Fund Update: 30 June 2020

Magellan Infrastructure Fund

ARSN: 126 367 226

Fund Facts

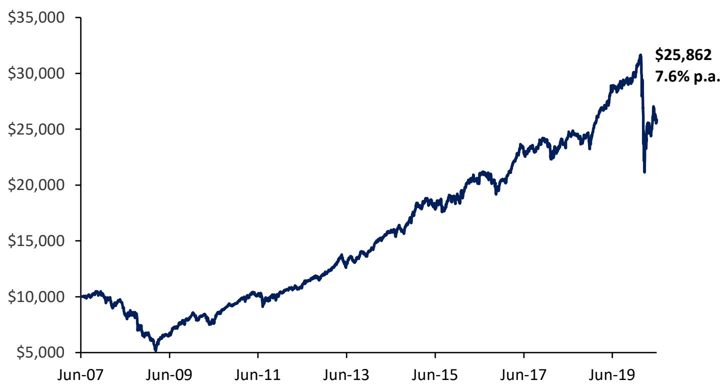
Portfolio Manager	Gerald Stack
Structure	Global Listed Infrastructure Fund, $AUD Hedged
Inception Date	1 July 2007
Management Fee[1]	1.05% per annum
Buy/Sell Spread[1]	0.15%/0.15%
Fund Size	AUD $2,239.3 million
Distribution Frequency	Six Monthly
Performance Fee[1]	10.0% of the excess return of the units of the Fund above the higher of the Index Relative Hurdle (S&P Global Infrastructure Index A$ 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.

[1]All 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
- Typical cash exposure between 0% - 20%
- $10,000 minimum investment amount.

Performance Chart growth of AUD $10,000*



Fund Performance*

	Fund (%)	Index (%)**	Excess (%)
1 Month	-1.3	-2.1	0.8
3 Months	7.1	10.7	-3.6
6 Months	-13.5	-20.4	6.9
1 Year	-8.9	-16.2	7.3
3 Years (% p.a.)	4.3	-1.4	5.7
5 Years (% p.a.)	7.7	2.6	5.1
7 Years (% p.a.)	10.3	6.2	4.1
10 Years (% p.a.)	12.9	7.9	5.0
Since Inception (% p.a.)	7.6	4.2	3.4

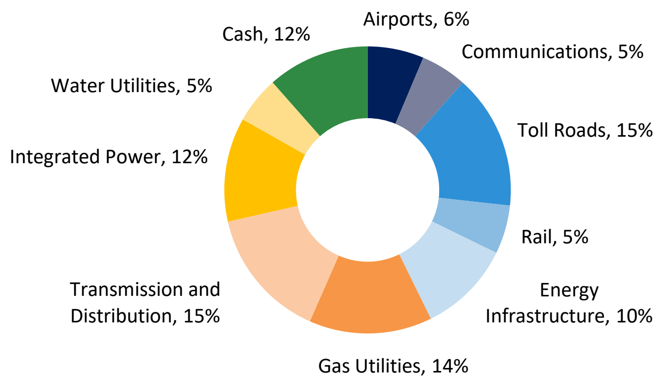
Fund Risk Measures^

	5 Years	Since Inception*
Upside Capture	0.6	0.6
Downside Capture	0.3	0.4

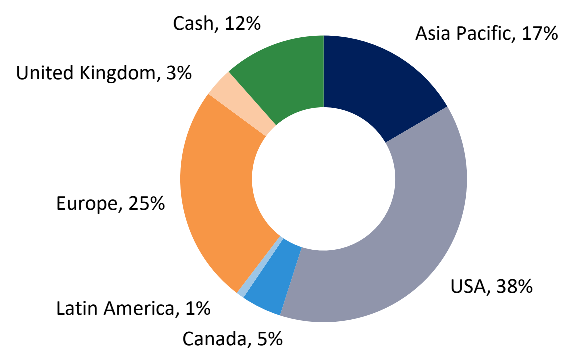
Top 10 Holdings

	Sector#	%
Transurban Group	Toll Roads	6.1
Atmos Energy Corp	Gas Utilities	5.8
Crown Castle International	Communications	5.2
Red Electrica Corporacion	Transmission and Distribution	5.0
Eversource Energy	Integrated Power	4.6
Enbridge Inc	Energy Infrastructure	4.5
Sempra Energy	Gas Utilities	4.5
Xcel Energy Inc	Integrated Power	4.3
Vopak NV	Energy Infrastructure	4.2
Snam SpA	Gas Utilities	3.6
	TOTAL:	47.8

Sector Exposure#



Geographical Exposure#



^ 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. Cash exposure includes profit/loss on currency hedging. Exposures may not sum to 100% due to rounding.
* 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 Total Return 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.

Fund Commentary

The Fund recorded a positive return in the quarter. Stocks that contributed the most included the investments in Transurban and Atlas Arteria of Australia and Crown Castle International of the US. Transurban and Atlas Arteria gained on a view that less-harsh recessions than previously expected would curb the hits to traffic on their toll roads in Australia, Europe and North America. Crown Castle rose as lockdowns boosted traffic on its communications towers.

The only stock that fell to any extent in local-currency terms was Sydney Airport, which declined after the Australian government said that the Australian border would likely stay closed until next year. Three other stocks, US electricity utility First Energy, railroader Canadian Pacific and United Utilities of the UK, showed slight declines in local-currency terms after investors favoured other opportunities as economies reopened.

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

Stock Story: Red Electrica

Europe wants to become greener in energy terms. Spain is ambitious in this area too. In April, Madrid submitted its plan to the EU that declared the country is aiming for renewables to produce 74% of total electricity by 2030 and 42% of total energy demand. To show how ambitious Spain is, the plan entails installing more than two gigawatts of wind energy capacity and three gigawatts of solar capacity each year through the decade. This is a huge investment in clean energy.

This is a big opportunity for Red Electrica, which operates Spain's electricity power transmission grid. The Madrid-based utility, which earned two billion euros in revenue in 2019, performs a critical role in the functioning of the electricity market. Its responsibilities include not only building and maintaining the high-voltage transmission grid but also the day-to-day operations of the market and the long-range planning for the system through its role as the transmission system operator.

To keep up with the rapid growth in maintenance, intra-European connectivity and renewable energy, the company plans to spend about 2.9 billion euros over 2018 to 2022, a 39% increase in the annual rate of spending compared with the prior business plan. While the company is still working through its latest long-term plan, it is likely Red Electrica's investment spending will remain at these elevated levels.

In many businesses, capital expenditure would be considered a cost to investors. However, in a well-functioning regulated utility market, the company is entitled to receive compensation for the fair costs of running the business. This cost is paid primarily by customers and businesses through a component of the electricity access tariffs. As such, the capital spending falls within the 'fair costs' on which the company earns a regulated return, the source of 91% of Red Electrica's gross profits in 2019. It is already decided that Red Electrica will be allowed to earn a base return of 5.58% on its regulated asset base from 2021 to 2025, with an opportunity for higher returns if the company can find efficiencies in its operations.

Another favourable dynamic is the recent improvement in the regulatory oversight for the company. In 2019, the Spanish government granted increased independence to the National Commission of Markets and Competition, the regulatory body tasked with, among other things, setting the fair level of revenues that Red Electrica can charge. This came about due to a mandate from the European Commission. From an investment perspective, independent economic regulation is critical to investors receiving predictable, transparent and fair outcomes. This is especially true in areas as politically sensitive as energy prices.

In addition to its Spanish grid, Red Electrica has been gradually developing and acquiring a collection of electricity transmission assets in South America, including assets in Chile, Peru and, more recently, Brazil. These assets typically generate capacity-payment (that is, predominantly fixed) income streams.

Overall, the better regulation and capital expenditure opportunity in Spain position Red Electrica to deliver what investors expect from a utility and infrastructure stock; namely, one that will deliver reliable income streams with some capital growth.

However, like any investment, Red Electrica comes with risks. The company, for instance, has in recent years acquired a stake in a satellite provider Hispasat that is too far outside of the core business to be judged an attractive acquisition. However, this investment is a minority in the business mix and doesn't undermine the overall investment case.

Further, like many utilities, Red Electrica employs significant debt to fund its significant capital needs. However, the rating agencies are sanguine about Red Electrica's financial profile. (Moody's has an investment-grade Baa1 rating on the company; Standard & Poor's and Fitch rate it A-.)

Finally, as for every business now, covid-19 poses operational and financial challenges. In Spain, electricity demand has fallen significantly during the lockdown and is still gradually recovering to prior levels. However, from an investment perspective, Red Electrica's exposure to this is minimal and its revenues are largely fixed, with any shortfall legally required to be compensated in future years.

Sources include company filings and website and Bloomberg.