Fund Update: 31 December 2022

Magellan Infrastructure Fund

ARSN: 126 367 226

Fund Facts

Portfolio Manager	Gerald Stack
Structure	Global Listed Infrastructure Fund, A$ Hedged
Inception Date	1 July 2007
Management Fee[1]	1.05% per annum
Buy/Sell Spread[1]	0.15%/0.15%
Fund Size	AUD $2,402.1 million
Distribution Frequency	Semi-annually
Performance Fee[1]	10.0% of the excess return of the units of the Fund above the higher of the Index Relative Hurdle (S&P Global Infrastructure Net Total Return Index (A$ Hedged)) and the Absolute Return Hurdle (the yield of 10-year Australian Government Bonds). Additionally, the Performance Fees are subject to a high water mark.

[1]All fees are inclusive of the net effect of GST

Fund Features

- Benchmark-unaware exposure to global listed infrastructure
- Conservative definition of core infrastructure
- Relatively concentrated portfolio of typically 20 to 40 investments
- Seeks to substantially hedge the capital component of the foreign currency exposure back to Australian dollars
- Typical cash exposure between 0% - 20%
- $10,000 minimum investment amount.

3 Year Rolling Returns (measured monthly)^*

Against Global Infrastructure Benchmark	1 Year	3 Years	5 Years	Since Inception
No of observations	12	36	60	151
Average excess return (% p.a.)	-1.4	1.5	2.0	3.4
Outperformance consistency	8%	67%	77%	89%

Fund Performance^

	Fund (%)	Index (%)+	Excess (%)
1 Month	-3.4	-3.4	0.0
3 Months	6.9	7.2	-0.3
1 Year	-5.9	1.3	-7.2
3 Years (p.a.)	-1.4	0.5	-1.9
5 Years (p.a.)	3.6	3.5	0.1
10 Years (p.a.)	9.1	7.9	1.2
Since Inception (p.a.)	7.0	5.2	1.8

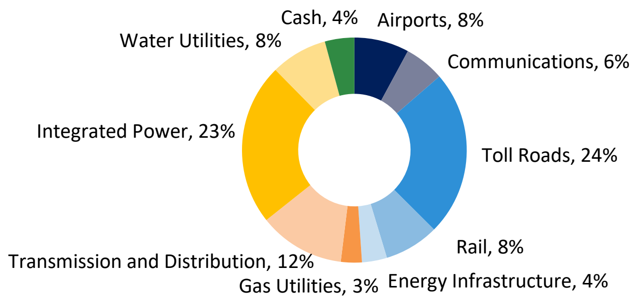
Fund Risk Measures**

	5 Years	Since Inception
Upside Capture	0.6	0.7
Downside Capture	0.6	0.5

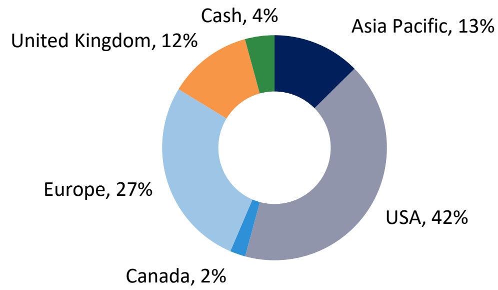
Top 10 Holdings

	Sector#	%
Transurban Group	Toll Roads	7.3
Vinci SA	Toll Roads	7.2
National Grid Plc	Transmission and Distribution	5.3
Ferrovial SA	Toll Roads	5.0
Sempra Energy	Integrated Power	4.7
Aena SME SA	Airports	4.5
United Utilities Group Plc	Water Utilities	4.4
Atlas Arteria	Toll Roads	4.3
Norfolk Southern Corporation	Rail	4.0
Evergy Inc	Integrated Power	3.8
	TOTAL:	50.5

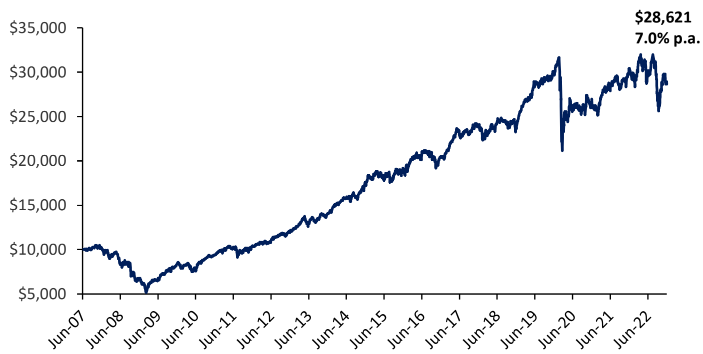
Sector Exposure#



Geographical Exposure#



Performance Chart growth of AUD $10,000^



Sectors are internally defined. Geographical exposures are by domicile of listing. Cash exposure includes profit/loss on currency hedging. Exposures may not sum to 100% due to rounding.
^ 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). Fund Inception 1 July 2007.
* 3-year returns are calculated and rolled monthly in AUD, with the outperformance consistency indicating the percentage of positive excess returns since inception.
+ S&P Global Infrastructure Net Total Return Index (A$ Hedged) spliced with UBS Developed Infrastructure and Utilities Net Total Return Index (A$ Hedged) prior to 1 January 2015. Note: as the UBS Developed Infrastructure and Utilities Net Total Return Index ($A hedged) ceased to be published from 31 May 2015, it was replaced by Magellan on 1 January 2015 with the S&P Global Infrastructure Net Total Return Index (A$ Hedged).
** Upside/downside capture shows if a fund has outperformed the global market during periods of market strength and weakness, and if so, by how much. The MSCI World Net Total Return Index (A$ Hedged) has been used as the representative of the global market to calculate this risk measure.

Fund Commentary

The portfolio recorded a positive return in the December quarter as inflation and 10-year bond rates pulled back from September highs. The stocks that contributed the most were French toll road and airport operator Vinci, US rail company Norfolk Southern and UK water utility United Utilities. Vinci rose as traffic on its roads and at its airports exceeded expectations. Norfolk Southern advanced as Congress intervened in a long-running labour dispute to force a settlement on the unions that were holding out. United Utilities lifted as the draft methodology for the next regulatory period was well received and UK bond rates fell.

The stocks that detracted the most were the investments in US utility Dominion Energy, and US tower companies Crown Castle and American Tower. Dominion Energy fell as the management team announced a strategic review of the business that could lead to changes to earnings guidance. Crown Castle and American Tower lagged as interest rates and inflation remained elevated.

Stock Story: Transurban

Transurban

While the economic storm of the global financial crisis (GFC) raged in 2008/2009, Transurban's portfolio of Australian toll roads continued to grow traffic volumes or had very muted declines. While it is easy to say Australia was far less affected by the GFC than the rest of the world, the resilience of urban toll roads (where traffic was far less impacted than many other forms of transport infrastructure) was repeated time and again across the globe, even in some of the more affected countries such as Portugal.

Today's storm is of a different making – inflation and interest rates have ravaged markets while recession looms. However, it is the nature of urban toll roads and, by extension, the world's largest urban toll road company, Transurban, that places them in one of the strongest positions as:

- Traffic volumes exhibit little economic sensitivity;
- Tolls are largely inflation linked; and
- Debt costs are predominantly fixed in the short to medium term.

From an underlying traffic point of view, one of the reasons urban toll roads are so resilient is because of the variety of trip types they are used for. Contrary to common belief, prior to the pandemic a Transurban survey in Australia showed only 16% of respondents nominated commuting as the main reason they use toll roads. Urban toll roads allow people to move more easily around the cities they live in and hence traffic on these roads is usually more resilient to an economic downturn.

While today's drivers are different, there are echoes of 2008 in where we stand today. In 2008, inflation in Australia was accelerating on the back of high energy prices (Brent Crude topped US$143 bbl in 2008) and rates were rising until the subprime crisis sent a chill through financial markets.

Today oil prices, inflation and rates are all elevated compared to recent history. However, we believe that Transurban is well placed to benefit from the inflation spike – 68% of its revenue has a direct passthrough of inflation with a further 4% being dynamic pricing (which captures inflation indirectly) – yet its costs are not increasing at the same rate. Most obviously, Transurban's debt is largely fixed and the average debt tenor is seven years, with only around 11% of total proportional drawn debt to be refinanced in the next two years. This means Transurban is getting the benefit of the increased toll from the inflation spike through to the end of its concessions but is likely to pay only a limited amount more in financing costs if the central banks are successful in bringing inflation, and hence interest rates, back under control.

Some investors suggest that the company is not attractive because the yield is now similar to the Australian 10-year bond yield. While we appreciate yield is important for some investors, it should be remembered that yield is one component of shareholder return. At its simplest level, consensus estimates for FY2023 and FY2024 EBITDA growth are more than 10% p.a. With 98% of debt on a fixed interest rate over this period and with an average debt tenor of 7 years, we expect this to translate into even higher cash flow in the short to medium term. Even without this benefit, at a base level, if you assume that the yield remains stable at ≈3.8% and underlying cash flow is growing at > 10%, all else equal we expect that the total return from an investment in Transurban shares should be approximately 13.8%.

One thing investors often forget about Transurban is the significant option value inherent in the portfolio of assets that it has. For example, the existing portfolio of assets operated by Transurban includes several expansionary projects such as the widening of the M7 motorway in Sydney (project approval was announced in late December), the Gateway and Logan motorways in Brisbane, and bidirectional tolling on the I-95 and extension of the I-495 in Virginia, USA amongst others. Incumbency should also provide Transurban with a significant advantage in bidding for new projects in existing markets through scale and informational advantage and should afford it a privileged opportunity to craft solutions for government partners that are also accretive to shareholders, such as a toll increase on the M7 to partly fund NorthConnex.

To paraphrase Benjamin Graham, in the short term the market is a voting machine, in the long term it is a cash flow weighing machine. We believe that consistent growth leading to an ever-expanding weight of underlying cash flows will ultimately be reflected in the stock price.