Strategy Update: 31 December 2019

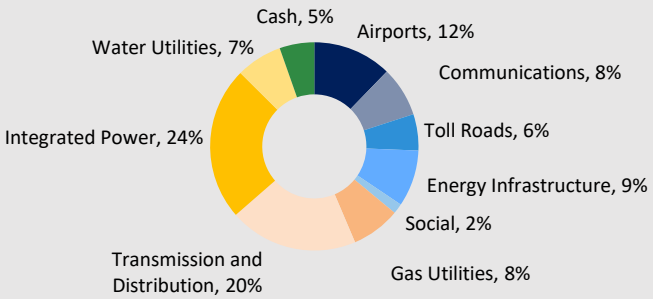
Magellan Core Infrastructure (AUD Hedged)

Portfolio Manager	Strategy Inception Date	Total Strategy Assets	Total Infrastructure Assets [1]
Gerald Stack	17 December 2009	AUD $8,413.4 million	AUD $17.633.8 million

Objective	Approach
Capital preservation in adverse markets	Diversified rules-based portfolio applying our proprietary infrastructure classification
Pre-fee return of CPI plus 5%p.a. through the economic cycle	Benchmark unaware
	Highly defensive, inflation-linked exposure

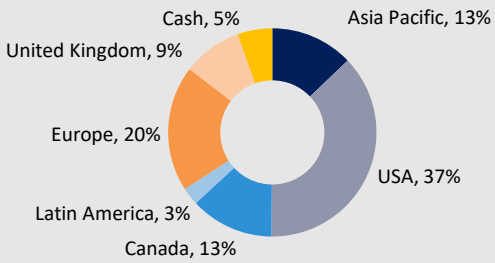
Top 10 Holdings[2]	Sector[2]	%
National Grid PLC	Transmission and Distribution	3.0
Fortis Inc	Transmission and Distribution	3.0
Enbridge Inc	Energy Infrastructure	2.9
Aena SME SA	Airports	2.9
TC Energy Corp	Energy Infrastructure	2.8
Transurban Group	Toll Roads	2.8
Sydney Airports	Airports	2.7
Cellnex Telecom SA	Communications	2.7
Snam Rete Gas SpA	Gas Utilities	2.2
Emera Inc	Transmission and Distribution	2.1
	TOTAL:	27.1

Sector Exposure[2]



AUD 5 Year Risk Measures[4]	Against Global Equities	Against Infrastructure Benchmark[5]
Upside Capture	0.5	1.1
Downside Capture	-0.1	0.8
Beta	0.3	0.9
Correlation	0.3	0.8

Geographical Exposure[2]



Cumulative Performance[3]	3 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	7 Years (% p.a.)	10 Years (% p.a.)	Since Inception (% p.a.)
Composite (Gross)	2.8	28.3	13.3	11.7	14.6	15.0	15.1
Composite (Net)	2.7	27.5	12.6	10.9	13.8	14.2	14.4
Global Infrastructure Benchmark	2.9	25.3	10.2	7.6	11.2	9.7	9.8
Excess (Gross)	-0.1	3.0	3.1	4.1	3.4	5.3	5.3
MSCI World NTR Index Hedged to AUD	7.3	26.7	12.0	10.0	13.2	12.0	12.1

Annual Performance[3]	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009*
Composite (Gross)	28.3	-1.7	15.4	10.6	7.9	28.0	16.7	16.3	15.6	15.9	1.9
Composite (Net)	27.5	-2.4	14.6	9.8	7.2	27.1	15.8	15.5	14.8	15.1	1.9
Global Infrastructure Benchmark	25.3	-6.7	14.4	14.1	-5.4	22.9	18.5	9.1	4.7	5.7	0.9
Excess (Gross)	3.0	5.0	1.0	-3.5	13.3	5.1	-1.8	7.2	10.9	10.2	1.0
MSCI World NTR Index Hedged to AUD	26.7	-7.4	19.8	10.4	3.8	12.3	31.8	18.8	-2.3	12.6	1.1

1 Comprised of all Infrastructure Strategies.
2 The data is based on a representative portfolio for the strategy. Refer to the GIPS Disclosure below for further information. Sectors are internally defined. Geographical exposure is by domicile of listing. Exposures may not sum to 100% due to rounding.
3 Returns are for the Global Core Infrastructure Hedged to AUD Composite and denoted in AUD. Performance would vary if returns were denominated in a currency other than AUD. Refer to the GIPS Disclosure section below for further information. Composite (Net) returns are net of fees charged to clients and have been reduced by the amount of the highest fee charged to any client employing that strategy during the period under consideration. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. Fees are available upon request.
4 Risk measures are for the Global Core Infrastructure Hedged to AUD Composite before fees. The Global Equity Index is the MSCI World NTR Index (hedged in USD).
5 The Benchmark or Global Infrastructure benchmark is comprised of the following: from inception to 31 December 2014 the benchmark is UBS Developed Infrastructure & Utilities NTR Index (hedged to AUD) and from 1 January 2015 onwards, the benchmark is the S&P Global Infrastructure NTR Index (hedged to AUD). Note: the UBS Developed Infrastructure and Utilities NTR Index (hedged to AUD) ceased to be published from 31 May 2015, replaced on 1 January 2015 with the S&P Global Infrastructure Index NTR (hedged to AUD).
* Returns are only for part year.

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The Global Infrastructure Benchmark is comprised of the following: from inception to 31 December 2014 the benchmark is UBS Developed Infrastructure & Utilities Index Net Total Return (AUD Hedged) and from 1 January 2015 the benchmark is S&P Global Infrastructure Net Total Return Index (AUD Hedged). The benchmark changed because UBS discontinued their index series.
The UBS Developed Infrastructure & Utilities Index Net Total Return (AUD Hedged) 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. The index is hedged to Australian dollars.
The S&P Global Infrastructure Net Total Return Index (AUD Hedged) is a market capitalisation weighted index that is designed to track 75 companies from around the world diversified across three infrastructure sectors energy, transportation and utilities. 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.

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Magellan Asset Management Limited, doing business as MFG Asset Management in jurisdictions outside Australia and New Zealand, (MFG Asset Management) claims compliance with the Global Investment Performance Standards (GIPS ®)

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The Global Core Infrastructure Hedged in AUD composite is a global strategy investing in strictly defined or "pure" infrastructure companies (typically 80-100). The filtered investment universe is comprised of stocks that 1. generate reliable income streams, 2. benefit from inflation protection and have an appropriate capital structure. The investment objective of the strategy is to minimise the risk of permanent capital loss; and achieve superior risk adjusted investment returns over the medium to long-term. The composite is hedged to Australian dollars with Forward contracts. The composite was created in December 2011.

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 copy of the composite's GIPS compliant presentation and/or the firm's list of composite descriptions are available upon request by emailing client.reporting@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.

AUD is the currency used to calculate performance.

Strategy Commentary

The portfolio recorded a positive return in for the quarter. The stocks that added the most on a contributions basis were the investments in National Grid of the UK, Enbridge of Canada and ADP of France. National Grid jumped 9.0% after the defeat of the Labour Party in the general election held in the UK on December 12 removed the uncertainty that utilities could be nationalised at below-market prices. Enbridge surged 13% after adjusted earnings per share of 56 Canadian cents beat forecasts. ADP added 8.5% after the latest counts showed the campaign to force a referendum on whether or not the French government could sell all or some of its 50.6% stake in the Paris airport system was well short of the number needed. A change to the French constitution in 2008 allows a referendum on certain issues if 20% of members of parliament and 10% of the electorate – about 4.7 million people – back the proposal. The latest counts showed barely one million people have signed the online petition that has until March to reach its target.

Stocks that detracted the most on a contributions basis included the investments in Aguas Andinas of Chile, Duke Energy of the US and Fortis of Canada. Aguas Andinas plunged 20% as talk intensified that street riots over the cost of living would prompt the Chilean government to cut the rate of return the water utility enjoys. Duke Energy slid 3.8%, even though the company posted third-quarter earnings that beat expectations, as reports showed trade wars are reducing US manufacturing activity and hence demand for its gas and electricity services. Fortis lost 2.9% after the electrical utility's results for the third quarter, which showed a profit of US$278 million, was only in line with the same period a year earlier.

Movements in stock prices are in local currency.

Stock story: American Water

In the US, more than two trillion gallons (9.1 trillion litres) of water are lost each year – that means 20% of treated water is wasted. About 900 billion gallons (4.1 trillion litres) of untreated sewage every year pours into US waterways. The problem is about 240,000 water mains break each year, which is no surprise given that many of country's pipes were laid early to mid-last century and they had a lifespan of only 75 to 100 years. This year, 44% of US water-pipe infrastructure is expected to be assessed as 'poor', 'very poor' or 'life elapsed', another way of saying 'needs replacing'. As for quality, the American Society of Civil Engineers gave US drinking water a 'D' in 2017 while the country's wastewater facilities was rated 'D+' – some of the body's harshest assessments of US infrastructure.

Billions of dollars would need to be spent in coming years to improve the US's water and wastewater systems. But this will be difficult given the size and fragmented nature of the industries. The US is home to about 50,000 water systems where 84% of the population is served by water systems run by municipal authorities. About 10,000 of the US's water systems serve fewer than 3,000 customers and about 1,400 are under some sort of enforcement action to remedy deficiencies. The country maintains 15,000 wastewater systems where 98% of the US population is served by city authorities. About 2,200 of these wastewater systems are under some sort of formal enforcement action. (By way of comparison, the US hosts only 3,800 electrical and 1,400 gas systems.)

American Water Works, the largest listed water utility in the US, eyes the problems with the US's water and wastewater systems as an opportunity to expand while earning higher returns for investors from what is a low-risk industry operationally – unlike gas lines, water mains and pipes typically don't explode. The strategy of the New Jersey-based company that earned US$3.4 billion in revenue in fiscal 2018 from servicing 14 million people across 46 US states and one Canadian province has three prongs.

American Water's main focus is to boost the amount of capital on which it can earn a regulated but fair return by spending US$20 billion to US$22 billion over the next 10 years to improve its network. In the US (and elsewhere), utilities are granted monopoly rights in an area. In exchange, regulators ensure essential services stay affordable by limiting the return a utility can earn on its capital investment. The setup means that the best way for a utility to boost revenue is to increase the amount of approved capital spending on which it can earn a regulated return.

American Water, which enjoys an average weighted return of 9.8% from its regulated activities, expects to replace nearly 2,000 miles (3,200 kilometres) of mains and collection pipes over the next five years. As American Water has typically replaced only about 0.8% of its pipeline network a year (which, in industry jargon, translates to a 130-year

replacement cycle), the company has a vast opportunity to invest in its network to ensure robust growth in regulatory revenue in coming years.

American Water's second prong is to expand through takeovers. American Water plans to spend up to US$1.2 billion on acquisitions from 2020 to 2024 and there are plenty of targets because only 16% of the US's water systems and just 2% of the wastewater systems are investor-owned. Last year, the company finalised 19 purchases in eight states that added more than 50,000 regulated connections. That boosted the number of deals completed since the start of 2015 to 82, which came with 173,000 new customers in 10 states.

The city authorities that operate many water systems in the US are keen to sell because offloading assets eases their financial stress and they are under political pressure to improve water quality – something American Water is better at than they are. That American Water has a strong operating history, a good reputation and is familiar to many state regulators streamlines takeover approvals.

The third prong is that management is focused on running American Water more efficiently. Management intends to reduce expenses to 31.5% of revenue by 2023, down from 35% in 2019 and from 46.1% in 2010. The company is cutting its cost-to-income ratio by adopting technology, improving supply systems and by scrutinising costs. Because returns are regulated, cutting costs is usually the quickest route for a utility to boost returns to shareholders.

The three prongs have helped American Water deliver solid shareholder gains in the past five years – the company has recorded a compounded growth rate of 10% in dividend payments and average annual revenue growth of 3% over the period. In coming years, they are likely to help American Water deliver to investors what they expect from infrastructure and utility assets – namely, dependable and transparent earnings streams spiced with some capital growth.

To be sure, none of American Water's strategies is guaranteed to succeed to the extent sought; dealing with so many regulators has its time-consuming side and regulators could always make unfavourable decisions when it comes to regulated returns. In addition, climate change could complicate operations of water utilities. The company has financed takeovers and capital spending with debt of US$7.6 billion at the end of 2018. Even allowing for these qualifications, American Water has fulfillable plans in place that are likely to provide investors with secure cash flows and some capital growth from low-risk activities in coming years.

Four arms

The history of American Water traces to 1886 when the American Water Works & Guarantee Company was founded. While much happened in between, 2003 was a year of note because American Water was acquired then by the German utility RWE, which in 2008 listed the company via a 'spin-off'.

American Water these days consists of four businesses. The most important is the regulated business that operates metered water services in about 1,600 communities in 15 states, each with a regulator. This unit's assets consist of 51,000 miles (82,000 kilometres) of pipes, 621 water-treatment plants, 1,000 wells, 130 wastewater plants, 1,300 water-storage facilities and 1,400 pumping stations. This regulated business brings in more than 85% of the company's revenue even though water customers on average pay less than one US cent per gallon. About 25% of regulated revenue is sourced from New Jersey while another 20% comes from Pennsylvania.

American Water's unregulated arm (or 'Market-Based Business' as the company calls it) includes its Contract Operations Group, which runs water facilities for cities and businesses. Another is the Homeowner Services Group, which offers services to 1.5 million homeowners and small businesses to guard against the cost of repairing water and sewer pipes. Lastly, the Military Service group provide water services to about 16 US military bases.

With these businesses, American Water is primed to help improve the US's decrepit water and wastewater systems in coming years while keeping investors happy.

Sources include company filings and website, Bloomberg and Hoover's, a Dun & Bradstreet Company and infrastructurereportcard.org.