Magellan Select Infrastructure

Key Facts

Portfolio Manager	Gerald Stack & Dennis Eagar
Strategy Inception Date	1 July 2007
Total Infrastructure Assets[1]	AUD $6,160.5 million
Total Strategy Assets	AUD $1,925.3 million

AUD Hedged Gross Performance[2]

	Composite	Index	Excess Return
3 Months (%)	7.3	6.1	1.2
6 Months (%)	12.5	4.7	7.8
1 Year (%)	13.1	-3.9	17.0
3 Years (% p.a.)	18.3	10.1	8.2
5 Years (% p.a.)	16.8	10.3	6.5
7 Years (% p.a.)	20.2	12.2	8.0
Since Inception (% p.a.)	9.8	4.7	5.1

	Composite	Index[3]	Excess Return
2007 (%)*	2.7	6.5	-3.8
2008 (%)	-33.4	-27.5	-5.9
2009 (%)	25.5	10.0	15.5
2010 (%)	13.0	5.7	7.3
2011 (%)	12.4	4.7	7.7
2012 (%)	16.8	9.1	7.7
2013 (%)	19.1	18.5	0.6
2014 (%)	24.0	22.9	1.1
2015 (%)	12.6	-5.4	18.0
2016 (CYTD %)	7.3	6.1	1.2

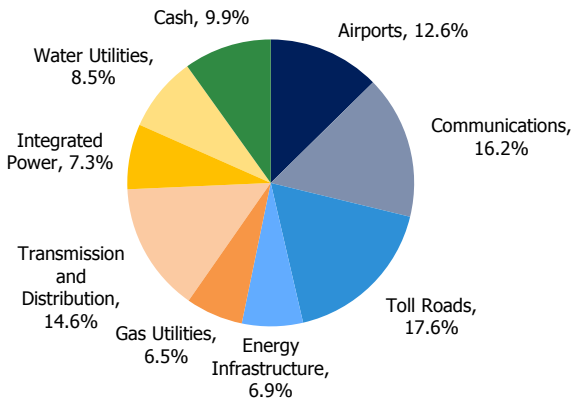
AUD Hedged 5 Year Risk Measures[2]

	Against Benchmark[3]	Against Global Equities[4]
Upside Capture	1.0	0.7
Downside Capture	0.3	-0.1
Beta	0.6	0.3
Correlation	0.8	0.5

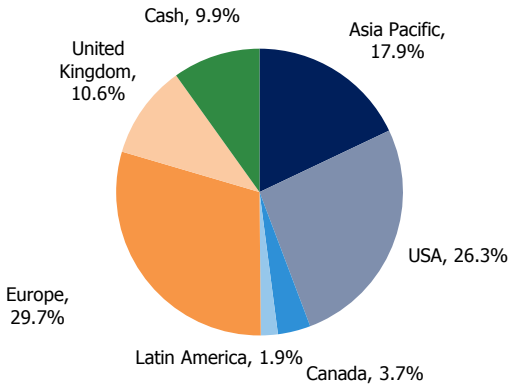
Top 10 Holdings[5]

	Sector	%
Transurban Group	Toll Roads	9.2
National Grid PLC	Transmission and Distribution	6.0
Crown Castle International	Communications	6.0
Atlantia SpA	Toll Roads	5.0
ITC Holdings Corp	Transmission and Distribution	4.6
SES S.A.	Communications	4.5
Flughafen Zeurich AG	Airports	4.0
Enbridge Inc	Energy Infrastructure	3.7
Eutelsat Communications	Communications	3.2
Vopak NV	Energy Infrastructure	3.2
	TOTAL:	49.4

Industry Exposure[5]



Geographical Exposure[5]



[1] Total Firm Infrastructure assets comprises of the Select Infrastructure strategy and Core Infrastructure strategy.
[2] Returns and risk measures are for the Select Infrastructure Hedged in AUD Composite and denoted in AUD. Refer to the end of the document for further information.
[3]The Global Infrastructure benchmark is comprised of the following: from inception to 31 December 2014 the benchmark is UBS Developed Infrastructure & Utilities AUD Hedged NTR Index and from 1 January 2015 onwards, the benchmark is the S&P Global Infrastructure NTR (A$ Hedged) Index.
* Returns are only for part year.
[4] The Global Equity Index is the MSCI World (AUD Hedged) Net Total Return.
[5] Representative portfolio. The exposures are by domicile of listing.

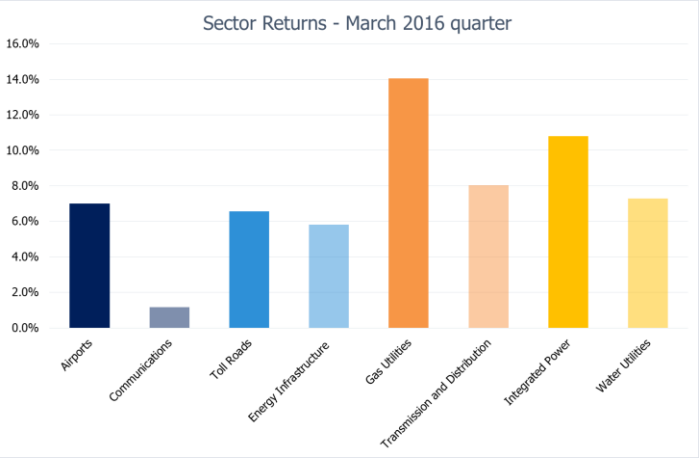
Performance

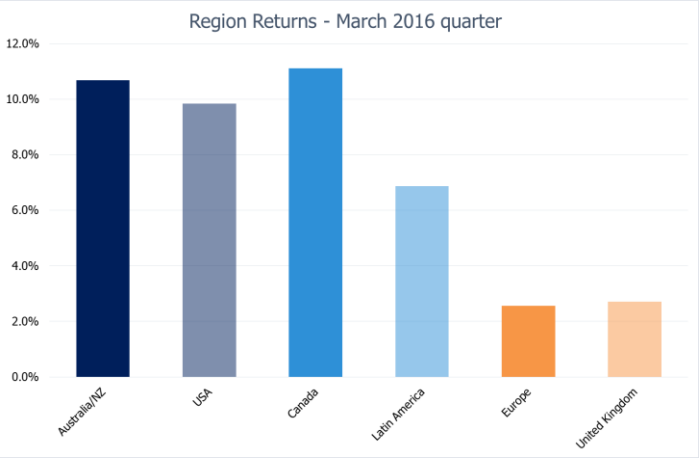
Over the March 2016 quarter, in Australian dollar terms, the Strategy returned +7.3% before fees. This was 1.2% better than the benchmark of 6.1%. The 1 year return to 31 March 2016 for the Strategy was +13.1%, 17.0% better than the benchmark return of -3.9%. The Strategy also outperformed global equities by 16.4% over the year to 31 March 2016 with the MSCI World NTR (AUD hedged) Index returning -3.3%.

The March 2016 quarter saw very strong share price performance by US utilities offset by weak performance by European and UK infrastructure & utility stocks. The best performing stocks held by the Fund during the quarter (in local currency terms) included Australian toll road company, Macquarie Atlas Roads, with a Total Shareholder Return (TSR) of +20.2%, US utilities Atmos Energy (+18.5%), WEC Energy Group (+18.1%), Westar Energy Inc (+18.0%) and XCEL Energy Inc (+17.4%). The worst performing stocks in the portfolio during the quarter were German airport company, Fraport (-9.6%), Italian toll road companies, SIAS (-8.2%) and Atlantia (-0.5%), and UK water utility United Utilities (-1.3%).

There was significant variability in the returns for the quarter for stocks that Magellan Asset Management Limited ('Magellan') excludes from its investable universe. On the positive side, US competitive power generation companies were up more than 16% while US/Canadian rail companies were up over 5%. In contrast, Japanese rail companies were down an average 13%, as were Japanese regulated electricity utilities. Chinese infrastructure stocks were also down around 13%, European competitive power generation companies were down an average 5% and US oil & gas pipeline Master Limited Partnerships ('MLPs') were down more than 4%.

The Strategy's returns for the quarter by sector and region in local currency terms are shown in the following graphs:





Strategy

The Strategy remains consistent with previous periods and is not expected to change over the long term.

The Strategy seeks to provide investors with attractive risk-adjusted returns from the infrastructure asset class. It does this by investing in a portfolio of listed infrastructure companies that meet our strict definition of infrastructure at discounts to their assessed intrinsic value. We expect the Strategy to provide investors with real returns of approximately 5% to 6% over the longer term.

We believe that infrastructure assets, with requisite earnings reliability and a linkage of earnings to inflation, offer attractive, long-term investment propositions. Furthermore, given the predictable nature of earnings and the structural linkage of those earnings to inflation, 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.

Topic in Focus – Crude Awakening for MLPs

Investing in assets linked to oil and gas has been a volatile, yet rewarding experience for many investors over the past decade. The general ascension of the United States in the production stakes has provided a platform for expanding investment in the sector. MLPs have been at the centre of this proliferation, delivering investors tax-advantaged income streams through investments in energy and natural resources sectors. But the downward trend in energy prices that has taken hold since mid-2014 has dragged the MLP sector down with it and in the process, exposed the vulnerabilities of income streams that are linked to energy prices.

Investing in the energy sector can take many forms and can be channeled through a range of investment vehicles, from investments in private equity, listed corporations and structured debt through to purpose-built funds. Among the alternatives, the MLP structure has proven popular among asset managers, institutions and individual investors.

The MLP structure evolved through laws passed by US Congress in the mid-1980s. The US Government had a clear incentive to develop a framework for greater self-sufficiency for its energy needs and to reduce the external risks to its own economy. This structure sought to improve the economic viability for companies operating within the oil and gas industry through the incorporation of income pass-through provisions and tax deferral features.

Development of the structure led to a widespread uptake by owners and operators of US energy infrastructure such as natural gas and crude oil pipelines, storage terminals, natural gas processing plants, LNG import and export facilities and other mid-stream operations.

The sector has grown from only a handful of companies in the early 1990's to over 100 MLPs operating largely within the oil and gas sector, representing approximately US$500 billion in market value[6]. MLPs operating mid-stream assets represent

82% of that total market capitalisation, although only 19 of these MLPs hold an Investment Grade credit rating[7].

Testing times for MLPs

Historically, MLPs as an asset class have offered investors:

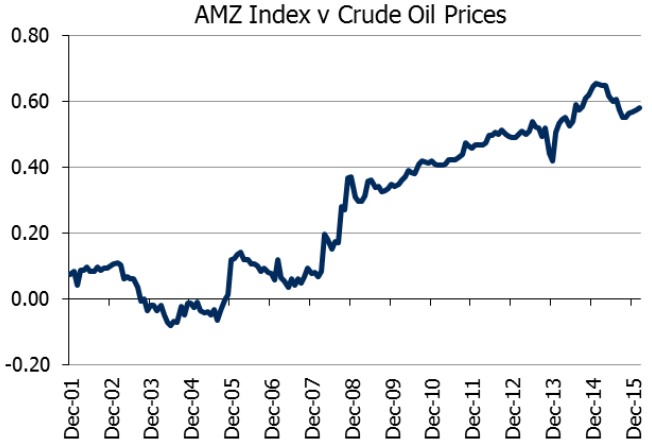
1. Reliable cash flows – primarily from fee-based volumes, typically with inflation-linked tariffs
2. Low correlation to commodity prices
3. Growth potential – stemming from technological improvements like shale gas and oil extraction

While these investment characteristics have been sustained through generally stable operating conditions for the sector, in more recent times we have seen these characteristics break down.

The capitulation of energy prices since mid-2014 has seen an increase in the correlation of MLPs to energy prices which has reduced the degree of differentiation from other corporate-based investments in the oil and gas sector.

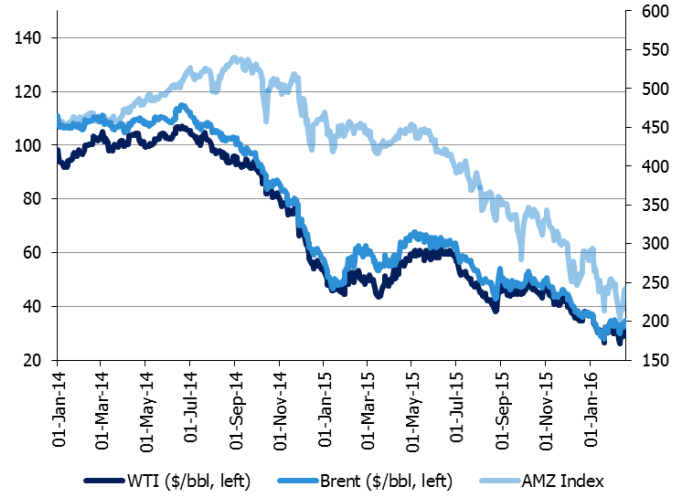
Figure 1 shows that the long term correlation between MLPs and commodity prices has been historically low, but today MLPs exhibit a greater link to movements in commodity prices – particularly crude oil. This correlation has risen from close to zero in 2005 to 0.6 in 2015. Magellan suspects that this may be a function of the changing risks in the MLP space, which we highlight later in this report. Critically, the increased sensitivity to crude oil prices has seen some operators experience negative returns while others have delivered declining yields.

Figure 1: Rising correlation of MLPs to commodity prices



Source: Alerian, Bloomberg, Magellan Asset Management Limited

Figure 2: MLPs following energy prices



Source: Alerian, Bloomberg, Magellan Asset Management Limited

A combination of greater energy infrastructure capacity (i.e. competition), depressed energy prices and highly levered balance sheets now present a key challenge for MLPs. Notwithstanding the recent partial recovery in commodity prices, investors need to consider the flow-on effects, particularly in the scenario of a protracted period of low crude oil prices. Likely implications for MLPs include:

1. Distribution cuts to fund future growth or reset to more sustainable levels at the expense of future growth;
2. Tighter access to capital market funding; and
3. Asset value write-downs (thereby adding further strain to credit metrics).

More importantly, the impact of depressed commodity prices has become increasingly apparent within capital expenditure budgets, which we see invariably hindering future cash flow growth.

The sustained decline in energy prices has had a pronounced impact on MLP distribution yields and distribution coverage ratios are likely in decline. This trend is prevalent in the distributions for energy limited partnership closed-end funds (CEF), whereby 14 of the 26 CEFs in the category announced distribution cuts between December 2015 and February 2016[8].

Figure 3: Significant Distribution Cuts

			Amount			
Fund name	**Ticker**	**Frequency**	**Current ($)**	**Previous ($)**	**Change (%)**	**Pay date**
Goldman Sachs MLP and Energy R	GER	Quarterly	0.16	0.34	-52.24	2/29/16
Goldman Sachs MLP Income Opps	GMZ	Quarterly	0.21	0.35	-39.13	2/29/16
Clearbridge American Energy MLP	CBA	Quarterly	0.20	0.31	-34.43	2/29/16
Kayne Anderson Energy Total Return	KYE	Quarterly	0.33	0.49	-32.65	1/15/16
Clearbridge Energy MLP TR Fund	CTR	Quarterly	0.29	0.36	-19.44	2/26/16
Clearbridge Energy MLP	CEM	Quarterly	0.36	0.44	-19.32	2/26/16
Clearbridge Energy MLP Opps	EMO	Quarterly	0.32	0.40	-18.99-	2/26/16
Kayne Anderson MLP	KYN	Quarterly	0.55	0.66	-16.67	1/15/16
Nuveen All Cap Energy MLP Opps	JMLP	Quarterly	0.29	0.34	-15.20	2/16/16
Salient Midstream & MLP Fund	SMM	Quarterly	0.33	0.37	-11.92	2/29/16
Kayne Anderson Midstream Energy	KMF	Quarterly	0.45	0.51	-11.76	1/15/16
Tortoise Pipeline & Energy	TTP	Quarterly	0.41	0.45	-9.44	2/29/16
Kayne Anderson Energy Dev Co.	KED	Quarterly	0.48	0.53	-9.43	1/15/16
Tortoise Power & Energy Infrast.	TPZ	Monthly	0.13	0.14	-9.09	3/31/16

Source: Morningstar, data as of 28 February 2016.

Peeling back the layers of risk

The dynamics for MLPs are changing and we believe there are now a deeper level of risks which investors need to be cognisant of including (but not limited to):

Increased competition: There has been a considerable buildout in the North American energy infrastructure space over the past decade. Between 2009 and 2014, US companies added nearly 14,000 miles of crude oil pipeline, representing an increase of 26%[9]. In a weak environment for commodity prices, we have seen re-contracting to competitors where contract tenures have shortened (by 50% in some cases) and other commercial terms renegotiated increasingly in the customer's favour.

In addition, competition potentially increases exposure to lower creditworthy counterparties. Magellan suspects this may have played a part in a Plains All American customer defaulting on a long-term contract, which represented 10% of a major pipeline's capacity.

Increased balance sheet risk: MLPs may be pressured to offer higher payouts and distribution growth to attract cheaper capital which in turn is used to fund new and higher return projects. Lower income levels can lead to asset sales

or capital draw down and consequently, higher leverage ratios (>4.0x Debt/EBITDA) which is ultimately unsustainable. We saw this in 2014 when Boardwalk Partners became overly geared, contributing to its distribution being reduced by 81%.

Weak governance: Under the MLPs General Partner (GP)/Limited Partner (LP) structure, the GP is retained on behalf of the LPs to operate the MLP on their behalf. This structure highlights two weaknesses:

1. LPs have restricted voting rights or say on management, compensation and mergers/acquisitions; and
2. GPs are incentivised to acquire assets and take on more debt which may not be sustainable.

A confluence of lower commodity prices, declining income, high distribution expectations and balance sheet misalignment create a clear set of risks for MLP investors.

Purer forms of infrastructure yield more favourable characteristics

These observations warrant a reassessment of the fundamental investment proposition underlying MLPs. We believe that investors typically seek investments in listed infrastructure for their attractive investment characteristics in terms of:

1. Stable, inflation-linked cash flows;
2. Long term contracts typically backed by government regulation;
3. Low correlation with equities and other asset classes; and
4. A stable operating environment through significant natural barriers to competition.

We believe that whilst MLPs may be good investments, we do not believe they possess the characteristics that infrastructure investors seek. We believe MLPs do not deliver stable reliable returns and so do not meet our definition of infrastructure. Magellan continues to consider and utilise exposures to the Energy sector via mid-stream and down-stream operators within the listed infrastructure sector and we believe that these areas better exhibit the desired characteristics of stable income than the current income distribution profile of the MLP space.

[6] Source: Master Limited Partnerships Association, August 2015
[7] Source: Alerian
[8] Morningstar, "MLPocalypse Averted for Now", March 2016
[9] Wall Street Journal, "Energy Pipeline Boom Ebbs", 9 September 2015

IMPORTANT NOTICE

This material is being furnished to you to provide summary information regarding Magellan Asset Management Limited ('Magellan') and an investment fund or investment strategy managed by Magellan ('Strategy'). No distribution of this material will be made in any jurisdiction where such distribution is not authorised or is unlawful. This material is not intended to constitute advertising or advice of any kind and you should not construe the contents of this material as legal, tax, investment or other advice.

The investment program of the Strategy presented herein is speculative and may involve a high degree of risk. The Strategy is not intended as a complete investment program and is suitable only for sophisticated investors who can bear the risk of loss. The Strategy may lack diversification, which can increase the risk of loss to investors. The Strategy's performance may be volatile. The past performance of the Strategy is not necessarily indicative of future results and no person guarantees the performance of the Strategy or the amount or timing of any return from it. There can be no assurance that the Strategy will achieve any targeted returns, that asset allocations will be met or that the Strategy will be able to implement its investment Strategy or achieve its investment objective. The management fees, incentive fees and allocation and other expenses of the Strategy will reduce trading profits, if any, or increase losses. The Strategy will have limited liquidity, no secondary market for interests in the Strategy is expected to develop and there are restrictions on an investor's ability to withdraw and transfer interests in the Strategy. In making an investment decision, you must rely on your own examination of any offering documents relating to the Strategy.

No representation or warranty, express or implied, is made with respect to the correctness, accuracy, reasonableness or completeness of any of the information contained in this material. This information is subject to change at any time and no person has any responsibility to update any of the information provided in this material. Magellan will not be responsible or liable for any losses, whether direct, indirect or consequential, including loss of profits, damages, costs, claims or expenses, relating to or arising from your use or reliance upon any part of the information contained in this material including trading losses, loss of opportunity or incidental or punitive damages.

This material is strictly confidential and is being provided to you solely for your information and must not be copied, reproduced, published, distributed, disclosed or passed to any other person at any time without the prior written consent of Magellan. Any trademarks, logos, and service marks contained herein may be the registered and unregistered trademarks of their respective owners. Nothing contained herein should be construed as granting by implication, or otherwise, any licence or right to use any trademark displayed without the written permission of the owner.

Performance is compared to the Global Infrastructure Benchmark, which 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 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.

GLOBAL INVESTMENT PERFORMANCE STANDARDS (GIPS®) DISCLOSURE

Magellan claims compliance with GIPS®.

For the purpose of complying with GIPS, the Firm is defined as all discretionary portfolios managed by Magellan.

The Select Infrastructure composite is a concentrated global strategy investing in strictly defined or "pure" infrastructure companies, (typically 20-40). The filtered investment universe is comprised of stocks that 1. generate reliable income streams 2. benefit from inflation protection and 3. 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. 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. A compliant presentation can also be obtained by emailing this address.

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.