MAGELLAN ASSET MANAGEMENT LIMITED

HALF YEARLY INVESTOR REPORT

31 DECEMBER 2012

Magellan Infrastructure Fund

Dear Investor,

I am pleased to write to you as an investor in the Magellan Infrastructure Fund (the **Fund**) for the six months ended 31 December 2012.

For the six months ended 31 December 2012, the Fund showed a positive return of 8.5%, which exceeded the market benchmark (the UBS Developed Infrastructure & Utilities Index $A Hedged Net TR Index) by 4.5%. For the year ended 31 December 2012, the Fund showed a positive return of 15.1%, an excess over the market benchmark of 6.0%.

PORTFOLIO STRATEGY

The Fund seeks to provide investors with superior risk-adjusted returns from the infrastructure asset class by investing in a portfolio of listed infrastructure companies that meet Magellan's definition of infrastructure, have attractive characteristics and are acquired at a discount to their assessed values.

The investment style of the Fund reflects three key principles:

1. The infrastructure asset class, appropriately defined, is characterised by monopoly-like assets that face reliable demand and, hence, has a structural advantage to generate reliable investment returns. The Fund uses strict criteria to determine the investable infrastructure investment universe.

2. Intensive, rigorous bottom-up research can enable a portfolio of infrastructure assets that possess attractive characteristics to be purchased at a discount to their assessed intrinsic values.

3. Minimising downside risks to an investment portfolio is key to generating superior long-term investment returns. This philosophy is core to all of Magellan's investment products.

Infrastructure assets are typically monopolies that provide an essential service to the community and whose earnings are linked to inflation, i.e. earnings rise and fall with inflation and offer investors protection from the impacts of inflation. Over time the stable, reliable earnings of infrastructure assets are expected to lead to a combination of income and capital growth for investors.

The majority of the universe of assets that we consider for the Fund is made up of:

- regulated utilities (including both regulated energy utilities and regulated water utilities); and
- infrastructure, which includes airports, ports, toll roads and communications infrastructure assets.

We estimate that utilities comprise approximately 75% of the potential universe for the Fund. Utilities are typically regulated by a government-sponsored entity with such regulation requiring the utility to provide efficient service to the community and, in return, permitting the utility to earn a fair rate of return on the capital it has invested in its operations. As the utility provides a basic necessity, e.g. energy or water, there is minimal fluctuation in demanded volumes in response to the economic cycle and the price charged for the utility service can be adjusted with limited impact upon demanded volumes. As a result, the earnings of regulated utilities are expected to be stable, irrespective of economic conditions.

Regulation of infrastructure companies is generally less intensive than for utilities and allows companies to accrue the benefits of volume growth, i.e. the returns to infrastructure companies are linked to growth in passengers, vehicles or containers. As economies develop and grow we expect the underlying level of aviation, shipping and vehicle traffic to increase and, as a result, the revenues and earnings derived by infrastructure assets are expected to grow.

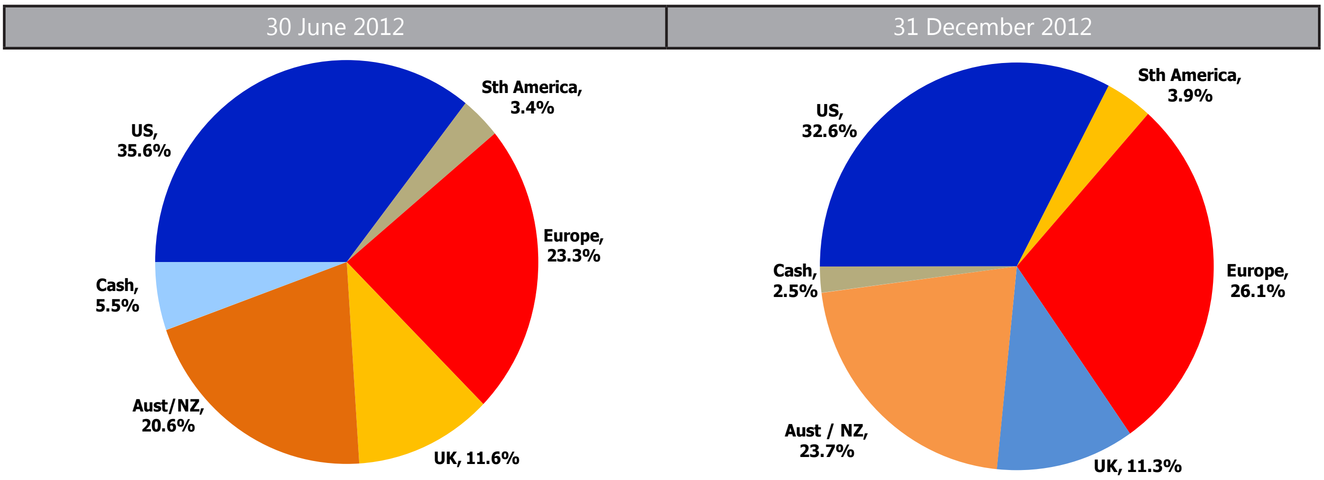
PORTFOLIO SUMMARY

As at 31 December 2012, the Fund's portfolio consisted of 29 stocks (there were also 29 stocks at 30 June 2012). The composition of the portfolio by sector at 30 June 2012 and 31 December 2012 was as follows:

	Portfolio Weight (%)	
	30 June 2012	31 December 2012
Toll Roads	13.4%	15.9%
Airports	15.0%	14.6%
Ports	2.8%	2.6%
Communications	6.0%	9.0%
Energy Utilities	41.6%	40.5%
Water Utilities	15.7%	14.9%
Cash	5.5%	2.5%

The major sector changes to portfolio composition during the period was an increase in exposure to toll roads offset by a decrease in the weighting of energy and water utilities.

The composition of the portfolio by geography at 30 June 2012 and 31 December 2012 was as follows:



The major changes to geographic exposures were a reduction in the weightings of the US offset by an increase in the weighting of Europe.

In July 2012, the Fund paid a distribution of 2.45 cents per unit in respect of the year ended 30 June 2012. This takes the cumulative distributions paid to unit holders to 26.24 cents per unit since the inception of the Fund in July 2007.

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 our view, in the current uncertain economic and investment climate, the historically reliable financial performance of infrastructure investments makes them particularly attractive, and an investment in listed infrastructure can be reasonably expected to reward patient investors with a 3 to 5 year time frame.

KEY STOCK IN FOCUS
ITC Holdings

ITC Holdings (NYSE: ITC), is an independent US electric transmission company and is a core holding for the Fund.

ITC Holdings is the largest independent electric transmission company in the US, operating high-voltage interstate transmission systems in Michigan, Iowa, Minnesota, Illinois, Missouri, Kansas and Oklahoma. Combined, these systems serve peak load of 25,000 megawatts. Pending regulatory approvals, ITC Holdings will also add the US Gulf Coast region to its geographic footprint via the addition of Entergy' s transmission assets.

The Fund has identified two key investment tenets with respect to US energy infrastructure:

1. The need for the US to address its aging and unreliable transmission system, and;

2. The superiority of federal regulation relative to state regimes in the US. ITC Holding' s strategy of actively investing in needed transmission under the federal regulatory framework makes this stock very attractive by global standards.

Old, Unreliable and Underinvested

America' s energy grid, designed specifically for cities and rural communities, was once considered a global benchmark. Today, that power grid stretches more than 164,000 miles and consists of more than 3,000 electric utilities, municipal systems and rural electric cooperatives. That same grid, however, is now defined as outdated, unreliable and underinvested.

According to ITC Holdings, 70% of US transmission lines are at least 25 years old, while 60% of circuit breakers are more than 30 years old. These aging power assets have also had to operate during a period (40 years) when the US population has grown by 50% and energy consumption has effectively doubled. The investment response has also been disappointing, with annual investment in new transmission facilities over the last 25 years actually declining over the period. Moreover, the US added fewer than 700 miles of new transmission lines over the last ten years as compared to the roughly 11,000 miles added in new natural gas pipelines.

Demands on the transmission grid will not likely ease any-time soon. According to the US Energy Information Administration, generation capacity will increase approximately 33% by 2035 as a result of increased gas-fired generation (from inexpensive shale gas production) and renewable sources (wind and solar farms). This projected capacity increase would essentially be the response to an expected 31% rise in power usage over the same period.

The state of the US transmission grid finally became a household issue when the Northeast and parts of the Midwest region suffered extensive blackouts in 2003. Not surprisingly, government studies following those outages pointed to underinvestment and a shortage of proper maintenance as key contributors. The studies went further to suggest that the lack of investment was due to a breakdown in transmission regulation – cost allocation, planning, and siting. In response, the federal government passed the Energy Policy Act (EPAct) of 2005.

Among other energy initiatives, the EPAct included several provisions intended to give the Federal Energy Regulatory Commission (FERC) greater oversight and authority over the transmission grid. One key provision explicitly required FERC to promote greater transmission investment through incentive ratemaking, while another provision gave the Commission better siting authority for transmission corridors of national interest.

Unrivalled Regulation

In response to the EPAct directive, FERC established a regulatory framework for interstate transmission assets that Magellan considers to be one of the most constructive (i.e. investor-friendly) across the infrastructure universe.

For ITC Holdings, whose interstate assets are regulated by the FERC at the federal level, this means it faces an environment where its regulated utilities can earn an allowed return on equity (ROE) ranging from 12.2% to 13.9% - high by comparison to other regimes. These FERC-regulated earnings also carry minimal risk having guaranteed revenues that have zero commodity or volume exposure.

State-regulated transmission/distribution assets will typically earn ROEs of 10-11% on debt/equity ratios of 50%. Furthermore, state regulation is often susceptible to regulatory lag that stems from the slow recovery of costs brought about by backward looking ratemaking and protracted rate review processes. Magellan attributes the adversarial and protracted rate review process to the fact that distribution charges represent a sizeable portion of the average household electric bill (24% versus 7% for transmission costs according to the Energy Information Administration).

The table below provides a summary of the key differences between federal versus state regulation.

Table 1: Comparison of Federal and State Transmission Regulation

	Federal Regulation (FERC)	Typical State Regulation
Rate Structure and Ratemaking	• Formula Rate - Forward-looking rate-setting mechanism - Annual rate adjustments based on projected revenue requirement	• Fixed rates between multi-year rate cases • Rate increases require formal rate cases in which prudence must be affirmatively defended • Rate making process is often adversarial and protracted and may delay recovery of costs
Allowed Returns	• FERC-approved ROE - ITC Transmission – 13.88% - METC – 13.38% - ITC Midwest – 12.38% - ITC Great Plains – 12.16% • Assumed 60%/40% equity-debt capital structure	• Typical ROE in 9-11% range • Typically assume 50%/50% equity-debt capital structure
Regulatory Lag	• Achieved ROEs equal allowed ROEs. No regulatory lags due to forward-looking ratemaking and immediate cost recoveries	• Achieved ROEs tend to be below allowed ROEs. Regulatory lags often result from backward-looking ratemaking and cost disallowances

FERC continues to maintain an accommodative environment for transmission regulation. In 2011, the Commission issued FERC Order 1000 with the aim of furthering competition in transmission construction and reliability. The order provided a more level playing field for companies such as ITC Holdings by removing barriers around transmission planning and cost allocation.

Key highlights of Order 1000 include:

- Planning – Transmission providers would be required to participate in the regional planning process. The process would itself need to consider the most cost-efficient solutions to address regional transmission needs, including state/federal renewal standards.

- Cost Allocation – Regional planning entities would be required to allocate construction costs commensurate with consumer benefits.

- Right-of-First-Refusal (ROFR) – An incumbent utility's ROFR to build new regional transmission assets would be eliminated, thereby allowing greater participation from independent transmission companies such as ITC Holdings.

While the FERC has clear objectives around improving transmission capacity and reliability, it nevertheless remains sensible about administering its policies. In November 2012, the FERC issued a Policy Statement that suggested the commission would take a much more sensitive approach to evaluating transmission incentives. Some investors subsequently interpreted this negatively, yet we viewed this statement constructively on the basis that FERC's stance was consistent with its established incentive policies. Magellan believes that base and incentive ROEs for transmission will not suffer materially in the near to intermediate term given the Commission's obligation to promote investment under the EPAct.

CONCLUSION

Overall, Magellan's current assessment of transmission regulation in the US reinforces our view that ITC Holdings remains well positioned to continue delivering solid and stable returns. Furthermore, we are of the view that the market continues to under-appreciate ITC Holding's regulatory environment. To this extent, this same assessment provides us with additional comfort in the Fund's investment in Northeast Utilities and National Grid PLC, both of which own substantial FERC-regulated transmission assets.

Yours sincerely,

Gerald Stack

Gerald Stack
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