MFG Core Infrastructure

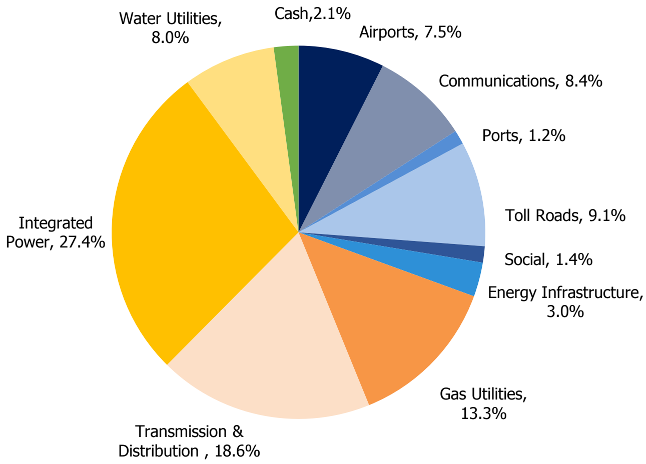
Key Facts

Portfolio Manager	Dennis Eagar / Gerald Stack
Inception Date	19 December 2009
Total Infrastructure Assets[1]	USD $3,834.9 million
Composite Size[2]	USD $439.7 million
Total Core Infrastructure Assets	USD $3,010.6 million

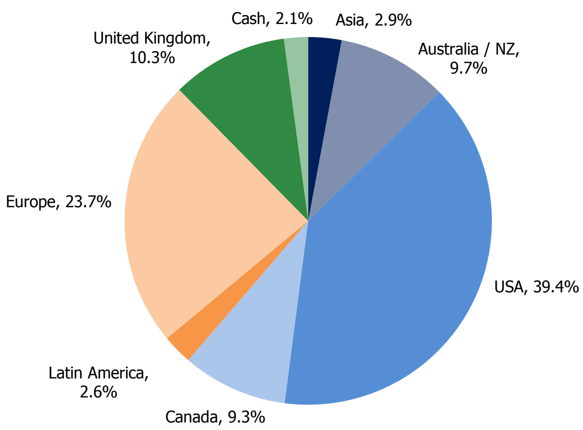
Top 10 Holdings[4]

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

Industry Exposure[4]



Country Exposure by Domicile of Listing[4]

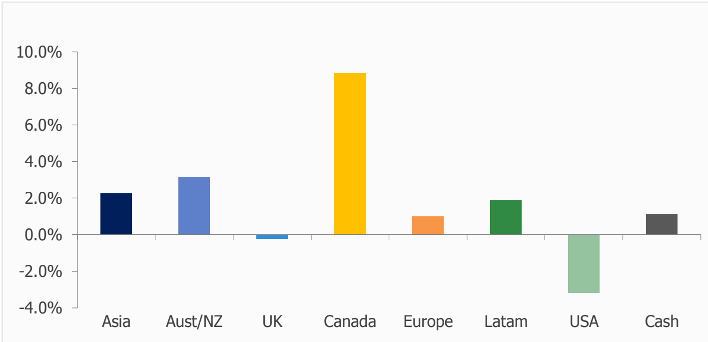


Performance

During the September 2014 quarter in USD terms, the MFG Core Infrastructure Strategy ('Strategy') returned -3.9%, compared with the benchmark UBS Infrastructure and Utilities Index's return of -4.3%. The returns for the calendar year to the end of September were 10.9% for the Strategy and 10.4% for the benchmark. The returns for the 12 months to the end of September were 16.0% for the Strategy and 13.4% for the benchmark. The returns for the two years to the end of September were 14.2% p.a. for the Strategy and 12.7% p.a. for the benchmark.

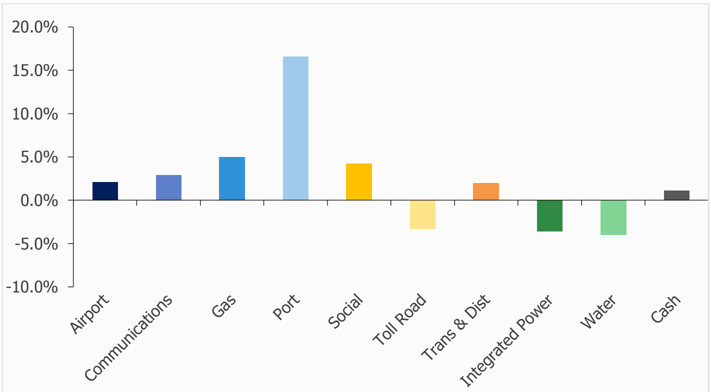
The Strategy's Canadian and Australian exposures generated strong positive returns during the quarter, but these were largely mitigated by negative returns from its US and UK stocks.

Figure 1: Regional returns – September 2014



The Ports sector performed strongly during the period, recovering ground lost over the previous two quarters. Elsewhere, the Integrated Power and Water Utility sectors were impacted by the decline in US stocks although, interestingly, both the Gas Utility and Power Distribution and Transmission sectors delivered positive returns. The following graph shows returns for the quarter by sector.

Figure 2: Sector returns – September 2014



Over the quarter, the best performing stocks in the Strategy were Dutch oil and chemical tank storage company Vopak (Total Shareholder Return (TSR) of +19.7%), Mexican Airport Operator OMAB (TSR of +17.3%), Canadian pipeline company TransCanada (+14.2%), Spanish gas pipeline company Enagás (+12.4%) and Zurich Airport (+10.0%).

[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
[4] Representative Portfolio. ^Refer overleaf for further information.

The 10 worst performing stocks in the Strategy were all US utilities, with particularly large negative returns recorded for Cleco Corp (-17.7%), PNM Resources (-14.5%), Allete Inc (-12.7%), NorthWestern Corp (-12.4%) and Atmos Energy (-10.0%).

As mentioned, the Strategy's utility exposures were a drag on performance, with both water and energy utilities down over 3% for the quarter. Most of this fall occurred in the last month of the period as investor sentiment was impacted by rising bond yields in the US. There may be further weakness in utility share prices over coming months, but MFGAM remains comfortable with the Strategy's utility exposures:

- Almost universally among the Strategy's holdings, management have taken advantage of the appetite for high-quality debt offerings to put in place debt structures that are largely insulated from short-term movements in bond yields. Companies now have:
  - Very high levels of fixed-price debt, often around 90% of total debt in the current period.
  - Much smoother debt maturity profiles, with average maturities in excess of 7 years, meaning that in any one year typically only 5%-10% of the total debt becomes due for refinancing.
- We are confident that the regulatory regimes to which the Strategy's utilities are exposed will provide more than adequate protection (albeit with some regulatory lag) to the impact on those businesses of higher interest rates.
- There is evidence that the correlation between bond yields and the dividend yield of US regulated utilities has significantly diminished over the last decade (acknowledging that there was a quite high correlation through the 1980's and 1990's).
- Additionally, many of the Strategy's US utility holdings have the capacity to increase dividends by increasing payout ratios (because of declining capex requirements), which will help mitigate the effects of rising rates.

In terms of stocks included in the benchmark index but excluded from MFGAM's universe of investable stocks, the unregulated power generation market again performed poorly, delivering an average TSR of -5.6%, while French construction and toll road company, Vinci, delivered a TSR of -15.7%. Countering those falls were strong performance from Korean utilities (average TSR of +23.7%) and Japanese stocks (TSR of +4.4%). Stocks in these two markets have been particularly poor performers over recent years so some recovery in their share prices did not surprise us.

Portfolio

During the quarter, two stocks, US utility UNS Energy and Australian Gas Utility Envestra, were removed as a result of takeovers.

The graphs on page 1 show the sector and regional exposures of the Strategy during the September 2014 quarter.

Investment in Telecommunication Towers

The Strategy holds exposures in two US-listed telecommunication tower companies, Crown Castle International Corp and American Tower Corp. Communications towers are structures designed to hold communications equipment for wireless applications such as mobile telephony, television, radio, public safety communications networks and so on. The focus of both the above companies is facilitating the transmission of mobile telephony and data.

Growth Market

Demand for mobile data is very strong, driven by widespread adoption of smartphones and tablets. Humans have a seemingly insatiable desire for increased connectivity. Cisco estimated that in 2013:

- Global mobile traffic grew 81%. 45% of global mobile traffic was offloaded to WiFi networks or femtocells, without which traffic would have grown by 98%.
- Smartphones represented 27% of mobile handsets, but 95% of mobile handset traffic.
- 4G devices represent just 3% of all mobile connections, but 30% of the mobile traffic.
- The average mobile-connected tablet generates 2.6x more traffic than the average smartphone and the average mobile-connected laptop 4.6x more.
- Video represented over 50% of mobile traffic.

Cisco forecasts that mobile data traffic will expand 11 times between 2013 and 2018, representing a compound annual growth rate of 61%. This is from a combination of increased penetration of mobile-connected devices and increased data use per device.

The only way that telecommunications companies will be able to meet this demand is with improved technology, more spectrum, or more cell sites. Given the scale of the demand increase, and the limitations of the laws of physics, growth in cell sites (situated on towers or other structures) is an absolute certainty.

Towers are Critical

Wireless transmission equipment can be placed on any structure. However, as signals degrade when faced with obstacles like buildings and trees, the best results are typically achieved when equipment is placed high above the clutter level. This is where towers come in. Tower-mounted wireless equipment is known as a macrocell site for its wide footprint relative to other "small" cells. Wireless towers are generally the least expensive way for a carrier to achieve broad coverage over a given geographic area.

As mobile telephony became possible, carriers first built their own towers to hold only their own equipment. Later, independent wireless tower companies built towers on which they co-located multiple carriers, making it cheaper for each carrier. At the same time, each new tenant provides very high incremental margins to the tower owner, generating strong returns and free cash flow as more tenants use the tower.

Carriers typically choose a tower based solely on location (when seeking to improve coverage or capacity of their wireless networks). There is typically little competition between existing towers. In addition, it is very difficult to build new towers due to local community opposition, providing an effective barrier to entry. As a result, very few new towers are being built in the US.

Once equipment is mounted on a tower, it is very costly for a carrier to switch due to actual moving costs and the fact that one transmitter cannot be moved in isolation without impacting overall coverage (therefore adjacent equipment also potentially needs to moved). Reflecting the long-term importance of towers to network integrity, carriers typically enter 10-year contracts for new equipment installations.

Crown Castle International owns 31,500 communications towers in the US and Australia. While its towers hold an average of 2.4 tenants per tower, the company notes that every tower can support at least one more tenant at little incremental cost. American Tower owns over 67,000 towers in 14 countries.

Outlook and Strategy

The Strategy is designed to provide investors with real returns of 5% to 6% over the longer term. Such a return assumes that all stocks are fairly priced at the start of the return period, i.e. stocks don't have to be cheap to start with to generate our expected long-term return. Despite the fact that the Strategy's returns in recent years have been well above our long-run return expectations, we continue to believe that it will deliver high single-digit absolute returns over the medium term.

There have been minimal changes to the types of stocks held in the Strategy over the last decade and no changes to the rules used to determine what stocks should be excluded or included in the Strategy. It has served investors well up to this time, and we firmly believe it will continue to do so while acknowledging that, if markets continue to rise at double-digit rates, the Strategy will underperform broader equity markets.

Regardless, MFGAM notes that there remain many potential catalysts for an equity market downturn against which an investment in the Strategy would, on the basis of historical evidence, prove a very valuable defensive hedge.

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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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The Magellan Global Core Infrastructure 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