Annual Investor Report

Core Infrastructure Strategy | June 2015

By Dennis Eagar, Portfolio Manager, Magellan Core Infrastructure

Dear Investor

I am pleased to write to you as an investor in the Magellan Core Infrastructure Strategy (the 'Strategy') for the year ended 30 June 2015. The objective of the Strategy is to provide shareholders with reliable, inflation linked returns through all stages of the economic cycle.

Our underlying investment philosophy has not changed since we launched the Strategy in mid 2007. We seek to buy and hold an investment portfolio of what we regard as outstanding infrastructure companies. We aim to invest in infrastructure and utility companies that possess attractive fundamentals at prices that enable the Strategy to achieve superior risk adjusted returns over a three to five year period.

The universe of infrastructure assets that are held by the Strategy is made up of two main sectors:

- **Utilities**, including both regulated energy utilities and regulated water utilities. Utilities comprise approximately 60% of the Strategy. Utilities are typically monopolies and are, therefore, subject to economic regulation. This requires the utility to efficiently provide an essential service to the community and, in return, 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 demand volumes in response to the economic cycle and the price charged for the utility service can be adjusted with limited impact upon demand volumes. As a result, the earnings of regulated utilities have been, and are expected to continue to be, stable irrespective of economic conditions; and
- **Infrastructure**, which includes Airports, Toll Roads, Ports, Broadcast Communications Infrastructure and Energy Infrastructure (primarily oil & gas pipelines). Regulation of infrastructure companies is generally done through contracts that regulate the prices the company can charge (rather than the earnings) and allows companies to accrue the benefits of volume growth. As economies develop, grow and become more inter-dependent, we expect the underlying levels of aviation, shipping and vehicle traffic to increase as will demand for all forms of communications and energy.

Historically, the Strategy has used the UBS Developed Markets Infrastructure & Utilities index as its benchmark. However, during the year, UBS discontinued production of this (and many other indices). Consequently, Magellan has adopted the S&P Global Infrastructure Index as the benchmark for all its global listed infrastructure strategies.

Performance

The Strategy returned +9.3%, before fees hedged in Australian dollars for the year ending June 30, 2015. The Strategy's return outperformed the 7.5% return of its benchmark, by 1.8%.

The non-utility sectors held in the Strategy performed well during the year with Airport stocks generating a weighted average return of 26%, Ports 25%, Energy Infrastructure 16%, Communications 12% and Toll Roads 10%. The utility exposures performed modestly with a weighted average return of 3%.

Geographically, Asia Pacific and Latin American stocks were the strongest performers returning 22% and 20% respectively. US stocks dragged the performance of the Strategy down, returning less than 1% on average.

The best performing stocks in the Strategy during the year were Mexican airport company OMAB (Total Shareholder Return of +60%), New Zealand power utility Vector (+40%), another Mexican airport company ASURB (+38%), Zurich Airport (+35%), Auckland Airport (+33%) and Australian toll road company Transurban (+32%). Approximately one-third of the stocks in the Strategy saw negative returns for the year, the vast majority being US utilities. US utilities had delivered exceptional returns in previous years so some fall back was not unexpected.

In terms of the stocks included in the new benchmark index but excluded from the Strategy because they do not meet Magellan's stringent definition of investment grade infrastructure:

- Companies with a meaningful exposure to competitive power generation delivered negative returns as did pipelines with a meaningful exposure to the price of oil (Magellan includes oil & gas pipelines in the Strategy only if their earnings are not dependent on the price of the product being transported and they are not structured as MLPs);

- Japanese stocks were up strongly generating a weighted average return of +62%;

- Chinese infrastructure stocks were also up strongly (+25%) although results were highly variable from a high of +41% (China Merchant Holdings) to a low of -48% (China Resources and Transportation Group). However, Chinese infrastructure stocks fell heavily in the last month of the year and continued to do so post year end.

A Reflection on the Last Five Years

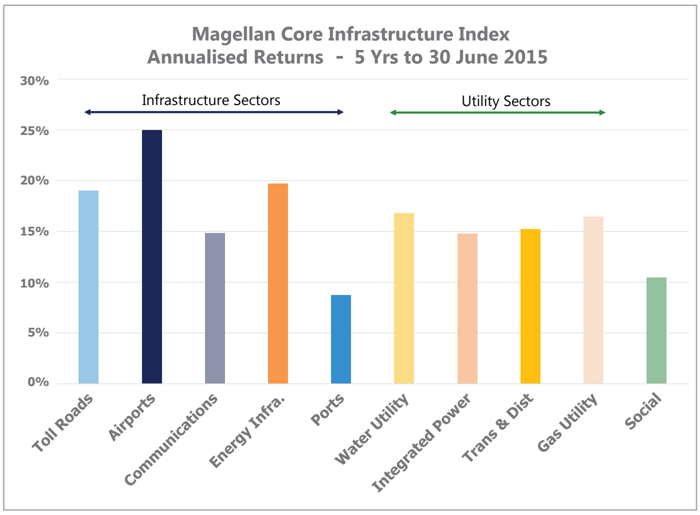
As we have discussed in previous investor letters, there is no universally agreed definition of what is or is not an infrastructure asset. Therefore, every manager needs to define their investment universe as the first step in building a portfolio. Magellan uses what most asset consultants and research houses judge to be the most conservative definition of the term infrastructure of all listed infrastructure managers globally. Magellan refers to the universe of stocks meeting our definition as the Magellan Core Infrastructure Index. The following analysis uses the performance of stocks included in this index to review the key trends in the last five years.

Over the last 5 years, the Magellan Core Infrastructure Index returned 18.4% per annum before fees (compared to a before fee return from the Magellan Select Infrastructure Strategy of 19.8% per annum). The following graph shows returns by sector over this period (which we calculate by taking the average local currency return of the stocks in that sector). The key observations to be made from this data are:

- As we would expect, the returns from the utility sectors were more consistent than the non-utility sectors

- The higher returning non-utility sectors were led by the Airports sector which returned 25% pa over the period.

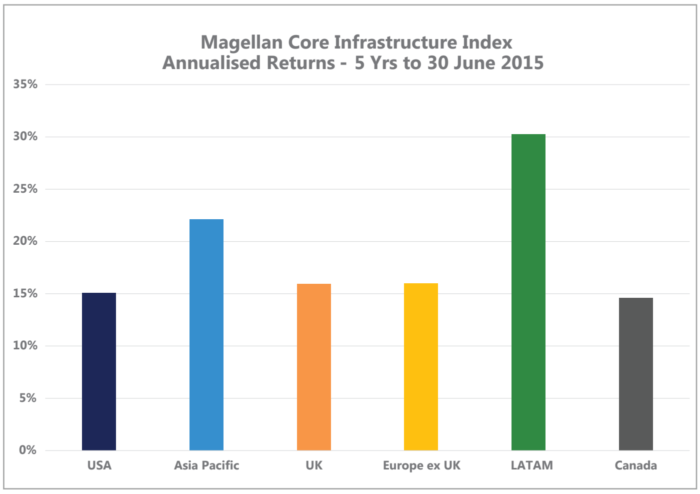
Figure 1: Magellan Core Infrastructure Index by Sector.



Source: Magellan Asset Management Limited

The next graph shows returns by region. Clearly, the Latin American returns, which are primarily driven by four Mexican airport companies, were outstanding while the Asia Pacific stocks also performed very strongly (note that we only include developed markets in the Asia Pacific region). It is worth noting that, despite the ongoing economic problems in Europe, stocks from that region performed in line with the US, UK and Canada.

Figure 2: Magellan Core Infrastructure Index by Geography.



Source: Magellan Asset Management Limited

In terms of individual stock performance:

- The best performing stock was Mexican airport company OMAB with a TSR of 38.5%;
- 5 of the 6 best performing stocks were airports;
- Pleasingly, only one stock of the 86 stocks in the index delivered a negative return over the five year period.

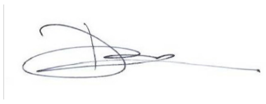
Finally, one of the key reasons that investors choose to include global listed infrastructure in their asset allocation is to diversify their exposures from global equity markets. One of the key criteria used to measure how effective an investment is at risk reduction and diversification is called 'Downside Capture'. This measures how the investment performs when equity markets go down. An analysis of performance over the five years to 30 June 2015 shows that the Magellan Core Infrastructure Index's downside capture ratio was -0.1 (and indeed the Strategy achieved the same result). This means that, on average, the index delivers investors a positive return when global equity markets fall.

Portfolio Outlook and Strategy

The Strategy is designed to provide reliable returns in all but the most extreme market conditions. Excluding the impact of FX effects, Magellan expects the strategy to provide a gross return of inflation plus 5% to 6% over the medium term. The Strategy marginally exceeded that expectation during the last year and we now see the utilities market as broadly in equilibrium while infrastructure stocks, particularly those in Europe, remain cheap.

Magellan believes that infrastructure and utility 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 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.

Yours sincerely,



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Performance is compared to the Global Infrastructure Benchmark which comprised of the following: from inception to 31 December 2014, the benchmark is UBS Developed Infrastructure & Utilities Index NTR Index (Hedged to AUD) and from 1 January 2015 onwards, the benchmark is the S&P Global Infrastructure NTR Index (Hedged to AUD). Both indices are market capitalisation weighted indices that are designed to measure the equity performance of listed Infrastructure and Utility stocks. Index results assume the reinvestment of all distributions of capital gain and net investment income using a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treaties. The index is hedged to Australian dollars.

GIPS® DISCLOSURE

Magellan claims compliance with the Global Investment Performance Standards (GIPS®). For the purpose of complying with GIPS, the Firm is defined as all discretionary portfolios managed by Magellan. The Magellan Core Infrastructure Hedged to AUD composite is a global Strategy investing in strictly defined or "pure" infrastructure companies (typically 80-120). To achieve investment objectives, the composite may also use derivative financial instruments including, but not limited to, options, swaps, futures and forwards. Derivatives are subject to the risk of changes in the market price of the underlying securities instruments, and the risk of the loss due to changes in interest rates. The use of certain derivatives may have a leveraging effect, which may increase the volatility of the composite and may reduce its returns. A list of composites and descriptions, as well as policies for valuing investments, calculating performance, and preparing compliant presentations are available upon request by emailing data@magellangroup.com.au

^ The representative portfolio is an account in the Composite that closely reflects the portfolio management style of the Strategy. Performance is not a consideration in the selection of the representative portfolio. The characteristics of the representative portfolio may differ from those of the composite and of the other accounts in the composite. Information regarding the representative portfolio and the other accounts in the composite is available upon request. Industry and Geographical Exposures are calculated on a look through basis based on underlying revenue exposure of individual companies held within the portfolio.