Magellan Infrastructure Fund

Fund Update: 30 September 2013

Key Facts

Portfolio Manager
Gerald Stack

Structure
Infrastructure Fund, $A hedged

Inception date
1 July 2007

Management and Administration Fee [1]
1.05% p.a.

Buy/Sell Spread[1]
0.15%/0.15%

Fund Size
AUD $498.7 million

Performance Fee[1]
10.0% of excess return over the higher of the Index Relative hurdle (UBS Developed Infrastructure and Utilities Net Total Return Index (hedged to AUD)) 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

Performance[2]

	Fund %	Index %[3]	Excess Return %
1 Month	2.2	3.7	-1.5
3 Months	3.1	3.8	-0.7
6 Months	4.0	4.2	-0.2
1 Year	15.2	16.1	-0.9
2 Years (p.a.)	16.5	14.6	1.9
3 Years (p.a.)	14.5	10.7	3.8
4 Years (p.a.)	15.1	9.6	5.5
5 Years (p.a.)	10.0	6.1	3.9
Since Inception (p.a.)	4.8	2.5	2.3
Since Inception	34.0	16.9	17.1

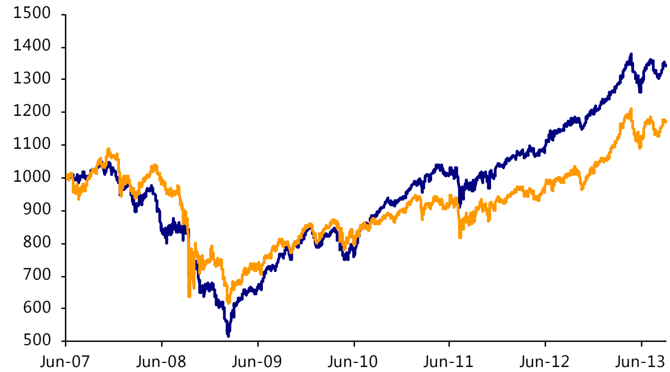
Top 10 Holdings

	Sector	% of Fund
Transurban Group	Urban Toll Roads	9.2%
Fraport	Airports	6.5%
National Grid	Transmission and Distribution	6.1%
Atlantia	Inter-Urban Toll Roads	6.1%
SES	Communications	5.9%
Auckland Airport	Airports	5.4%
Zurich Airport	Airports	4.8%
American Water Works	Water Utilities	4.0%
Eutelsat Communications	Communications	4.0%
Enbridge	Oil & Gas Pipelines	3.6%

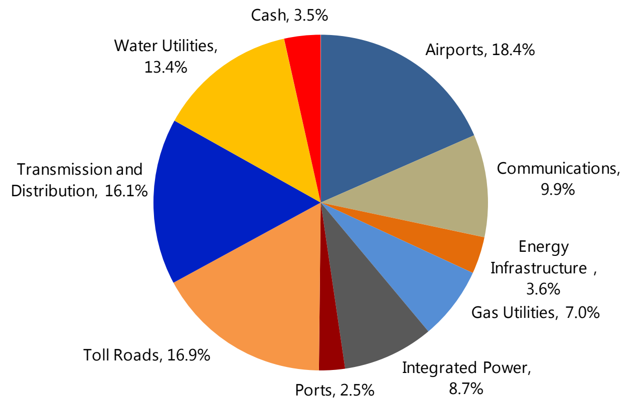
Regional Breakdown[4]

	% of Fund
North America	28.4
Europe ex-UK	30.1
United Kingdom	14.1
Developed Asia	0.1
Emerging Markets	4.7
Australia	13.3
New Zealand	5.4
Other	0.2
Cash	3.5
Total	**100**

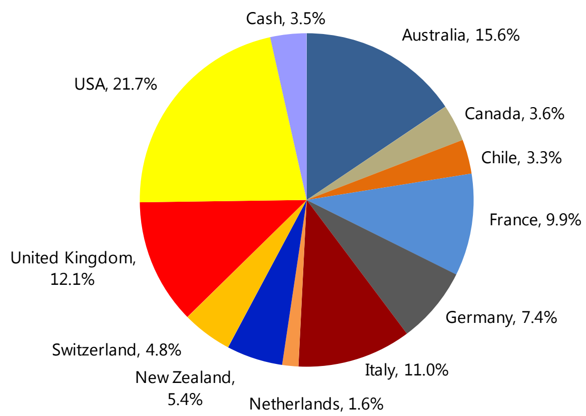
Performance Chart Growth of AUD $1,000[2]



Industry Breakdown



Country Exposure by domicile of listing[5]



[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]UBS Developed Infrastructure and Utilities Net Total Return Index (hedged to AUD)

[4]Calculated on a domicile of asset basis

[5]The exposures are by domicile of listing. It is the Fund's 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.

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Fund Commentary

During the September 2013 quarter the Fund generated a net return of +3.1% compared to the return of the benchmark (UBS Developed Infrastructure & Utilities Net Total Return Index (hedged to AUD)) of +3.8%. This brings the Fund's 5 year return to +10.0% p.a., compared to 6.1% p.a. for the benchmark return.

As in the previous quarter, the Fund's toll road and airport holdings provided strong returns during the quarter. Toll road exposures generated a weighted average Total Shareholder Return (TSR) of 9.0% and airports generated a weighted average TSR of 8.1%. The Fund's Gas Utilities also performed well with a weighted average TSR of 5.9%. Offsetting these results were modest or slightly negative returns from US & UK regulated electricity and water utilities, sectors that have provided very solid gains for the Fund over the last 5 years.

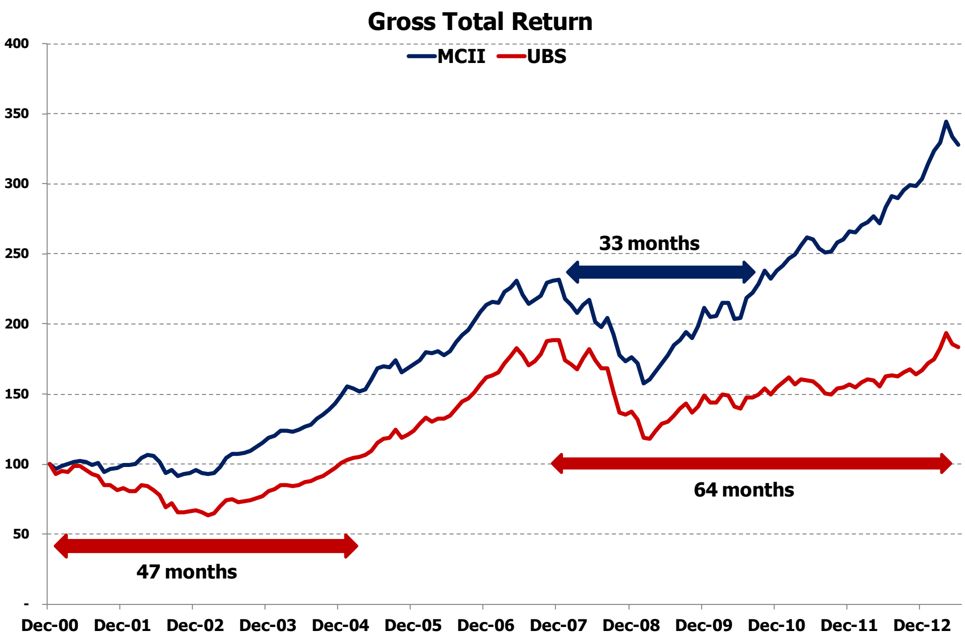
The key difference between the performance of the benchmark and the Fund was that the benchmark was boosted by strong performance from large European utilities that fail Magellan's definition of what constitutes "Infrastructure" as an investable asset class. These utilities, which have large unregulated energy businesses whose earnings are subject to a combination of competition and commodity price risk, have been poor investments over the last 5 years. For instance, Electricite de France generated a TSR of over 30% in the September 2013 quarter but a -41% TSR for the last 5 years. Other examples included GDF Suez +23% TSR for the quarter (-28% 5 year TSR) and Enel SpA +17% TSR for the quarter (-18% 5 year TSR).

During the quarter, Magellan increased the Fund's exposures to the toll road and airport sectors by a combined 4.2%, offset primarily by a commensurate reduction in holdings of US regulated utilities. The changes to the portfolio reflected valuation and risk assessments i.e. it is Magellan's assessment that the toll road and airport sectors currently reflect better value than US regulated utilities.

The Importance of Definition

Magellan believes that investors in infrastructure seek different risk and return characteristics than that available in other asset classes. As infrastructure assets provide services essential to the efficient functioning of communities they face predictable demand patterns. Provided there are no external factors affecting the infrastructure service provider (commodity prices, sovereign risk or competition) the predictable demand should translate to reliable earnings generation from the infrastructure asset. To ensure the earnings of infrastructure investments made by the Fund has the requisite reliability, Magellan excludes from its investment universe those companies whose earnings are materially affected by external factors.

The Fund's definition of what constitutes an investable "Infrastructure" asset class is more restrictive than that generally applied by index providers. This is well illustrated in the following graph which compares the performance of the Magellan approved infrastructure investment universe (the Magellan Core Infrastructure Index or MCII) to a commonly used benchmark index, the UBS Developed Markets Infrastructure & Utilities Index (UBS).



Source: MCII: Magellan Core Infrastructure Index (Local), UBS: UBS Developed Infrastructure and Utilities Net Total Return Index (hedged to AUD)

Key observations to note from the graph are:

- Since the start of the previous decade there have been two major equity market declines, the first at the beginning of that decade generally associated with the "tech-wreck" and the second in 2008 generated by a global credit market crisis.
- On the first occasion, returns from the Magellan Core Infrastructure Index were essentially unaffected while the UBS Developed Markets Infrastructure & Utilities Index fell 36% from its peak and took almost 4 years to return to its previous peak level.
- On the second occasion, the Magellan Core Infrastructure Index suffered material declines (being a credit market crisis, stocks with above average levels of leverage were clear victims of panic selling) along with the UBS Developed Markets Infrastructure & Utilities Index with the latter falling 47% from the peak while the MCII1 fell 42%. However, the MCII recovered that lost ground within 3 years (and has gone up a further 40% subsequently) while the UBS index has only just now recovered its lost ground, more than 5 years after its previous peak.

This history shows that by limiting the universe to investments with reliable earnings, the resultant investment portfolio may suffer poor performance when investment markets are volatile but it can be expected to recover market value relatively quickly due to the reliable, predictable nature of underlying earnings and cash flows.

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