MFG Core Infrastructure

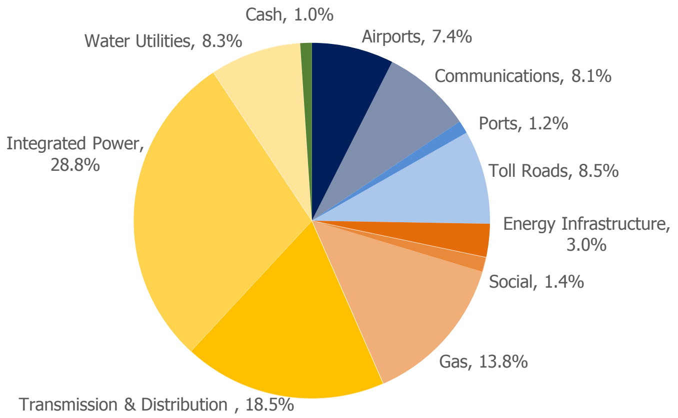
Key Facts

Portfolio Manager	Dennis Eagar / Gerald Stack
Inception Date	19 December 2009
Total Infrastructure Assets[1]	USD $3,941.3 million
Total Core Infrastructure Assets	USD $3,066.3 million
Composite Size[2]	USD $403.8 million

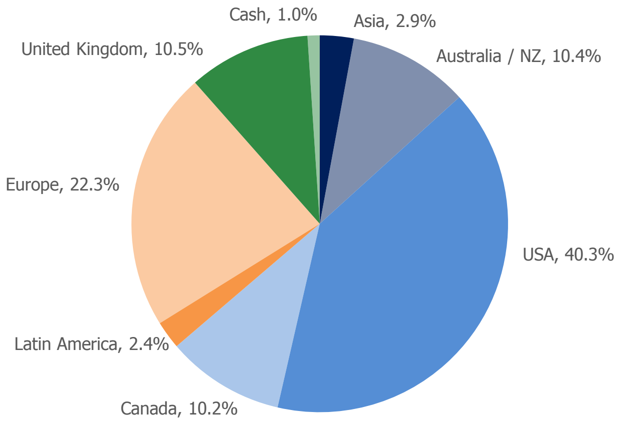
Top 10 Holdings[4]

	Sector	% of Strategy
TransCanada Corp	Gas Utilities	3.0
Enbridge Inc	Gas Utilities	3.0
Abertis	Toll Roads	3.0
Power Assets Holdings	Integrated Power	2.9
National Grid PLC	Transmission and Distribution	2.9
Transurban Group	Toll Roads	2.9
SES GDR	Communications	2.8
United Utilities Group Plc	Water Utilities	2.7
Red Electrica De Espana SA	Transmission and Distribution	2.6
Fortis Inc	Transmission and Distribution	2.5

Industry Exposure[4]



Country Exposure by Domicile of Listing[4]



Performance

During the December 2014 quarter in USD terms, the MFG Core Infrastructure Strategy ('Strategy') returned +5.8%, compared with the benchmark UBS Infrastructure and Utilities Index's[3] return of +3.4%. The returns for the 12 months to the end of December were 17.4% for the Strategy and 14.1% for the benchmark. The returns for the two years to the end of December were 15.7% p.a. for the Strategy and 14.2% p.a. for the benchmark. The outperformance in part reflected the benefit of the Strategy excluding all stocks from its investable universe that were materially dependent on oil prices.

Geographically, stock performance was strong across all markets including the USA (Total Shareholder Return (TSR) average of +14.3%), the UK (+10.0%), Canada (+9.2%) and Australia/NZ (+8.0%), while slightly weaker in Europe ex UK (+3.0%). All sectors provided positive returns for the period with the best performing sectors being Integrated Power Utilities (+14.7%), Toll Roads (+13.8%), Water Utilities (+11.8%) and Power Transmission & Distribution (+9.0%). The 23 best performing stocks in the quarter were all US utilities with the best performing stocks being Southwest Gas (TSR of 28.0%), Pinnacle West (+26.3%), Northwestern Corp (+25.7%) and Allete Inc (+25.4). The only significant negative performers for the quarter were toll road company OHL Mexico (-24.8%) after its major shareholder sold down a part of its stake and the company also sold a stake in its largest toll road asset to fund capex on other toll roads in its portfolio, German Port Hamburger Hafen (-8.2%), German Airport company Fraport (-7.3%) and Italian gas utility Snam Rete (-6.4%).

In terms of the stocks included in commonly used infrastructure indices but excluded from the Strategy's universe, Korean stocks performed poorly (average TSR of -10.1%) as did Power Generation stocks (-3.8%) including Greece's Public Power Corp (-42.6%), the UK's Drax Group (-28.8%), US utility ONEOK (-23.3%) and Australia's Origin Energy (-22.0%). US & Canadian rail stocks provided an average TSR of +2.1% while US Oil & Gas MLP's generated an average TSR of -11.5%. French construction and toll road company, Vinci, provided a TSR of 1.1%.

Risks of Increasing Interest Rates

In our view, the major risk currently faced by infrastructure (and other asset classes) is the impact of a potential increase in bond yields.

The past six months has witnessed an increase in underlying interest rates as investment markets turned their focus to the prospect the Fed will end its Quantitative Easing programme ('QE') in the next couple of years. We expect interest rates to continue to rise over the medium term. Increasing interest rates represent a challenge for all investment classes and infrastructure, although better placed than many assets, is not immune from these risks. While prevailing interest rates have been well below historical averages since the global financial crisis, we do not believe that long-term infrastructure investors made their investment decisions during the period since the GFC based on prevailing interest rates, but on a higher, more historically normal level of interest rates. As a consequence, while increasing interest rates represent a

1 Comprised of the total Firm Infrastructure assets, comprising the Select Infrastructure strategy and Core Infrastructure strategy.
2 Returns and risk measures are for the Global Core Infrastructure USD Composite. *Refer overleaf for further information.
3 Index: UBS Developed Infrastructure & Utilities Net Total Return Index (USD). Source: UBS. From 1 April 2015, the UBS Developed Infrastructure and Utilities Net Total Return Index (USD) will no longer be available. Thus as of 1 January 2015, the index was changed to the S&P Global Infrastructure Index (USD) Net Total Return.
4 Representative Portfolio. ^Refer overleaf for further information.

risk for investors in infrastructure assets, we believe that the medium-to-long-term risk is not that interest rates rise from present levels rather that they rise materially above "normal" levels.

The risks posed by an increase in interest rates are somewhat different for utilities and infrastructure assets.

- ***Utilities:*** Utilities operate under a contract with their communities under which the utility provides a reliable, efficient service and invests for the future, in return earning a fair return on the capital invested in its operations. Utilities are not able to exploit their natural monopoly power, but they are protected from both the fluctuations of the economic cycle and changes in variables outside their control, such as interest rates. Ultimately, the key determinant of the level of returns generated by regulated utilities is the return approved by their regulators. An increase in interest rates should lead to an increase in the approved rate of return (so that the utility continues to be able to earn a fair return). However, a utility can suffer because of mismatches and lags between increases in interest rates and subsequent accompanying increases in approved regulatory returns. Regulatory rates of return have been sticky as interest rates have declined and we expect that there will also be stickiness as they rise.

- ***Infrastructure:*** Infrastructure assets typically have an ability to pass the effects of inflation through to consumers via the price of the infrastructure service (e.g. tolls on a toll road are normally linked to inflation). However, where an infrastructure asset is partially funded by debt, an increase in interest rates (that is not accompanied by an increase in inflation) can increase the cost of the debt (with a lag if the debt interest costs are hedged) and, therefore, reduce the returns available to investors.

One of the interesting effects of the GFC has been the significantly increased focus of debt markets on the reliability of the debt of high-quality infrastructure and utility assets. The companies in which we invest now have access to more sources of debt, longer term debt and significantly cheaper debt than pre-GFC. As a consequence, almost all of the companies in which we invest have the significant majority of their debt in fixed interest rate structures that will insulate them from any rise in interest rates in the shorter term.

Company in Focus: Vopak

Headquartered in the Netherlands, Vopak owns liquid storage tanks located in ports around the world. In total, the company has 80 'terminals' in over 28 countries, with an aggregate tank capacity of 33 million cubic meters. The capacity of these tanks is contracted to customers, typically on a multi-year basis and the contracts are largely structured on a take-or-pay basis - meaning that Vopak receives the majority of its fees whether the customer uses the capacity or not. We view this contract structure positively, as there is little linkage between Vopak's revenues and volume throughput, which can be sensitive to commodity prices.

Vopak's asset base is diversified in terms of the regional and product markets in which it operates. 38% of the company's capacity is located in the Netherlands, 21% in EMEA (Europe, the Middle East and Africa), 22% in Asia, 10% in North America and 5% Latin America. In terms of the types of products, Vopak's earnings are split into oil products (approximately 50%), chemicals (20%), biofuels (10%) and liquefied natural gas (2.5%).

As a rule, the company derives profits from the imbalance between the geographic energy supply and demand sources around the world. Such imbalances exist for different types of oil products; for example, Europe exports petrol to the Americas while importing diesel and bunker (ship fuel). These imbalances create a need to store oil at both transport origins and destinations. Vopak's expertise, reputation and track-record allow it to get approval to develop new terminals and ensure its assets are located appropriately within the global energy supply chain.

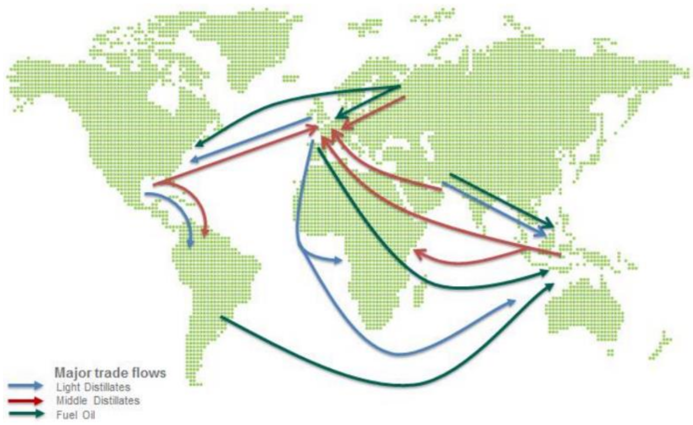


Figure 1: Major oil product trade flows. Source: Vopak Company Filings

This complexity in the global energy supply chain creates opportunity for Vopak. As demand continues to grow in regions with limited oil production, such as Asia, Vopak should be able to continue generating attractive returns and develop new projects.

However, Vopak's business is not without its risks. The company needs to maintain assets in the right trade-lanes, which requires ongoing execution from the management team (although this risk is somewhat reduced by having a relatively diversified asset base). Vopak has been pressured by increases in competing storage capacity in some regions, although its overall asset utilisation remains robust at 89%.

Another area of risk (and opportunity) is the level of demand for Vopak's oil storage capacity by specialised 'oil traders'. These traders will often buy oil and sell it 'forward' for delivery at a future date to lock in a profit. However, this activity requires the forward price to be above the current price and over the past few years this has not been the case. This has reduced the demand for oil storage in key hubs, such as Rotterdam, and contributed to marginally weaker utilisation and storage fees in some regions. However, following the recent oil price decline the 'forward curve' has reversed (see chart below). As a result, demand for Vopak's capacity should grow in its key trading hubs and this part of the market will begin to act as a tail-wind rather than head-wind.

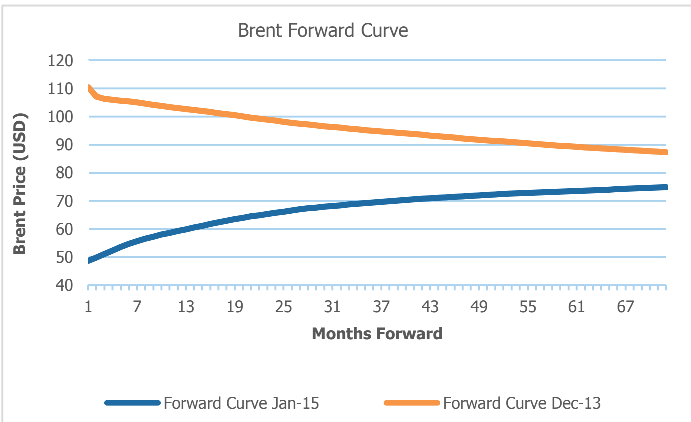


Figure 2: Brent Forward Curve change December 2013 to January 2015. Source: Thomson Reuters Eikon.

To summarise, Vopak is exposed to the energy industry through its operations, but has limited direct exposure to the price of oil itself. As a result, Vopak fits into the strategy of investing in low-risk infrastructure companies that are able to deliver steady, reliable returns. The company has continued to generate attractive returns on its investments, considering the risks its undertaking, with annual returns on invested capital of 16% to 20% between 2009 and 2013. We expect that it will continue to do so for the foreseeable future.

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Performance is compared to the UBS Developed Infrastructure & Utilities Index Net Total Return which is a market capitalisation weighted index that is 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.

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