MAGELLAN
ASSET MANAGEMENT LIMITED

Annual Investor Report

Magellan Infrastructure | June 2015

- Magellan Infrastructure Fund
- Magellan Infrastructure Fund (Unhedged)

Gerald Stack
Head of Investments and Portfolio Manager
Magellan Infrastructure Fund

Dear Investor,

I am pleased to write to you as an investor in the Magellan Infrastructure Fund (the 'Fund') for the year ended 30 June 2015.

During the 12 months to 30 June 2015 in Australian dollar terms, the Fund delivered a 12.3% return to unit holders, net of fees. This was 4.8% better than the benchmark return of 7.5%.

In July 2015, the Fund paid a distribution of 2 cents per unit in respect of the year ended 30 June 2015. This takes the total distributions paid to unit holders in the Fund in respect of full year 2015 to 2.9 cents per unit.

Our underlying investment philosophy has not changed since we launched the Fund in mid 2007. We seek to buy and hold an investment portfolio of what we regard as outstanding infrastructure companies. We aim to invest in infrastructure and utility companies that possess attractive fundamentals at prices that enable the Fund to achieve attractive risk adjusted returns over a three to five year period.

On 1 July 2013, we launched an unhedged version of the Fund. Over the 12 months to 30 June 2015, the Magellan Infrastructure Fund (Unhedged) ('MIFU') returned 20.1%, net of fees, which is 2.3% better than the benchmark return of 17.8%.

Portfolio Strategy

Generally, infrastructure assets are natural monopolies that provide an essential service to the community. Over time, the stable, reliable earnings of infrastructure assets are expected to lead to a combination of income and capital growth for investors.

The universe of infrastructure assets that we consider for the Fund is made up of two main sectors:

• **Utilities**, including both regulated Energy utilities and Regulated Water utilities. We estimate that utilities comprise more than 60% of the potential investment universe for the Fund. Utilities are typically regulated by a government sponsored entity. Such regulation requires the utility to efficiently provide an essential service

[1]The Global Infrastructure benchmark is comprised of the following: from inception to 31 December 2014 the benchmark is UBS Developed Infrastructure & Utilities Index NTR Index and from 1 January 2015 onwards, the benchmark is the S&P Global Infrastructure NTR Index.

to the community and, in return, earn a fair rate of return on the capital it has invested; and

- **Infrastructure**, which includes Airports, Ports, Toll Roads, Communications Assets and Energy Infrastructure (oil & gas pipelines). Regulation of infrastructure companies is generally less intensive than for utilities and allows companies to accrue the benefits of volume growth. As economies develop, grow and become more inter-dependent, we expect the underlying levels of aviation, shipping and vehicle traffic to increase as will demand for all forms of communications and energy.

Both utility and infrastructure companies provide an essential service while facing limited (if any) competition, and, because the service is essential, the price charged for the service can be adjusted with limited impact upon demand volumes. As a consequence, earnings are more reliable than those for a typical industrial company and generally enjoy inherent inflation protection.

Portfolio Summary

The Fund's investment portfolio has been constructed to reflect the most attractive investment opportunities that meet our qualitative criteria while also minimising the risk of permanent capital loss. As at 30 June 2015, the Fund's portfolio consisted of 28 investments (in comparison with 30 investments at 30 June 2014). The top ten investments represented 57.6% of the portfolio at 30 June 2015 compared with 58.2% a year previously.

The Fund also held approximately 10% in cash as at 30 June 2015, up from approximately 3% a year ago. The decision to hold such a material part of the portfolio in cash (which mirrors a similar strategy adopted by the Magellan Global Fund) reflects Magellan's view that markets will become increasingly volatile as we move closer to the US Federal Reserve increasing interest rates and as the crisis in Greece unfolds. This level of cash will allow us to move quickly to take advantage of buying opportunities that may consequently arise. Indeed, we took advantage of the selloff in the last two days of the financial year to increase our holding in one of the Fund's key stocks.

The composition of the Fund by sector at 30 June 2013, 2014 & 2015 was as shown in figure 1.

Over the course of the year, we have found utilities in the better performing economies of the world, effectively the most defensive infrastructure investment opportunities, to have become progressively more expensive. Accordingly, we have reduced the Fund's exposure to Regulated utilities in the US and UK and increased the Fund's exposure to Communications Infrastructure stocks and also increased our cash holding. The three Communications sector exposures included two European satellite companies owning perpetual rights to the key geostationary positions for satellites broadcasting television directly to homes throughout Europe and a company that owns more than 40,000 towers for the rebroadcasting of mobile phone telephony in the US.

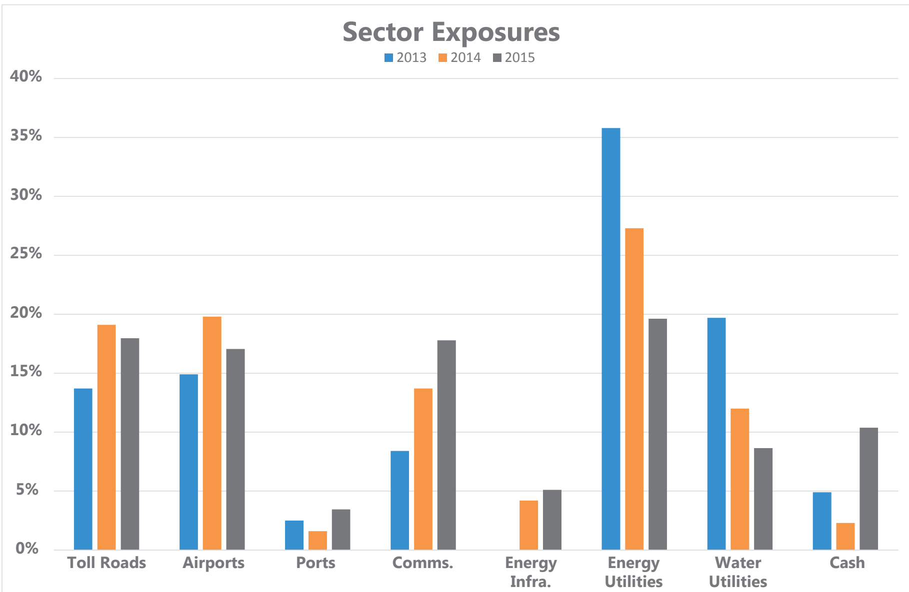
You will note the marked reduction in utilities over the last two years (28% today compared with 56% at 30 June 2013). This reflects utilities becoming expensive relative to other investment opportunities over the period with US utilities, in particular, exhibiting markedly higher prices as a result of the increased appetite for their defensive nature and relatively high yield. The reduction in the utilities weight despite our expectation of increased volatility reflects our view that the greatest risk to markets is rising US interest rates (and thus a decline in pricing), rather than a cyclical macro-driven downturn (and thus a decline in earnings). Notwithstanding this, we do envisage that increases in Treasury yields will cause volatility in the prices of some utilities (as they did in the 'taper tantrum' of 2013) at which point we will appraise their relative attractiveness and potentially seek to reintroduce them to the portfolio.

This move in portfolio exposures to utilities proved beneficial as the average return from Utility stocks held in the Fund during Full Year 2015 was only 2.7% compared to 17.4% for Non-Utility stocks.

The composition of the portfolio by geography at 30 June 2014 and 30 June 2015 was as shown in figure 2.

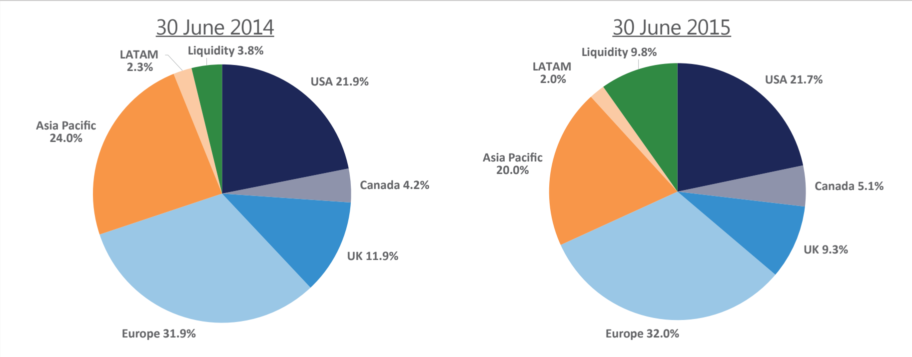
The top performing stocks in the Fund during the year were Zurich Airport (which delivered a Total Shareholder

Figure 1: Composition of the Fund by Sector.



Source: Magellan Asset Management Limited

Figure 2: Composition of the Fund by Geography.



Source: Magellan Asset Management Limited

Return (TSR) of 35.2%), Auckland Airport (TSR of 32.7%), Australian Toll Road company Transurban, which was also the Fund's largest holding during the year, (TSR of 31.8%), oil & chemical tank storage company Vopak (TSR of 29.1%) and Sydney Airport (TSR of 24.0%). Nine of the ten worst performing stocks in the portfolio were US utilities, although only three delivered negative returns for the year.

A Reflection on the Last Five Years

As we have discussed in previous investor letters, there is no universally agreed definition of what is or is not an infrastructure asset. Therefore, every manager needs to define their investment universe as the first step in building a portfolio. Magellan uses what most asset consultants and research houses judge to be the most conservative definition of the term infrastructure of all listed infrastructure managers globally. Magellan refers to the universe of stocks meeting our definition as the Magellan Core Infrastructure Index. The graphs in figure 3 and 4 use the performance of stocks included in this index to review the key trends over the last five years.

Over the last 5 years, the Magellan Core Infrastructure Index returned 18.4% per annum before fees (compared to a before fee return from the Magellan Infrastructure Fund of 19.8% per annum). The following graph shows returns by sector over this period (which we calculate by taking the average local currency return of the stocks in that sector). The key observations to be made from this data are:

- As we would expect, the returns from the Utility sectors were more consistent than the non-Utility sectors
- The higher returning non-Utility sectors were led by the Airports sector which returned 25% pa over the period.

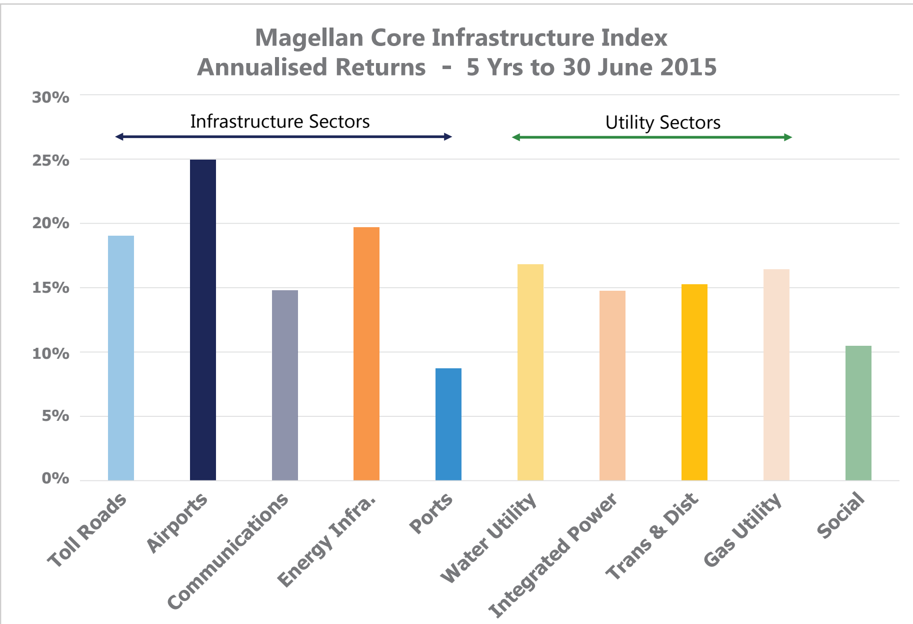
The graph in figure 4 shows returns by region. Clearly, the Latin American returns, which are primarily driven by four Mexican airport companies, were outstanding while the Asia Pacific stocks also performed very strongly (note that we only include developed markets in the Asia Pacific region). It is worth noting that, despite the ongoing economic problems in Europe, stocks from that region performed in line with the US, UK and Canada.

In terms of individual stock performance:

- The best performing stock was Mexican airport company OMAB with a TSR of 38.5%;
- 5 of the 6 best performing stocks were airports;
- Pleasingly, only one stock of the 86 stocks in the index delivered a negative return over the five year period.

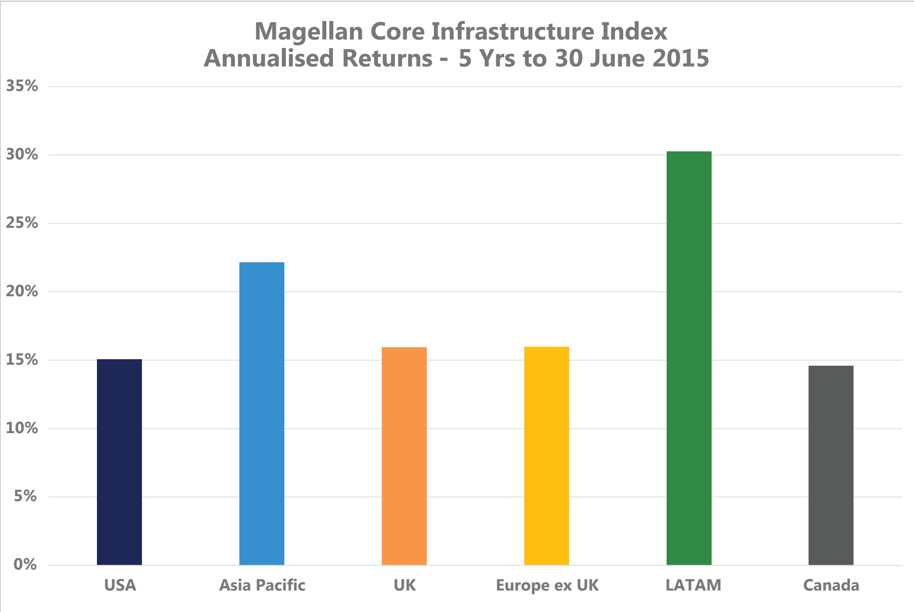
Finally, one of the key reasons that investors choose to include global listed infrastructure in their asset allocation is to diversify their exposures from global equity markets. One of the key criteria used to measure how effective an investment is at risk reduction and diversification is called 'Downside Capture'. This measures how the investment performs when equity markets go down. An analysis of performance over the five years to 30 June 2015 shows that the Magellan Core Infrastructure index's downside capture ratio was -0.1 (and indeed the Fund achieved the same result). This means that, on average, over the five years the Fund delivers investors

Figure 3: Magellan Core Infrastructure Index by Sector.



Source: Magellan Asset Management Limited

Figure 4: Magellan Core Infrastructure Index by Geography.



Source: Magellan Asset Management Limited

a positive return when global equity markets fall.

Outlook

Magellan believes that infrastructure assets, with requisite earnings reliability and a linkage of earnings to inflation offer an attractive, long-term investment proposition. Furthermore, given the predictable nature of earnings and the structural linkage of those earnings to inflation, the investment returns generated by infrastructure assets are different from standard asset classes and offer investors valuable diversification when included in an investment portfolio. In the current uncertain economic and investment climate, the reliable financial performance of infrastructure investments makes them particularly attractive and an investment in listed infrastructure can be expected to reward patient investors within a three to five year timeframe.

Notwithstanding the resilient nature of the stocks held in the Fund, as mentioned in our March 2015 letter, we expect to see increasing volatility in equity markets as interest rates start to rise in the US. We are, however, very confident that any increase in interest rates will have minimal negative impact on the actual financial performance of the stocks in the portfolio.

As is clear from much of the content of this letter, Magellan has a conservative approach to the management of this Fund. This will not change regardless of market conditions as we strongly believe such a defensive posture reflects the role infrastructure should play in any portfolio. This may mean that we will under-perform the benchmark if markets rise strongly, an outcome that would not cause us a moment's discomfort.

Yours sincerely

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