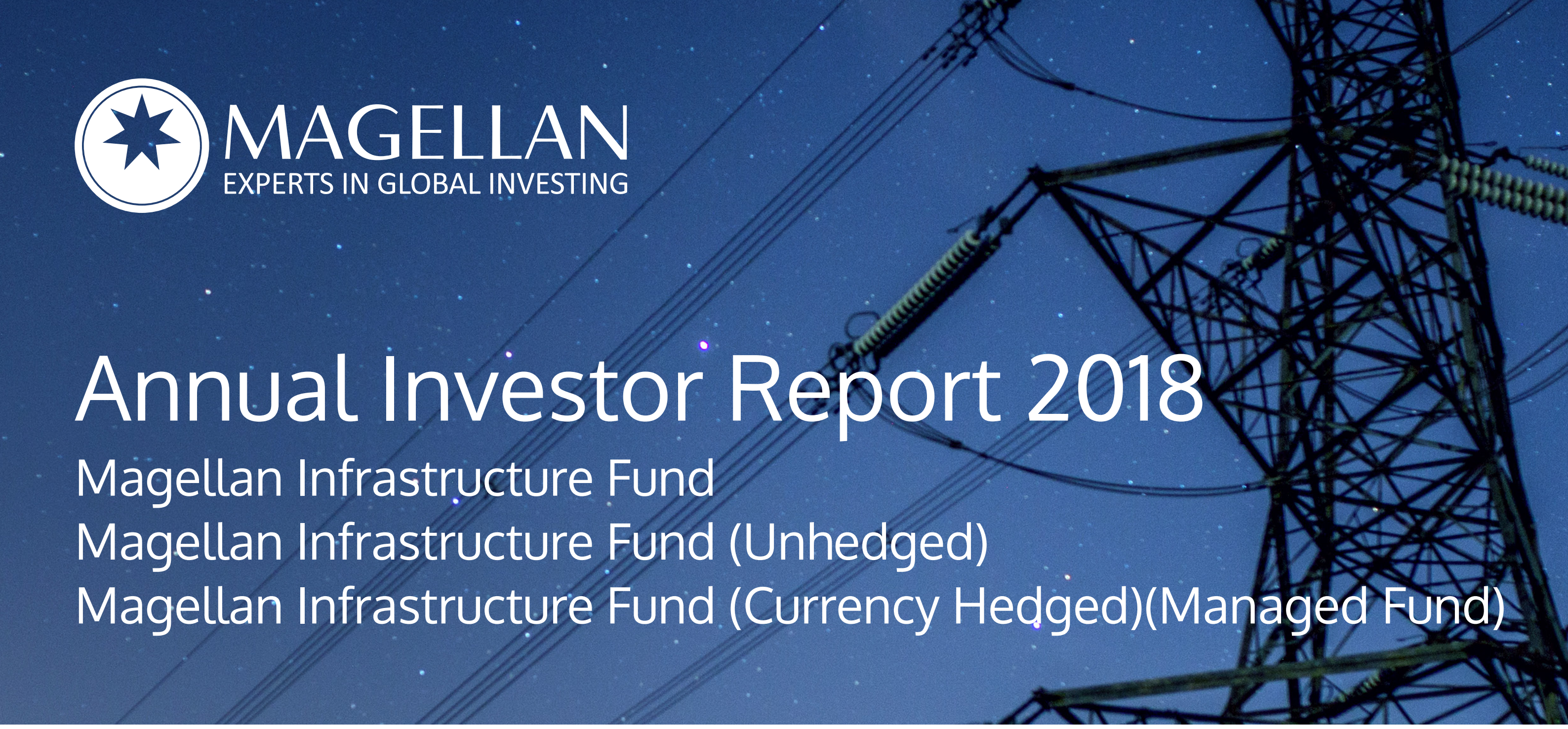


MAGELLAN
EXPERTS IN GLOBAL INVESTING

Annual Investor Report 2018

Magellan Infrastructure Fund
Magellan Infrastructure Fund (Unhedged)
Magellan Infrastructure Fund (Currency Hedged)(Managed Fund)

Dear Investor

I am pleased to write to you as an investor in the Magellan Infrastructure Fund.

For the 12 months to 30 June 2018, the Fund delivered a 6.9% net return (hedged in Australian dollars) to investors. This was 5.0% above the benchmark return of 1.9%. In July 2018, the Fund paid a distribution of 4.17 cents per unit, which boosted the distributions paid to investors in the Fund for 2017-2018 to 5.37 cents per unit.

Portfolio strategy

Our investment philosophy has not changed since we launched the strategy in mid-2007. We seek to build a portfolio of outstanding infrastructure and utility companies. We aim to invest in these companies at prices that deliver attractive risk-adjusted returns over a three- to five-year period.

Infrastructure and utility assets generally produce reliable earnings when providing essential services to the community. Over time, the predictable earnings or cash-flow streams derived from these assets are expected to deliver income and capital growth for investors.

Where our strategy is different is that we apply a stricter definition to what qualifies as infrastructure (a term often used here to include utilities). We believe that a key reason why investors invest in infrastructure is that they are seeking the reliable returns that are associated with the asset class. To ensure we achieve this key objective, we limit our investment universe to stocks that provide investors with predictable returns over an economic cycle. This means that we exclude infrastructure stocks whose earnings are exposed to competition, sovereign risk and changes in commodity prices.

The universe of infrastructure assets that we consider for the strategy mainly comprises two sectors:

- Regulated utilities, which includes energy and water utilities. We estimate that utilities comprise about 60% of the potential investment universe for the strategy. Utilities are typically regulated by a government-sponsored entity. Such regulation requires the utility to efficiently provide an essential service while allowing the utility to earn a fair rate of return on the capital it has invested.
- Infrastructure, which includes airports, ports, railroads, toll roads, communications assets and energy infrastructure (oil and gas pipelines). Regulation of infrastructure companies is generally less intensive than for utilities and allows companies to benefit from a greater number of people using their services. As economies develop and become more interdependent, we expect aviation, shipping and vehicle traffic to increase, as will demand for communications and energy.

Utilities and infrastructure companies provide essential services, while facing limited, if any, competition. Because the services are indispensable, the prices charged can be adjusted with limited impact on demand. As a consequence, earnings generated by infrastructure companies are more reliable than those for a typical industrial company and generally enjoy inherent protection against inflation. We believe that over the long term the share prices of the companies in which we invest will reflect the underlying earnings and cash flows. The reliability of the long-term earnings generated by infrastructure assets gives us confidence that investment returns will be reliable.

With infrastructure assets, the stability of earnings is influenced by competitive positioning and numerous risks. Key risks we consider are:

- Sovereign risk – We avoid countries where political decisions undermine the contractual position or potential earnings of a company. We only invest in countries where the judicial system and law are sound, so that contractual positions can be enforced as required.
- Regulatory risk – We avoid regulatory jurisdictions where regulatory processes are opaque or applied inconsistently.
- Commodity-price risk – We seek to avoid businesses whose earnings are meaningfully exposed to the price of the product they transport. Many pipeline businesses in the US, for example, are excluded for this reason.
- Leverage risk – We avoid businesses with excessive debt or ones that might struggle to pay their interest bills.

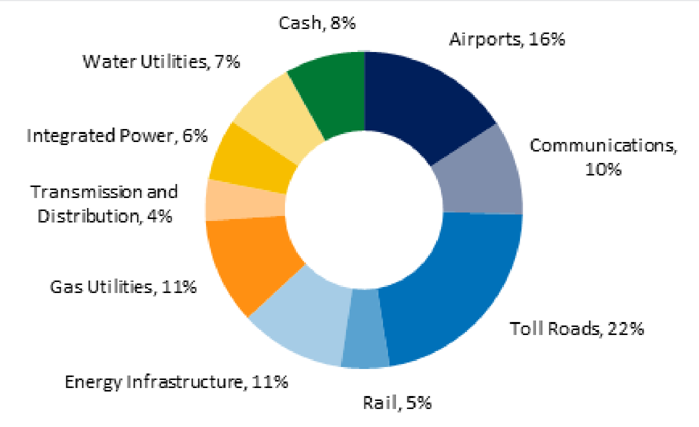
Portfolio review for 2017-18

At 30 June 2018, the portfolio consisted of 29 investments compared with 31 investments a year earlier. The 10 biggest investments represented 49% of the portfolio at 30 June 2018 compared with 45% a year earlier.

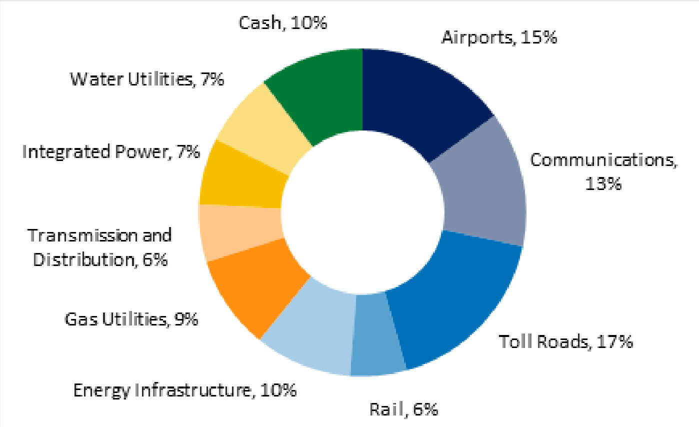
The strategy held approximately 8.1% in cash on 30 June 2018, about the same level as a year earlier. The decision to hold such a large cash holding reflects a view that accommodative monetary policy of recent years has boosted global asset prices and that the unwinding of this policy could lead to a repricing of assets. We expect to invest the bulk of our cash holding over the medium term.

The composition of the portfolio by sector at 30 June 2017 and 2018 was:

Portfolio by sector as at 30 June 2018



Portfolio by sector as at 30 June 2017



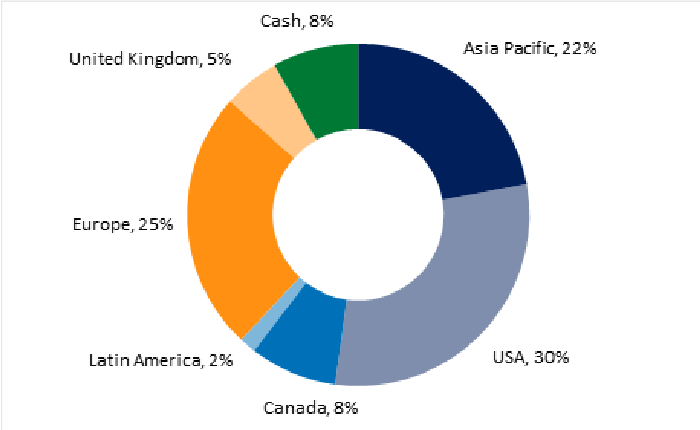
The key changes to the portfolio over the year are a small increase in the allocation to infrastructure segments (the blue and grey segment in the pie chart above) offset by a small reduction in the level of cash. Within the infrastructure allocation, we have increased the allocation to toll roads and airports and reduced the allocation to communications infrastructure.

The reduction in the allocation to communications reflects our decision to exclude satellite companies from our universe. Our infrastructure definition requires that a limited share of the earnings derived from the asset should be subject to competition. The earnings of satellite companies have historically been dominated by their satellite TV businesses where the satellite company broadcasts the TV signal for TV operators. When we initially invested in the satellite companies, we were attracted to the stable and attractive cash flows generated by the satellite TV businesses as demand for paid TV has historically been highly resilient to the economic cycle and is subject to limited competition between operators. However, the competitive dynamics in the non-TV part of the operators' businesses has been higher than anticipated. It is our assessment that, due to advancements in communications technology, a material component of the earnings of the satellite companies are now subject to competition. As a consequence, we sold two satellite companies during the year – SES and Eutelsat.

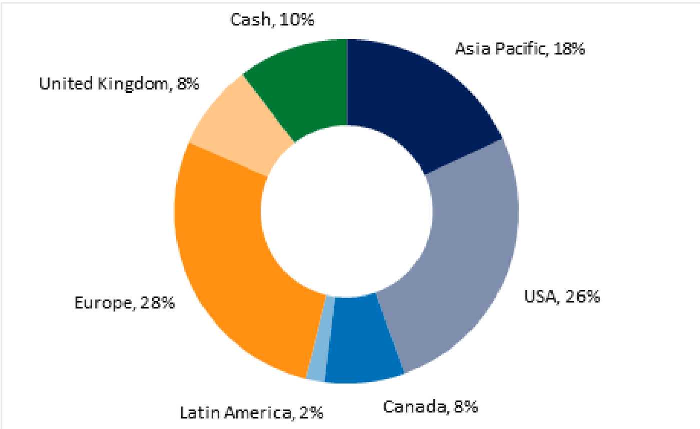
We have maintained the allocation to regulated utilities at about 30% of the portfolio. As we have noted in previous years, the easy global monetary conditions of recent years have boosted the share prices of regulated utility stocks. It has been our assessment that regulated utilities in the better-performing economies of the world, effectively the most-defensive infrastructure investment opportunities, were less attractive investments compared with opportunities available elsewhere in the infrastructure investment universe.

The composition of the portfolio by geography at 30 June 2017 and 30 June 2018 was:

Portfolio by region as at 30 June 2018



Portfolio by region as at 30 June 2017



While we have increased the share of the portfolio invested in North America over the course of the year, we remain underweight relative to our universe. The bulk of the available opportunities in North America are regulated utilities and, as outlined earlier, we judge that utilities are somewhat less attractive than other opportunities.

Contributors

The strategy’s best-performing stocks for the year to June 2018 were generally infrastructure companies rather than utilities. Buoyant economies helped toll roads, airports and communications companies to grow traffic, passenger and data volumes. Notwithstanding higher interest rates, this was sufficient to generate attractive investment returns, particularly for those companies insulated from political issues. The companies that performed best included:

- Airport operator ADP (formerly Aéroports De Paris), which benefitted from steady passenger growth and news that the French government is readying to sell its 50.6% stake in the company. It is believed a number of companies and unlisted infrastructure funds would be keen to acquire the interest of the French government in the belief that the operations of this company can be enhanced. Such an outcome could result in a takeover offer to remaining shareholders or an improvement in underlying financial performance that would benefit existing shareholders.

- North American rail companies Canadian Pacific and Union Pacific, which benefitted from lower US corporate taxes, steady operational performance and expectations that operational efficiencies will continue to improve.

- Italian toll road operator SIAS, which delivered strong performance over the year reflecting improvements to regulatory agreements and transparency to investors. The company finalised an agreement with the Italian government that will lead to toll increases on a number of its roads and it signed a new agreement for a concession in northern Italy. Further, the company improved the transparency of its structure through the sale of non-core assets and the release of a plan that helped clarify the company’s outlook.

- Getlink (formerly known as Eurotunnel), which recorded steady traffic growth and healthy financial performance. The share price benefitted when Italian toll-road company Atlantia bought 15.5% of the company.

  We note that the strong share-price performance of Getlink was in spite of the uncertainty surrounding the nature of the UK’s impending separation from the EU. The terms of the UK departure are unknown and any major disruption to trade between the UK and Europe could affect Getlink’s revenue as more than 140 billion pounds worth of goods pass through the tunnel.

- Atlas Arteria (formally Macquarie Atlas Roads), which enjoyed strong traffic growth from its key asset, French toll road APRR. This was more than enough to compensate for an underperforming Dulles Greenway in the US, which was hampered by improvements on competing routes as well as construction work in the corridor. Another contributing factor was the falling Australian dollar, which boosted cash flows in the reporting currency (Australian dollars). Finally, the company internalised the management from Macquarie on favourable terms, which will result in reduced fee leakage and increase cash flow over time.

Detractors

The strategy’s worst-performing stocks included Italian utilities Terna, SNAM and Italgas, North American energy infrastructure company Enbridge, the US regulated utility sector generally and UK regulated utilities.

- Italian-domiciled infrastructure companies faced political uncertainty, which hurt the outlook for toll road and utility companies held in the portfolio. The uncertainty hit the share prices of Italian-regulated utilities, including electricity-transmission company Terna, gas-transmission company SNAM and gas-distribution company Italgas, which all recorded negative returns for the year. While Italy formed a left-right populist government under Prime Minister Giuseppe Conte in June about three months after inconclusive elections, political uncertainty soared in May when the country veered towards a fresh poll during negotiations among parties to form government that could have been an unofficial vote on the country’s use of the euro.

  While the Italian businesses in which the portfolio invests are strong businesses, any potential changes to Italy’s connectedness to the EU institutional settings, no matter how unlikely, create uncertainty for these investments. The underlying financial performance for each of the Italian regulated utilities was strong and the outlook remains positive. Furthermore, these businesses are natural monopolies that provide essential services with management teams that Magellan regards as efficient and effective.

- Enbridge, which provides infrastructure in the form of pipelines that transport oil and gas across North America, faced adverse regulatory decisions. Key issues for Enbridge included the potential reduced earnings due to a revised policy statement from the Federal Energy Regulatory Commission regarding tax treatment for master limited partnerships (MLPs). While Enbridge is not an MLP, it owns interests in a number of related company MLPs. (The regulator announced that the tax-friendly MLP structure popular with pipeline firms would no longer be able to recover an income tax allowance in certain pipeline service contracts reducing its taxable income.)

- US-domiciled regulated utilities faced tighter monetary conditions. Higher 10-year US government bond yields acted as something of a headwind for the returns of these companies compared with the strategy’s investments in infrastructure companies.

- UK regulated utilities faced challenges from impending updates to regulated determinations and the potential threat of nationalisation. The process to determine regulated earnings for the UK water utilities will shortly heat up. OFWAT, the UK water regulator, in early 2019 will issue a draft determination for the period 2021 to 2026. It is expected that the allowed earnings for the utilities will decline compared with recent history due to the low level of prevailing interest rates. In addition to the uncertainties associated with the regulatory cycle, the Labour opposition party said that, if elected, it would nationalise key utilities at a price the Labour party considered appropriate rather than a price considered appropriate by investment convention or precedent. Both issues led to concerns about the reliability of future earnings to be derived from the UK regulated energy and water utilities.

Outlook

We expect global monetary conditions to become less accommodative in coming years, which means long-term interest rates are likely to rise. There are two key areas we focus on when we assess what higher interest rates could mean for infrastructure stocks:

- The impact on the businesses – We are confident that the businesses that meet our investment-grade infrastructure criteria are well placed to meet our expectations over the medium term even if interest rates rise.

- Impact on valuations and on debt and equity markets – An increase in interest rates can be expected to lead to higher debt costs and higher long-term discount rates. Our forecasts and valuations for the businesses in which we have invested take these factors into account. The history of financial markets, however, indicates that higher interest rates will increase uncertainty. Stocks that are regarded as 'defensive', including infrastructure and utilities, are often shunned when interest rates increase because investors switch to higher-growth sectors. It is our experience, however, that provided these businesses have solid fundamentals, their stock prices will revert to a longer-term trend that reflects their earnings profiles.

Notwithstanding volatility on equity markets, we expect the underlying earnings of infrastructure and utility companies in our conservative universe to remain reliable and predictable. Ultimately, the value of the companies in our portfolio reflect the future cash flows they are expected to generate and the risks associated with those revenue flows. We believe that investment markets are pricing in higher, more 'normal' levels of interest rates. This means that if interest rates increase over the medium term, we can expect the impact on asset prices to be somewhat muted because investors have already allowed for some increase in rates.

Even allowing for the resilient nature of the stocks held in the portfolio, we expect to see volatility in equity markets, particularly if US interest rates rise as we expect. We are confident, however, that any increase in interest rates will fail to hamper the financial performance of the stocks in the portfolio.

We believe that infrastructure assets, with their reliable earnings that are protected to a degree from inflation, are an attractive, long-term investment proposition. The predictable nature of their earnings compared with those offered by other asset classes means that infrastructure assets offer diversification benefits. In uncertain times, the reliable financial performance of infrastructure stocks makes them particularly attractive. An investment in listed infrastructure can be expected to reward patient investors.

Yours sincerely

Gerald Stack

Portfolio Manager

16 July 2018

Magellan Asset Management Limited

ABN 31 120 593 946, AFS Licence No. 304 301

MLC Centre, Level 36

19 Martin Place, Sydney NSW 2000 Australia

+61 2 9235 4888

info@magellangroup.com.au

www.magellangroup.com.au