

Magellan Infrastructure Fund

ARSN: 126 367 226

Fund Facts

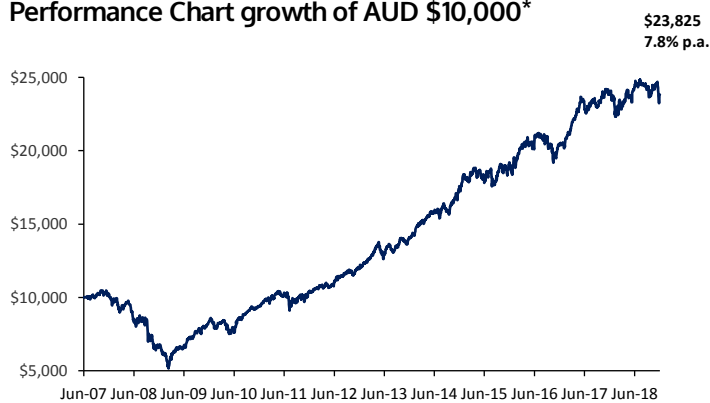
Portfolio Manager	Gerald Stack
Structure	Global Listed Infrastructure Fund, \$AUD Hedged
Inception Date	1 July 2007
Management & Administration Fee ¹	1.05% per annum
Buy/Sell Spread ¹	0.15%/0.15%
Fund Size	AUD \$1,588.2 million
Distribution Frequency	Six Monthly
Performance Fee ¹	10.0% of the excess return of the units of the Fund above the higher of the Index Relative Hurdle (S&P Global Infrastructure Index A\$ Hedged Net Total Return) 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
- Seeks to substantially hedge the capital component of the foreign currency exposure back to Australian dollars
- Maximum cash position of 20%
- \$10,000 minimum investment amount.

Performance Chart growth of AUD \$10,000*



Fund Performance*

	Fund (%)	Index (%)**	Excess (%)
1 Month	-2.8	-2.8	0.0
3 Months	-2.1	-4.2	2.1
6 Months	-2.2	-5.6	3.4
1 Year	-0.4	-6.7	6.3
3 Years (% p.a.)	7.7	6.8	0.9
5 Years (% p.a.)	11.1	7.2	3.9
7 Years (% p.a.)	12.6	9.0	3.6
10 Years (% p.a.)	13.5	8.3	5.2
Since Inception (% p.a.)	7.8	4.8	3.0

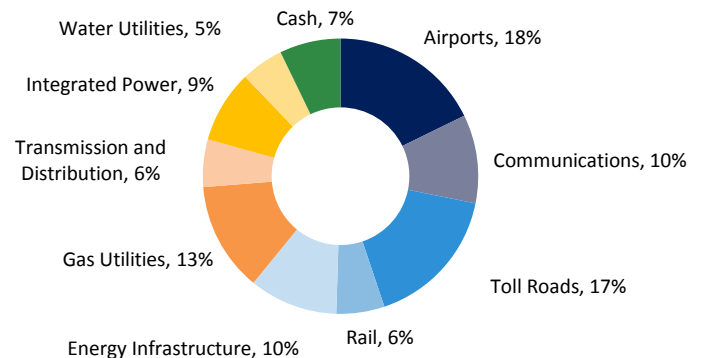
Fund Risk Measures[^]

	5 Years	Since Inception [*]
Upside Capture	0.6	0.7
Downside Capture	0.0	0.4

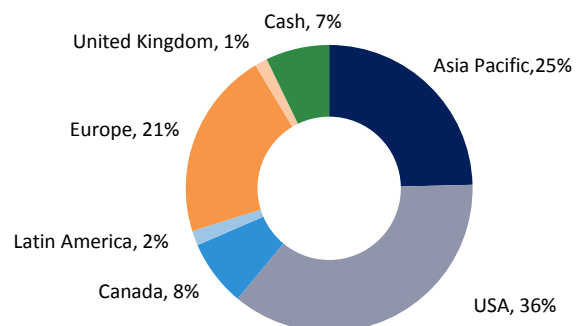
Top 10 Holdings

	Sector [#]	%
Transurban Group	Toll Roads	8.4
Atmos Energy Corp	Gas Utilities	6.2
Crown Castle International	Communications	6.0
Enbridge Inc	Energy Infrastructure	4.7
Sempra Energy	Gas Utilities	4.6
Atlas Arteria	Toll Roads	4.4
American Tower Corp	Communications	4.4
Eversource Energy	Integrated Power	4.2
Aena SME SA	Airports	4.1
Aeroports De Paris	Airports	4.0
TOTAL:		51.0

Sector Exposure[#]



Geographical Exposure[#]



^{*} 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.
^{**} S&P Global Infrastructure Index A\$ Hedged Net spliced with UBS Developed Infrastructure and Utilities Net Total Return Index (hedged to AUD). Note: as the UBS Developed Infrastructure and Utilities Net Total Return Index (hedged to AUD) ceased to be published from 31 May 2015, it was replaced by Magellan on 1 January 2015 with the S&P Global Infrastructure Index A\$ Hedged Net Total Return.
[^] Upside/downside capture shows if a fund has outperformed the global market during periods of market strength and weakness, and if so, by how much. The MSCI World Net Total Return Index AUD Hedged has been used as the representative of the global market to calculate this risk measure.
[#] 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 negative return for the quarter. Stocks that detracted the most on a contributions basis included the investments in ADP of France, Atlas Arteria of Australia, Canadian Pacific Railway and Zurich Airport. ADP shed 14% after the French government said the law to sell its controlling interest in the Paris airport operator wouldn't be ready until the end of the northern winter and it was considering selling its ownership on a piecemeal basis rather than to a strategic buyer. Atlas Arteria lost 10% on talk the 'yellow vest' protests in France that were triggered by a rise in tax on petrol and diesel for environmental reasons would disrupt toll revenue from its French-based highways. Canadian Pacific lost 11% as North American railroad operators sagged on talk a slower US economy would reduce volumes transported by rail. Zurich Airport dropped 18% after revealing that steps announced by Switzerland's regulator would lower its aviation revenue by 150 million Swiss francs.

Stocks that added the most on a contributions basis included the investments in Transurban of Australia, American Tower and Eversource Energy of the US. Transurban added 6.4% in weak markets as management finalised the acquisition of the WestConnex toll road in Sydney. American Tower jumped 9.4% after the owner of wireless communications towers raised guidance for fiscal 2018 and reported higher-than-expected earnings and sales figures for the third quarter. Eversource rose 6.5% after the power utility announced operating revenue for the third quarter that beat estimates and management indicated that it would increase capital expenditure guidance for the full-year result.

Key Stock in Focus – Canadian Pacific Railway



CANADIAN PACIFIC RAILWAY

Canadian Pacific Railway: Delivering consistent and attractive long-term returns thanks to a long-term efficiency drive.

In January 2017, Canadian Pacific's respected CEO Hunter Harrison unexpectedly resigned after more than four years in charge of Canada's second-biggest rail operator to join US-based peer CSX. Shares of CSX gained 15% on the news it had recruited the legendary instigator of super-efficient railroading.

Harrison's departure was significant because he symbolised the recent improvement in Canadian Pacific's business operations, even if that revamp had started nearly a decade before Harrison's arrival in 2012. Since the middle of the 2000s, Canadian Pacific has increased the efficiency and reliability of its services and cut costs. Importantly for investor returns, better operational performance allowed Canadian Pacific to lift its charges, resulting in higher margins, profitability and returns that led to a higher share price.

But Canadian Pacific shares rose 6% anyway over the month Harrison resigned and Keith Creel was installed as CEO. Investors could see the bigger trend. That North American railroad companies – and Canadian Pacific, in particular – had so revived themselves in recent time they were well positioned to benefit from an expected jump in freight volumes, which had languished over 2015 and 2016.

Cargo haulage was expected to increase over 2017 and 2018 for two reasons. The first was that demand was rising for commodities that are easily transported by rail; namely potash, grains and oil. The other was that a shortage of truck drivers in North America had boosted truck rates, which meant that rail operators could charge more to carry loads and still be the more economical and reliable option.

The rebound in haulage demand duly occurred, not just for Canadian Pacific but rival Canadian National Railway and other North American railway operators as well. An outlook for more growth and higher margins for North American railroad operators make the well-managed Canadian Pacific an attractive investment for those looking for infrastructure stocks that produce reliable and growing income streams. Canadian Pacific's share rose 24% over 2017 and 2018, a rise underpinned by investor confidence in the company's ability to maximise economies of scale and, ultimately, shareholder returns.

To be sure, even amid its rebound in recent years, Canadian Pacific has had plenty of challenges. The sluggish growth of 2015 to 2017 prompted the company to cut its workforce by 13% in October 2016. A cold snap early in 2018 dented operations and revenue for the first three months of the year. A future risk is that if the trade tensions were to intensify, tariffs on imports could slow haulage demand. More broadly, railways and railway transport are expensive to just maintain – Canadian Pacific spends about C\$1.4 billion a year ensuring its network stays operable. Any accidents can be costly and higher fuel costs could always hurt margins.

But, on balance, owning rail infrastructure across Canada and the US has advantages when haulage demand is climbing. An efficient operator like Canadian Pacific, which is enjoying greater growth in loads carried than the industry average, is expected to offer long-term investors the predictable and growing returns they expect from such a core economic activity.

Building Canada

Not many companies can claim to have built a nation. Canadian Pacific can. In 1871, British Columbia said it would only join the then four-year-old federation of Canada if the government built a railway across the country. Officials agreed so in 1881 Canadian Pacific was formed. Within four years, the company had completed a railway across Canada, six years ahead of schedule. In the 1890s, Canadian Pacific ventured into the US Midwest. About a century later, Canadian Pacific bought a bankrupt US railway to expand into the US northeast, all the way to the ports there.

Until recent times, however, the company was mostly shunned by investors. Railroads in North America have had a long history of destroying value. Operations were relatively costly yet slow and unreliable. Most in the sector also heavily discounted their prices to compete for volumes. Subsequently, the entire sector – including Canadian Pacific – saw limited profitability and loss of market share to each other and to competing modes of transport such as trucking.

Not surprisingly, Canadian Pacific's rail service was sub-par at the time. Deliveries typically took too long and didn't necessarily arrive on time. And business was often lost to trucks or rival Canadian National Railway. Steps to improve Canadian Pacific's performance were begun earlier this century. But it wasn't until Harrison arrived earlier this decade and the subsequent implementation of 'precision scheduled railroading' as his drive for 'doing more with less' was called that investors saw a meaningful turnaround in the company's performance.

Management in the Harrison era reduced congestion on major routes through better traffic management, decreased the number of trains and invested in better infrastructure. This allowed, among other things, Canadian Pacific to run fewer but longer trains at faster average speeds, as well as remove unnecessary headcount. Essentially, the strategy was about

optimising the company's assets. Moreover, the reduced congestion has allowed some shippers to move goods to delivery points that were once considered logistically unfeasible. Canadian Pacific still focuses on reducing transit times using better terminal and yard scheduling.

Nowadays, the efficient operator employs 8,000 people, runs 1,400 locomotives and owns or leases about 40,000 freight cars and 15,000 containers. The company boasts more than 100 loading facilities across North America and offers access to nine ports. Canadian Pacific offers the shortest route from Vancouver to the US Midwest and the quickest way to move goods from Toronto in the east of Canada to Calgary in the west where the company is based.

In fiscal 2017, Canadian Pacific's revenue of C\$6.6 billion earned from 2.6 million carloads of freight was 5% higher than a year earlier (even if the outcome was still lower than the company's record sales haul of C\$6.7 billion for fiscal 2015). Net income for fiscal 2017 doubled to C\$2.41 billion from a year earlier. For added perspective, net income in fiscal 2017 was about five times higher than five years earlier when net income in fiscal 2012 was C\$484 million.

As an added steadying force for returns, the company lugs goods from many industries – goods that are critical for the economy. Grain accounted for 24% of traffic in fiscal 2017. Energy, chemicals and plastics were 14% of haulage. Metals, minerals and consumer products were 12% of traffic. About 21% of cargo was classified as 'intermodal', which means it was in the form of containers that can be easily moved across trains, trucks and ships.

Canadian Pacific's focus on efficiency is evident by the improvement in key metrics such as average train speed, the average time trains spent at terminals, average train weight and average train length over the past five years. Average train speed, for instance, rose 23% from 2013 to 2017, while the number of hours that trains spent idle fell 7% over that time.

Over those five years, the key productivity measure (the adjusted operating ratio that compares costs to revenue) fell from 69.9% to 58.2%. Another feat is that in fiscal 2017 Canadian Pacific led the industry for safety for the 12th consecutive year.

Fiscal 2018 is proving just as promising. The result for the third quarter of 2018 showed revenue grew 19% from a year earlier to C\$1.9 billion. Net income soared 22% to C\$622 million.

The better times are expected to last a while yet thanks to the improvements achieved in the pre- and post-Harrison era.

Sources: Company filings and website.