund Performance[^]

	Fund (%)	Index (%) ⁺	Excess (%)
1 Month	1.3	1.3	0.0
3 Months	4.3	3.6	0.7
1 Year	3.0	12.1	-9.1
3 Years (p.a.)	4.9	4.1	0.8
5 Years (p.a.)	5.8	5.1	0.7
7 Years (p.a.)	9.3	7.0	2.3
Since Inception (p.a.)	10.9	8.6	2.3

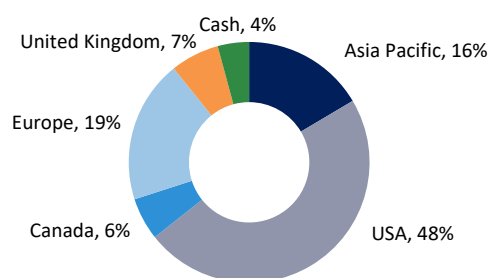
Top 10 Holdings

	Sector [#]	%
Transurban Group	Toll Roads	7.0
Enbridge Inc	Energy Infrastructure	5.7
Sempra Energy	Integrated Power	4.9
Atmos Energy Corporation	Gas Utilities	4.9
Crown Castle International	Communications	4.9
American Tower Corporation	Communications	4.8
Vinci SA	Toll Roads	4.6
Eversource Energy	Transmission and Distribution	4.2
Xcel Energy Inc	Integrated Power	4.1
Red Electrica Corporacion	Transmission and Distribution	3.9
TOTAL:		49.0

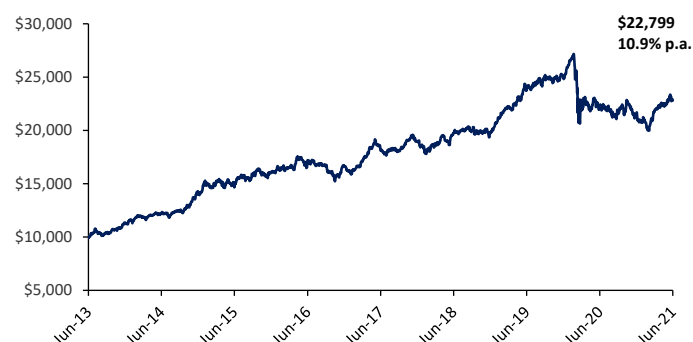
Sector Exposure[#]



Geographical Exposure[#]



Performance Chart growth of AUD \$10,000[^]



[^] 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.

⁺ 3-year returns are calculated and rolled monthly in AUD, with the outperformance consistency indicating the percentage of positive excess returns since inception.

⁺ S&P Global Infrastructure Net Total Return Index (A\$) spliced with UBS Developed Infrastructure and Utilities Net Total Return Index (A\$). Note: as the UBS Developed Infrastructure and Utilities Net Total Return Index (A\$) ceased to be published from 31 May 2015, it was replaced by Magellan on 1 January 2015 with the S&P Global Infrastructure Net Total Return Index (A\$).

[#] Sectors are internally defined. Geographical exposures are by domicile of listing. Exposures may not sum to 100% due to rounding.

Fund Commentary

The portfolio recorded a positive return in the June quarter when utilities was the only sector of 11 in the MSCI World Index to decline in US dollars. In local currency terms, the stocks that contributed the most were the investments in Crown Castle International of the US, American Tower Corp and Transurban of Australia. Crown Castle gained as the owner of 40,000 communications towers and more than 80,000 small cell sites in the US reported solid organic revenue growth of 6.3% for the first quarter, and raised earnings forecasts for the full year due to strong rental revenue and lower borrowing costs. American Tower rose after the company that provides co-location space to wireless carriers across its more than 186,000 communication sites globally announced decent first-quarter earnings and lifted full-year guidance on increased tower use. Transurban climbed after the operator of 21 toll roads in Australia, the US and Canada said that traffic had rebounded to pre-covid-19 levels in areas where pandemic restrictions had been lifted.

In local currency terms, the stocks that detracted the most were the investments in Eversource Energy and WEC Energy of the US and Sydney Airport. Eversource Energy fell after the Connecticut Public Utility Regulatory Authority slammed the utility that through subsidiaries offers electricity, natural gas and water services for its preparation for and response to Tropical Storm Isaias that hit in 2020. In a politically charged decision, the authority found that Eversource did not satisfy relevant performance standards, ordered an indefinite reduction of 90 basis points to subsidiary Connecticut Light & Power's authorised return on equity, ordered the opening of a regulatory docket to consider issuing civil penalties against the subsidiary and foreshadowed the disallowance of certain costs that the authority asserts were imprudently incurred were Eversource to seek recovery. Eversource has indicated it will appeal these findings. WEC Energy, which provides electricity and gas across four Midwest states, slid on concerns that utilities were most vulnerable to any rise in interest rates. Sydney Airport declined as Sydney entered its only second city-wide lockdown since the pandemic struck in early 2020.

In relative terms, the portfolio outperformed the benchmark index over the quarter despite a strong performance from oil-price-sensitive stocks (that we do not consider infrastructure) because strong performance from communications, toll roads and European utilities more than offset the weakness in US utilities.

Stock contributors/detractors are based in local currency terms unless stated otherwise.

Stock Story: Alliant Energy



A US utility that has provided power since the 1920s will likely have some coal-fired generation in its energy mix. However, decarbonisation goals and falling costs of alternative, clean energy sources, such as wind and solar, are driving a shift away from coal-fired power.

Alliant Energy, a near-century-old utility that provides power to nearly one million electricity and 420,000 gas customers in Iowa and Wisconsin, foresaw the demise of coal-fired generation more than a decade ago. Alliant realised that to satisfy climate change goals, it needed to eliminate coal as a source of power.

The utility that earned revenue of US\$3.4 billion in 2020 (85% from electricity and the remainder mainly from gas) set up 'Clean Energy Blueprints' to green its services in the two Midwest states where it operates. The blueprint for Iowa is about building state-of-the-art wind and solar energy capabilities to replace two coal-based facilities. For Wisconsin, the blueprint entails retiring two large coal-fired plants with solar-based assets that will provide clean energy to over 175,000 Wisconsin homes.

Alliant Energy is on track to hit its targeted 50% reduction in carbon emissions by 2030 (on 2005 levels), having achieved a 42% reduction in 2020. Alliant's success to date in reducing emissions seems to have accelerated its ambition to go green faster. Through industry-leading efforts in wind expansion, coupled with plans to add new solar and battery storage, the utility expects that by 2025, half its resource mix will be renewable.

Alliant Energy says it intends to eliminate all coal generation by 2040 but may achieve this feat earlier. Achieving this would help the company meet its aspirational goal of net-zero carbon emissions from the energy it generates by 2050.

Replacing coal-fired generation with cleaner power assets requires capital investment. Alliant Energy is expected to spend US\$5.9 billion from 2021 to 2024 and another US\$7 billion to US\$9 billion in the following five years on going green. Investors may normally be wary of a company that needs to invest vast amounts to upgrade its production facilities to meet modern requirements. To understand why Alliant Energy's spending builds a case for investing in the utility, it helps to understand how utilities are regulated.

The distinguishing aspect of utilities is that they are monopolies in their immediate surroundings because most of their customers have no choice but to buy the essential service they need from the local provider. These utility monopolies operate under the 'regulatory compact'. This means the utility is responsible for serving a particular territory under regulated terms. The utility is required to invest significant amounts of

capital to ensure effective, efficient and reliable service to its customers. In return, the utility has the right to recover its costs and earn a fair rate of return on the capital invested. The regulator defines which costs can be recovered, which assets can be included in the utility's "rate base" (on which it earns a return) and what the fair rate of return on these assets will be.

Capital expenditure is the key driver of rate base growth and hence earnings for US regulated utilities. Therefore, utilities generally seek to maximise capital expenditure. While the regulator encourages this investment to maintain and improve customer service, it also aims to mitigate excessive bill inflation by limiting such investment to prudent spending.

Alliant Energy operates in favourable regulatory jurisdictions where regulators support investment in renewable energy. The company expects to grow its rate base (on which it can earn regulator-approved returns) from about US\$11 billion in 2020 to about US\$14 billion in 2024. About 20% of Alliant Energy's rate base is renewable generation, a percentage that is expected to increase to 24% by 2024.

Another attractive feature of Alliant Energy is that it's a well-run company – witness the effort when the winds of a derecho slammed the US Midwest in August 2020. The largest storm in the company's history left more than 250,000 of its customers without power. Alliant Energy employees, alongside more than 2,000 line and tree-trimming crews from across the US and Canada, in just over a week replaced 3,000 power poles – the equivalent of 10 months of work – to restore power to its customers.

For investors, Alliant has delivered 5% to 7% underlying earnings-per-share growth over the past decade. The utility's green journey has the potential to deliver similar returns in coming years. Alliant Energy is thus a good fit for the infrastructure strategy that seeks to invest in stocks that provide regular income with the potential for some capital growth.

The key risk, inherent in all regulated utilities, is a deterioration in the regulatory environment that leads to lower allowed returns. However, Alliant Energy has a constructive relationship with its regulators and its decarbonisation plans are viewed favourably. An acceleration of electrification in home heating could pose a threat to Alliant's gas distribution network. However, Iowa and Wisconsin experience freezing winters when natural gas heating is still preferred. While alternative electric heating technology will likely improve over time, natural gas appears well supported for some time. In any case, this risk is limited for Alliant given gas distribution represents under 10% of its rate base. Furthermore, Alliant has received favourable regulatory treatment when retiring coal plants in the past, so this precedent bodes well in the potential situation of

forced retirement of gas distribution (or gas-fired generation) assets in the future.

Higher interest rates would add to the cost of Alliant Energy's investment in renewables. All utilities come with the execution risk of how they manage the bills of their customers while they recover the costs of their investments. Cyber attacks are also a risk for utilities but any impact should be short term in nature. Even allowing for these risks, the future is bright for a company that is going green as it approaches its second century.

Sources: Company website, annual report, Bloomberg, Dunn & Bradstreet.

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