Fund Update: 31 March 2015

Magellan Infrastructure Fund

ARSN: 126 367 226

Key Facts

Portfolio Manager	Gerald Stack
Structure	Global Listed Infrastructure Fund, $AUD Hedged
Inception Date	1 July 2007
Management & Administration Fee[1]	1.05%
Buy/Sell Spread[1]	0.15%/0.15%
Fund Size	AUD $780.0 million
Performance Fee[1]	10.0% of the excess return of the Units of the Fund above the higher of the Index Relative hurdle (S&P Global Infrastructure Index A$ 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 exclusive of the net effect of GST.

AUD Performance[2]

	Fund (%)	Index (%)[3]	Excess (%)
1 Month	1.8	1.0	0.8
3 Months	6.3	4.4	1.9
6 Months	15.0	11.2	3.8
1 Year	20.9	19.3	1.6
2 Years (% p.a.)	19.3	17.8	1.5
3 Years (% p.a.)	19.4	17.1	2.3
5 Years (% p.a.)	17.3	12.7	4.6
7 Years (% p.a.)	10.4	7.2	3.2
Since Inception (% p.a.)	8.2	5.9	2.3

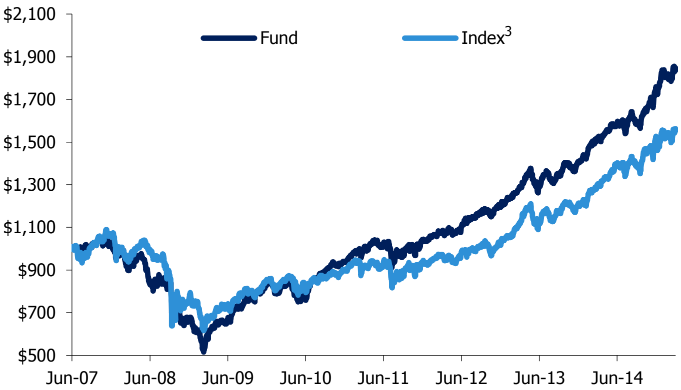
Top 10 Holdings

		% of Fund
Transurban Group	Toll Roads	9.0
Crown Castle International Corp	Communications	7.2
Atlantia Spa	Toll Roads	6.8
SES	Communications	6.0
National Grid Plc	Transmission and Distribution	5.8
Flughafen Zeurich AG	Airports	5.4
Enbridge Inc	Energy Infrastructure	4.8
Eutelsat Communications	Communications	4.5
Auckland International Airport	Airports	4.5
Fraport AG Frankfurt Airport Services	Airports	4.3

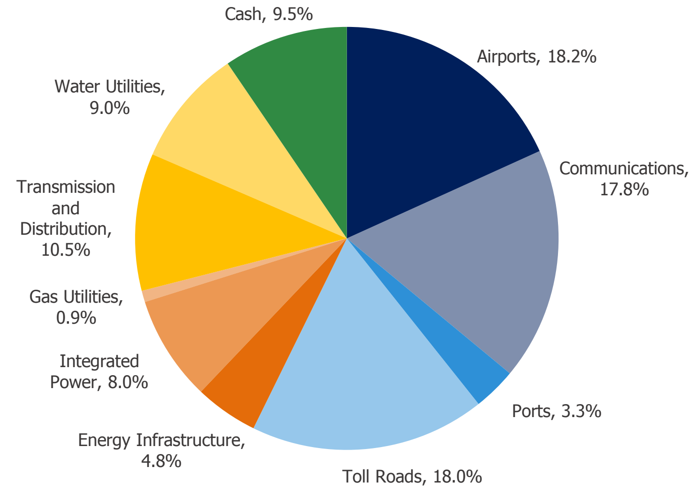
Regional Breakdown

	% of Fund
North America	30.0
Europe Ex-UK	27.1
United Kingdom	10.7
Developed Asia	0.3
Emerging Markets	4.4
Australia	13.3
New Zealand	4.5
Other	0.2
Cash	9.5
Total	**100**

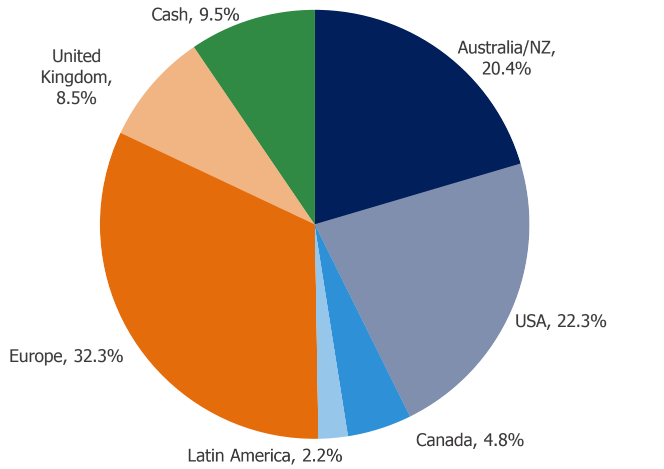
Performance Chart growth of AUD $1,000[2]



Industry Breakdown



Country Exposure by Domicile of Listing[4]



[2]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.
[3] 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 March 2015, it was replaced by Magellan on 1 January 2015 with the S&P Global Infrastructure Index A$ Hedged Net Total Return.
[4]The exposures are by domicile of listing. It is the Fund$ intention to substantially hedge the capital component of the foreign currency exposure of the Fund arising from investments in overseas markets back to Australian Dollars.

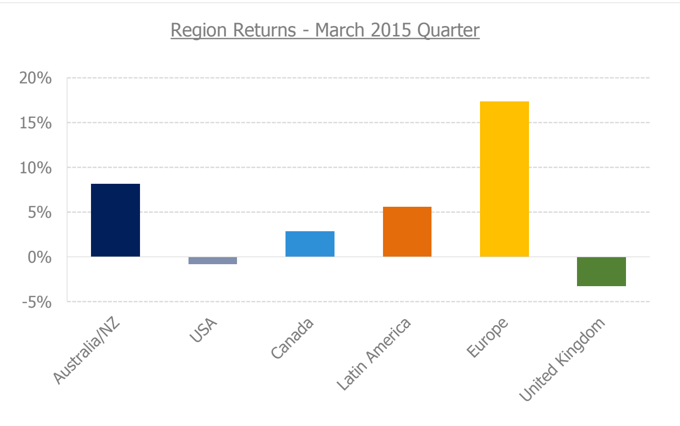
Performance

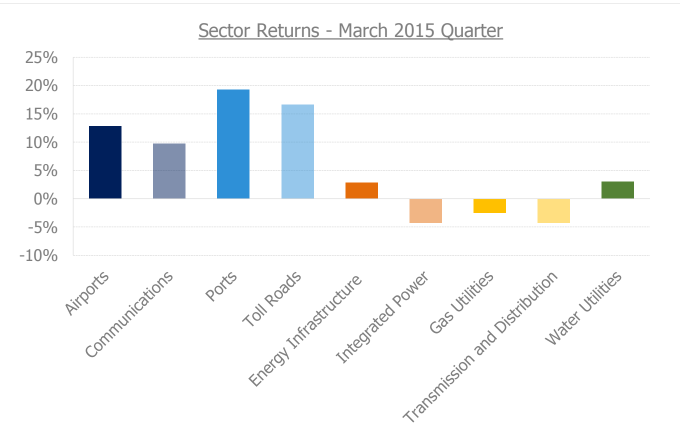
During the March 2015 quarter, in Australian dollar hedged terms, the Fund generated a return net of fees of +6.33%, 1.97% better than the benchmark S&P Global Infrastructure Index return of +4.36%. This brought the 1 year return for the Fund to +20.91% and the five year return to 17.29% per annum, 4.60% better per annum than the benchmark index.

The Fund's Utility exposures were a minor drag on performance during the quarter with a weighted average return of -2.1%. In contrast, the Fund's Infrastructure exposures returned a weighted average +12.6% for the quarter. The strong performance was driven by the Fund's Ports holdings (weighted average return of +19.3%), Toll Road (+16.7%), Airports (+12.9%) and Communications (+9.8%). Of particular note were the returns from Italian toll road company SIAS (+35.5%), another Italian company Atlantia (which owns the significant majority of the inter-urban toll roads in Italy as well as Rome Airport) of +26.5%, Oil & Gas Storage Tank company Vopak +19.3%, German Airport company Fraport +15.4% and satellite company Eutelsat +15.1%.

There were quite divergent returns from stocks included in commonly used benchmark indices but excluded from our universe of investable stocks. On the positive side, Chinese infrastructure stocks increased by an average of 17% for the quarter while European utilities with significant competitive power generation businesses increased by approximately 7%. In contrast, US competitive energy businesses declined by an average of 5%, US Oil & Gas MLPs were down an average 4% as were US rail companies. Brazilian infrastructure stocks also fell an average 10% during the period.

The Fund's returns by sector and region are shown in the following graphs.

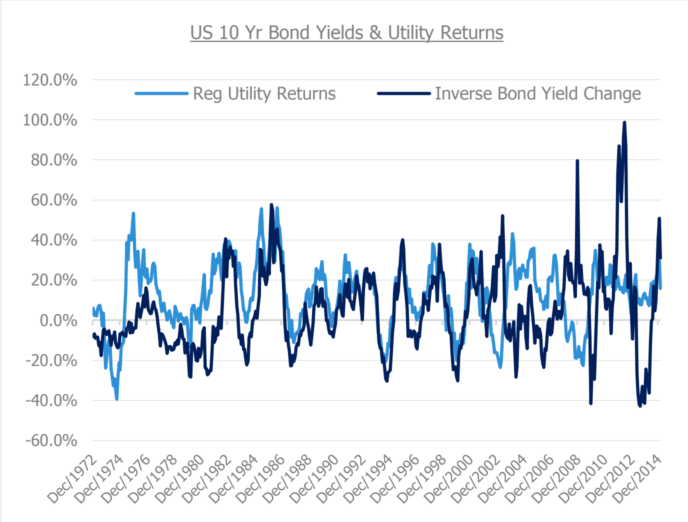




Bond Yields and Utility Returns

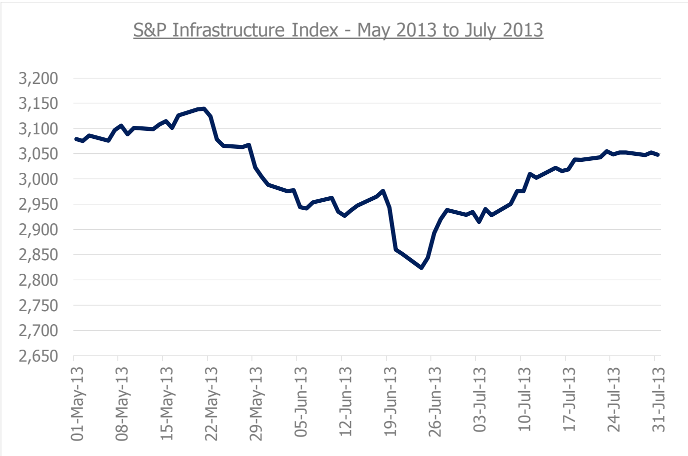
Over many years markets have traded infrastructure stocks, and particularly utilities, as "interest rate sensitive" stocks – on the logic that they carry more debt than the average industrial company and, therefore, a rise in interest rates will impact their earnings and/or mean that their relative dividend yield will become less attractive compared to less risky alternatives such as bank deposits. Superficially these arguments have merit.

But the relationship between bond yields and the share price performance of utilities can break down for many reasons. The following graph uses a Bernstein index of returns of regulated US utilities and the relative change in yield of US 10 year bonds (inverted to highlight correlation). As can be clearly seen, the two factors were highly correlated from the start of the utility return series in 1972 to around 2001 - but there has been effectively no correlation since (R squared of 0.0346 for the statistically minded).

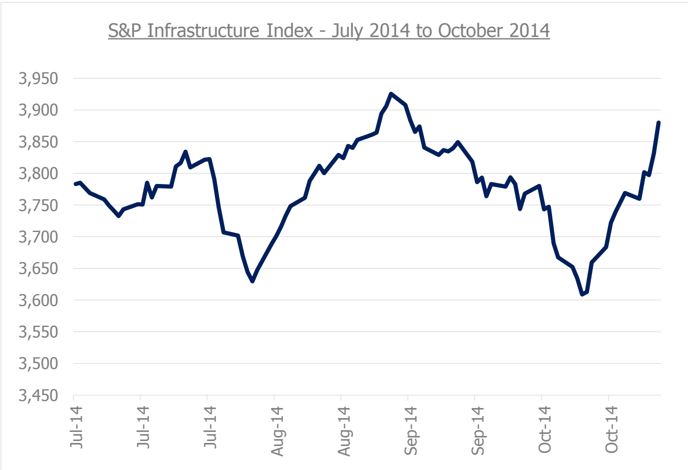


Source: Bernstein, Magellan

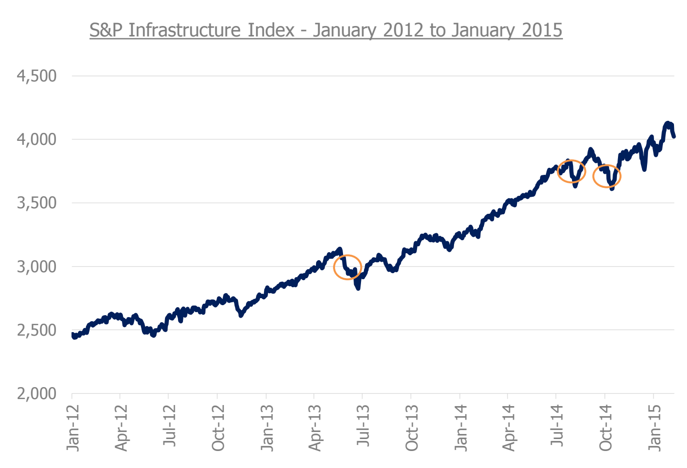
In more recent times we have seen the knee-jerk reaction of the market to actual or expected increases in short term rates in the US. As the following graph shows between 2 May 2013 and 25 June 2013, the S&P Global Infrastructure Index fell by 7.5% after 10 year US bond yields increased by 1.0%.



Similarly, twice in the second half of last year the S&P Global Infrastructure Index fell materially as markets became more focussed on potential bond yield increases.



But as the following graph showing the same S&P Global Infrastructure Index highlights that all three previously mentioned downturns are barely noticeable when viewed in the context of the performance of the sector over the last three years.



So what of the next few years? We believe that, while there is likely to be some short term volatility around US utility prices as interest rates progressively increase, the key determinant of the share price performance of those utilities will be their underlying financial performance. Magellan believes that rising interest rates will have, at worst, only a very marginal negative impact on their financial performance. This is because:

- High quality regulated utilities have been a major beneficiary of the Global Financial Crisis (GFC) because credit markets now offer debt to these companies that is:
    - Cheaper;
    - Longer term;
    - Available from many more sources
- Consequently, utilities now carry higher levels of fixed price debt and have relatively less debt maturing in any one year.
- Accordingly, any increase in interest rates will have little impact on their all up cost of debt. Indeed, the cost of debt for a number of companies can be expected to continue to fall over coming years as expensive pre-GFC debt is refinanced with much lower cost debt (albeit debt that is more expensive than right now).
- Finally, many of the US utilities have passed the peak in their capex programs which will allow dividend payout ratios to be increased to offset any comparative disadvantage they may face when traded as a dividend yield play.

Outlook and Strategy

The Fund seeks to provide investors with attractive risk-adjusted returns from the infrastructure asset class. It does this by investing in a portfolio of listed infrastructure companies that meet our strict definition of infrastructure at discounts to their assessed intrinsic values. We expect that the Fund should provide investors with real returns of approximately 5% to 6% over the longer term.

We believe that infrastructure assets, with requisite earnings reliability and a linkage of earnings to inflation, offer attractive, long-term investment propositions. 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 with a three to five year timeframe.