Magellan Sustainable Fund (Managed Fund)

MAGELLAN ASSET MANAGEMENT

TICKER: MSUF | APIR: MGE4669AU | ARSN: 645 516 187

AS AT 31 MARCH 2024

PORTFOLIO MANAGER ALAN PULLEN

INVESTMENT PHILOSOPHY

To invest in outstanding companies at attractive prices within a framework that considers environmental, social and governance risks and delivers very low carbon exposure, while exercising a deep understanding of the macroeconomic environment to manage investment risk.

OBJECTIVES

To achieve attractive risk-adjusted returns over the medium to long-term while reducing the risk of permanent capital loss. This incorporates consideration of environmental, social and governance risks and the application of a proprietary low carbon framework.

PORTFOLIO CONSTRUCTION

High conviction (20 - 50 securities), with high quality focus. Integration of ESG screens and risk assessment together with a proprietary low carbon framework overlay.

Typical cash and cash equivalents exposure between 0 - 20%.

INVESTMENT RISKS

All investments carry risk. While it is not possible to identify every risk relevant to an investment in the fund, we have provided details of risks in the Product Disclosure Statement. You can view the PDS for the fund on Magellan's website www.magellangroup.com.au.

ENVIRONMENTAL, SOCIAL, GOVERNANCE AND LOW CARBON

The fund excludes companies whose activities in our view may have wide-ranging detrimental impacts on society for example tobacco production, controversial weapons and mining of coal[^]

Companies are reviewed and scored for the materiality of their exposure to environmental, social and governance factors.

Exposures to industry exclusions is assessed by reference to the total (gross) revenue[+] of the company provided by MSCI ESG Manager.

We overlay our proprietary low carbon framework to deliver a portfolio with meaningfully lower carbon intensity than broader equity markets[++].

MAGELLAN SUSTAINABLE FUND (MANAGED FUND): KEY PORTFOLIO INFORMATION

TICKER	FUND SIZE	BUY/SELL SPREAD[1]	MANAGEMENT AND PERFORMANCE FEES[2]	INCEPTION DATE
MSUF	AUD $8.4 million	0.07% / 0.07%	1.36% p.a. and performance fee of 10% of dual hurdle excess return^	11 December 2020

^ 10.0% of the excess return of the units of the Fund above the higher of the Index Relative Hurdle (MSCI World NTR Index (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.

PERFORMANCE[3]

	1 MONTH (%)	3 MONTHS (%)	6 MONTHS (%)	1 YEAR (%)	3 YEARS (% p.a.)	Since Inception (% p.a.)
MSUF	1.8	11.8	20.1	28.7	12.5	11.9
MSCI World NTR Index (AUD)*	3.0	13.9	20.0	28.4	14.4	15.0
Excess	-1.2	-2.1	0.1	0.3	-1.9	-3.1

CALENDAR YEAR RETURNS	CYTD (%)	2023 (%)	2022 (%)	2021 (%)	2020 (part year)
MSUF	11.8	29.5	-17.1	22.3	-1.2
MSCI World NTR Index (AUD)*	13.9	23.0	-12.2	29.3	-0.3
Excess	-2.1	6.5	-4.9	-7.0	-0.9

Past performance is not a reliable indicator of future performance.

PERFORMANCE CHART GROWTH OF AUD $10,000[3]

Past performance is not a reliable indicator of future performance.

31 March 2024[#]	FUND	INDEX*
CARBON INTENSITY ($\mathrm{CO_2T/US\$1M}$ REVENUE)	28	96

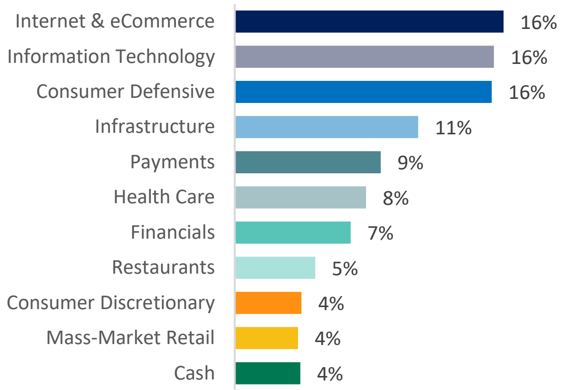
[#] Carbon intensity data available on a quarterly basis. Certain information ©2024 MSCI ESG Research LLC. Reproduced by permission. The Fund's carbon intensity score is calculated using MSCI data. In a limited number of circumstances, where data is not available or Magellan deems it appropriate, manual adjustments are made to the MSCI carbon intensity score for certain investments held by the fund.

[^] Please see the PDS for a full list of industry exclusions and revenue thresholds for exclusion.
[+] Net revenue or an estimate of gross (or net) revenue will be used where gross revenue is not available.
[++] Our low carbon framework aims to limit the carbon intensity of the portfolio to one-third of the weighted average carbon intensity of the MSCI World Index, as reported by MSCI. Please see the PDS for further detail.
[1] Only applicable to investors who apply for units directly with the Responsible Entity.
[2] Transaction costs may also apply – refer to the Product Disclosure Statement. All fees are inclusive of the net effect of GST.
[3] 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). Returns denoted in AUD.
* MSCI World Net Total Return Index (AUD). All MSCI data used is the property of MSCI. No use or distribution without written consent. Data provided "as is" without any warranties. MSCI and its affiliates assume no liability for or in connection with the data. Please see complete disclaimer in www.magellangroup.com.au/funds/benchmark-information/

TOP 10 HOLDINGS

STOCK	SECTOR[4]	%
Microsoft Corporation	Information Technology	7.4
Alphabet Inc	Internet & eCommerce	7.1
Nestlé SA	Consumer Defensive	7.0
Amazon.com Inc	Internet & eCommerce	4.8
Meta Platforms Inc	Internet & eCommerce	4.5
Eversource Energy	Infrastructure	4.1
Booking Holdings Inc	Consumer Discretionary	4.1
UnitedHealth Group Inc	Health Care	4.0
SAP SE	Information Technology	4.0
Intercontinental Exchange Inc	Financials	4.0
	TOTAL:	**51.2**

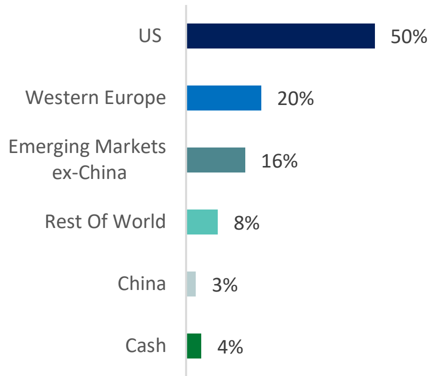
SECTOR EXPOSURE BY SOURCE OF REVENUE[4]



TOP CONTRIBUTORS/DETRACTORS 1 YEAR[5]

TOP 3 CONTRIBUTORS	CONTRIBUTION TO RETURN (%)
Meta Platforms Inc	5.3
Microsoft Corporation	3.7
Alphabet	3.6
TOP 3 DETRACTORS	**CONTRIBUTION TO RETURN (%)**
Dollar General Corporation	-0.7
Nestlé SA	-0.6
Reckitt Benckiser Group	-0.6

GEOGRAPHICAL EXPOSURE BY SOURCE OF REVENUE[4]



[4] Sectors are internally defined. Geographical exposure is calculated on a look through basis based on underlying revenue exposure of individual companies held within the portfolio. Exposures may not sum to 100% due to rounding.
[5] Shows how much the stock has contributed to the fund's gross return for the period in AUD. Excludes non-disclosed positions established in the latest quarter.

Market Commentary

Global equity markets posted strong returns in the March quarter, with the MSCI World Index rising 8.9% in USD and 13.9% in AUD. The sectors with the largest gains were Communication Services (up 13.7%), followed by Information Technology (12.8%) and Financials (12.0%), while the laggards were Utilities (down 2.2%), Consumer Staples (-4.8%) and Materials (-5.6%). The Nikkei 225 rose 20.6% in the quarter, outpacing the S&P 500 (10.2%), STOXX Europe 600 (7.0%), S&P/ASX 200 Accumulation Index (5.3%) and the MSCI Emerging Markets Index (1.9%). China's CSI 300 rose 3.1%.

The main drivers of these strong returns were improved earnings outlooks and sentiment. US economic data released during the quarter were stronger than expected, though not strong enough to suggest that a broad-based reacceleration in inflation was likely. Earnings results for the December quarter released in the March quarter led to sizeable earnings upgrades. Overall, this dataflow saw investors reduce the number of quarter percentage point (0.25%) Federal Reserve rate cuts they expect by the end of 2024 from six to three, while also pushing up the US 10-year Treasury yield by 30bp to 4.2%.

In Europe, several countries including Germany, Finland, the UK and Ireland entered a technical recession by posting two consecutive quarters of negative GDP growth for the second half of 2023. The 10-year German government bond yield increased 30bp to 2.3%, a move broadly in line with movements in global sovereign bond yields.

In Japan, the Bank of Japan ended its negative interest policy that had been in place since 2016. Japanese equity returns have benefited from corporate governance changes that promote returns and a return of inflation, which boosts nominal growth rates. The yield on Japanese 10-year government bonds rose 10bp to end the quarter at 0.7%. While the Chinese authorities are also attempting to improve corporate profitability, we believe that relatively low trading multiples in China are justified by permanent political and governance risks and the more difficult economic backdrop in the medium term.

Fund Commentary

The Fund delivered strong absolute performance in the quarter, albeit slightly below market returns, reflecting conservative positioning. Key contributors for the quarter included Meta Platforms, SAP and TSMC. Meta reported a solid 4Q23 result and provided much-stronger-than-expected 1Q24 revenue guidance, benefiting from strong user engagement trends, broad-based improvements in advertiser demand and strong traction of its Reels and AI ad performance products. Market conviction in Meta's AI-related growth opportunities and improved management focus on cost discipline and shareholder returns continues to build. SAP reported a solid Q4 result with accelerating cloud growth and an implicit raise of its mid-term 2025 EBIT and FCF guide. It also announced a €2b restructuring program as it reinvests in AI capabilities for its products and internal operations. Overall, the result supported SAP's cloud growth thesis and we remain positive on the momentum and resilience of core ERP. TSMC delivered a modest Q4 beat on what the company described as recovering from a bottoming-out and provided strong FY24 revenue growth guidance in the low to mid-20s in USD, implying FY24 revenue 6.5% ahead of our estimates at the midpoint. The guidance increased investor confidence on demand recovery and comported with ASML's bookings strength.

Key detractors included Reckitt, American Tower and UnitedHealth Group. Reckitt was affected by weaker-than-expected sales volumes in the 4Q result as well as an unexpected accounting issue in its Middle East business. It was further affected by a jury verdict over an outstanding lawsuit awarding $60 million to a plaintiff citing US infant formula manufacturers failed to communicate elevated risks of infants developing necrotising enterocolitis when fed preterm infant formula under the care of neonatologists in hospital. Both the ruling against Reckitt as well as the magnitude of the award were unexpected. The market reaction to these events suggests much of the future obligation from similar product liability lawsuits is in the price. American Tower underperformed on higher US interest rates, to which it is particularly sensitive given fixed escalators and higher leverage. For UnitedHealth Group the upcoming US elections are affecting the regulatory backdrop for US managed care organisations, with lower-than-expected reimbursement decisions and anti-trust investigations announced in the quarter. In addition, the company was affected by a cyber security breach. We view these issues as short term and transitory, with plan re-pricing and re-designs as well as operating expense savings as key offsets.

Index movements and stock contributors/detractors are based in local currency terms unless stated otherwise.

Developments in Sustainability

In March 2024, the EU AI Act was approved by the European Parliament. This is a significant piece of regulation to mitigate the social and human rights risks of AI. The use cases of AI are categorised and restricted according to whether they pose an unacceptable, high or low risk to human safety and fundamental rights. It is important for technology providers and users of AI to adhere to this regulation as penalties can include bans and fines. The Magellan Investment Team discuss the social and regulatory risks of AI in our Insights piece: Social and Regulatory Risks of AI – Magellan Financial Group (magellangroup.com.au).

In February 2024, Magellan signed the 2024 Investor statement on Ethical AI. As a new member of the Collective Impact Coalition (CIC) for Ethical AI, we are happy to share that the CIC for 2024 has been launched.

The main Global Annual General Meeting (AGM) season commenced in March. Similar to 2023 we continue to see an increase in sustainability-related shareholder proposals. The proposals are focused on shareholder rights, and the management of material risks ranging from health and wellness to climate, diversity and human rights.

Outlook

That markets continued rally in Q1 was partly justified by solid fundamentals, with strong earnings for many of our companies and the macroeconomic backdrop largely stable. Nonetheless, valuations remain full and downside risks are evident in the shorter term should earnings or the macroeconomic backdrop deteriorate. Indeed, indicators suggest inflation may remain higher than target levels, prompting the Federal Reserve to delay anticipated rate cuts even further. At current market valuations there is little room for such an outcome, and we continue to position the portfolio conservatively.

Over the long term, we consider that our companies remain well placed to deliver solid earnings growth in the years ahead, reflecting their high quality, strong free cash flow generation, and the benefit of long-term structural tailwinds such as AI adoption.

Stock Story: Mondelez

(Lucina Martin – Investment Analyst)

Mondelēz International

Over the last decade, Mondelez, one of the world's largest snacking companies, has evolved and strengthened its economic moat, reaccelerated growth and increased the reliability of its earnings algorithm.

Although Mondelez itself is a young company, following the split from Kraft Foods in 2012, it stands on the shoulders of a portfolio of iconic, century-old brands including Cadbury, Oreo, Milka and Ritz. Its global biscuit and chocolate categories have delivered steady compound growth of ~+4.5% between 2009 and 2023* and exhibited strong pricing power, rational competition and minimal disruption from private label manufacturers. Thanks to its differentiated brands, product innovation and marketing, Mondelez holds dominant #1 and #2 market share positions in these categories, which together account for 80% of its $36b global revenue base. As a result of its dominance, Mondelez is in a position of strength to negotiate with its key retail partners on pricing programs, shelf allocation and innovation launches. Likewise, its scale advantage across marketing, distribution, research and development, and ingredient procurement are the key foundations of its economic moat.

However, there have been times in the company's history, most recently 2014 to 2018, when poor execution weighed on top-line growth and brand momentum. Mondelez's previous governance structures were rigid, and decision-making was centralised and top-down focused. Prior management teams were too concentrated on cost control and short-term profitability at the expense of innovation and marketing reinvestments to support the long-term brand equity of the portfolio. While global 'power brands' remained a focus, unfortunately there was a long tail of underperforming local brands, which weighed on growth, created complexity within its manufacturing operations and affected their trusted partner status with key retailers.

The acceleration in Mondelez's growth in more recent years has been driven by the culmination of various deliberate actions by the current management team to introduce a longer-term mindset to brand investments and portfolio management. The prior organisational structure was redesigned, decentralising core operations to bring greater decision-making power to the regional teams who know the local consumer best. Complementing this, a new remuneration framework was introduced to incentivise balanced revenue growth and sustainable margin expansion. Importantly, this framework also aimed to minimise short-term, irrational decisions such as excessive discounting to boost market share growth, and underinvestment in marketing to achieve profitability targets.

**Source: Euromonitor*

These improved foundations have bolstered the key tenets of Mondelez's economic moat and unlocked growth across the business. Since the strategy was first implemented in 2018, the business has delivered ~+8% organic revenue growth and ~+12% constant currency EPS growth, which are well above its long-term objectives of +3-5% and +7-9% respectively. The company has achieved these objectives despite increasing its advertising budget by around 75% and investing in strategic capabilities such as consumer analytics, manufacturing automation and various digital tools to optimise procurement planning and reduce wastage.

Mondelez's in-depth knowledge of its snacking consumer is a key competitive advantage, particularly as the company continues to evolve its portfolio alongside changing consumer preferences. Recently, Mondelez has disposed of certain chewing gum and high-sugar candy brands while remaining focused on its core biscuits and chocolate products that consumers continue to seek out as permissible indulgences. The advent of GLP-1 weight-loss drugs will likely create new consumption trends for a subset of Mondelez's developed market consumers, which the company will need to monitor closely and continue to adapt to. Meanwhile in emerging markets, which account for 39% of total revenue, tailwinds to category growth from rising middle class incomes, premiumisation and expanding distribution to new cities should be enduring.

Mondelez's consumer data advantage, sophisticated manufacturing and distribution capabilities as well as its financial capacity to acquire new brands, position it well to continue to evolve its portfolio and remain an incumbent snacks player over the long term. A capable management team, together with improved governance and incentive structures, further enhances our conviction.