MFG Select Infrastructure (USD)

MFG ASSET MANAGEMENT

AS AT 30 SEPTEMBER 2023

PORTFOLIO MANAGER	GERALD STACK

INVESTMENT PHILOSOPHY	OBJECTIVES	PORTFOLIO CONSTRUCTION
To prudently invest in outstanding infrastructure and utilities companies at attractive prices that exhibit highly predictable cashflows.	To achieve attractive risk-adjusted returns over the medium to long term; while reducing the risk of permanent capital loss.	Concentrated 20-40 stock portfolio applying MFG Asset Management's proprietary infrastructure classification. Valuation driven benchmark-unaware strategy. Highly defensive, inflation-linked exposure.

MAGELLAN SELECT INFRASTRUCTURE (USD)

TOTAL STRATEGY ASSETS	TOTAL INFRASTRUCTURE ASSETS[1]	INCEPTION DATE
USD $4,881.8 million	USD $9,757.4 million	02 May 2013

USD PERFORMANCE[2]	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)	-9.1	5.8	2.1	3.0	4.3	6.4	6.1
Composite (Net)	-9.3	5.0	1.3	2.2	3.5	5.6	5.2
Global Infrastructure Benchmark[4]	-7.5	5.9	6.5	3.2	3.4	4.2	3.9
Excess (Gross)	-1.6	-0.1	-4.4	-0.2	0.9	2.2	2.2
MSCI World NTR Index⁺	-3.5	22.0	8.1	7.3	9.3	8.3	8.6

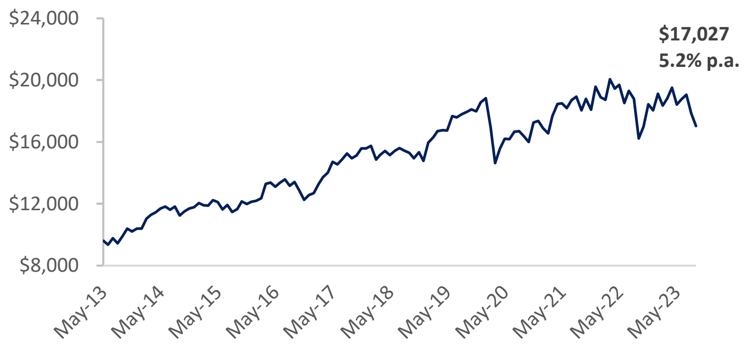
CALENDAR YEAR RETURNS[2]	CYTD (%)	2022 (%)	2021 (%)	2020 (%)	2019 (%)	2018 (%)	2017 (%)	2016 (%)	2015 (%)	2014 (%)	2013 (%)*
Composite (Gross)	-5.1	-7.0	13.6	-5.7	26.7	-4.4	25.0	4.4	3.9	14.1	4.6
Composite (Net)	-5.7	-7.8	12.7	-6.4	25.7	-5.2	24.0	3.6	3.1	13.2	4.0
Global Infrastructure Benchmark[4]	-4.5	-1.0	11.0	-6.5	25.8	-10.4	19.1	11.4	-12.2	14.1	0.9
Excess (Gross)	-0.6	-6.0	2.6	0.8	0.9	6.0	5.9	-7.0	16.1	0.0	3.7
MSCI World NTR Index⁺	11.1	-18.1	21.8	15.9	27.7	-8.7	22.4	7.5	-0.9	4.9	14.7

Past performance does not predict future returns.

USD 5 YEAR RISK MEASURES[5]

	Against Global Equities	Against Global Infrastructure Benchmark[4]
Upside Capture	0.7	0.9
Downside Capture	0.8	0.9
Beta	0.8	0.8
Correlation	0.9	0.9

PERFORMANCE CHART GROWTH OF USD $10,000 (NET)[2]



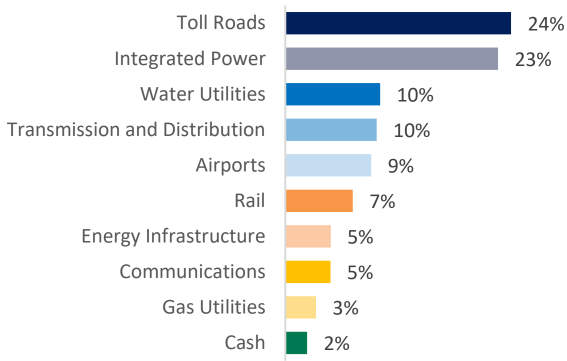
Past performance does not predict future returns.

[1] Comprised of all Select Infrastructure strategies.
[2] Returns are for the Global Select Infrastructure Composite and denoted in USD. Performance would vary if returns were denominated in a currency other than USD. Refer to the GIPS Disclosure section below for further information. Strategy inception is 02 May 2013. 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.
[3] Outperformance consistency indicates the percentage of positive excess returns for rolling 3 year returns since inception in USD.
[4] The Benchmark or 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 and from 1 January 2015 onwards, the benchmark is the S&P Global Infrastructure Index Net Total Return. Note: the UBS Developed Infrastructure and Utilities Index Net Total Return ceased to be published from 31 May 2015, replaced on 1 January 2015 with the S&P Global Infrastructure Index Net Total Return.
[5] Risk measures are for the Global Select Infrastructure Composite calculated before fees in USD. The Global Equities Index is the MSCI World NTR Index⁺.
⁺All MSCI data used is the property of MSCI. No use or distribution without written consent. Data provided "as is" without any warranties. MSCI and its affiliates assume no liability for or in connection with the data. Please see complete disclaimer in www.mfgam.com.au/funds/benchmark-information/
*Part year return.

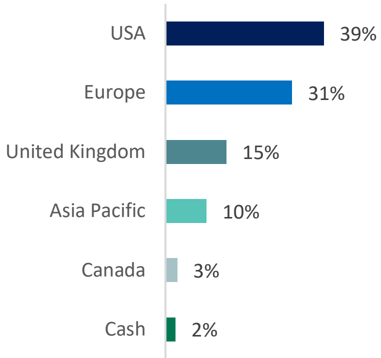
TOP 10 HOLDINGS[6]

STOCK	SECTOR	%
Vinci SA	Toll Roads	6.5
Transurban Group	Toll Roads	6.4
Ferrovial SE	Toll Roads	6.3
Aena SME SA	Airports	5.8
National Grid Plc	Transmission and Distribution	5.6
Severn Trent	Water Utilities	4.7
United Utilities Group Plc	Water Utilities	4.6
Sempra Energy	Integrated Power	4.4
Norfolk Southern Corporation	Rail	4.1
WEC Energy Group Inc	Integrated Power	4.0
	TOTAL:	52.4

SECTOR EXPOSURE[6]



GEOGRAPHICAL EXPOSURE[6]



[6] 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.

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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 Net Total Return Index and from 1 January 2015 the benchmark is S&P Global Infrastructure Net Total Return Index. The benchmark changed because UBS discontinued their index series. The UBS Developed Infrastructure & Utilities Net Total Return Index 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 S&P Global Infrastructure Net Total Return Index 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.

GLOBAL INVESTMENT PERFORMANCE STANDARDS (GIPS®) DISCLOSURE

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 ®).

For the purpose of complying with GIPS, the Firm is defined as all discretionary portfolios managed by MFG Asset Management, excluding brands managed by subsidiaries operating as distinct business entities. MFG Asset Management is a wholly-owned subsidiary of the publicly listed company Magellan Financial Group Limited. MFG Asset Management is based in Sydney, Australia. Total Firm assets is defined as all assets managed by MFG Asset Management, excluding assets managed by subsidiaries operating as distinct business entities.

The Global 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. The composite was created in May 2013.

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

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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.

USD is the currency used to calculate performance.

Strategy Commentary

The strategy recorded a negative return in the September quarter as 10-year bond rates lifted rapidly as jobs and spending remained resilient, suggesting central banks would need to do more to tame inflation. The stocks that detracted the most were the investments in Australian toll road company Transurban, U.S. rail company Norfolk Southern and U.S. tower company American Tower. Australian toll road operator Transurban traded down on rising Australian bond yields and weaker-than-expected traffic in one of its key markets. U.S.-based rail company Norfolk Southern fell as U.S. bond yields jumped and as they reduced full-year revenue expectations at their H1 result in late July on a slower-than-expected recovery in volumes post the derailment as well as declining fuel surcharges and storage revenue. American Tower declined on the back of higher rates, and as key customers faced potential remediation costs and other liabilities associated with the use of legacy lead cables up until the 1950s.

The only stock that contributed was Netherlands-listed toll road and airport group Ferrovial. The Ferrovial share price rose on better-than-expected traffic from its largest asset, the 407 ETR toll road in Canada, and strong traffic performance from Heathrow Airport.

Stock contributors/detractors are based in local currency terms unless stated otherwise.

Outlook

Notwithstanding our expectations for greater volatility in the short to medium term driven by inflation and interest rates, we are confident that the underlying businesses we have included in our defined universe and in our investment strategy will prove resilient over the longer term. We regard the businesses we invest in to be of high quality and, while short-term movements in share prices reflect issues of the day, we expect that share prices in the longer term will reflect the underlying cash flows leading to investment returns consistent with our expectations.

The strategy seeks to provide investors with attractive risk-adjusted returns from infrastructure securities. 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 believe that infrastructure assets, with requisite earnings reliability and a linkage of earnings to inflation, offer attractive, long-term investment propositions. Furthermore, we believe the resilient nature of earnings and the structural linkage of those earnings to inflation means that investment returns typically generated by infrastructure stocks are different from standard asset classes and offer investors diversification when included in an investment portfolio. We believe that in the current uncertain economic and investment climate, the historically reliable financial performance of infrastructure investments makes them attractive, and an investment in listed infrastructure has the potential to reward patient investors with a long-term time frame.

Stock Story: Norfolk Southern

(Yathavan Suthaharan – Investment Analyst)

NS NORFOLK SOUTHERN

On 3 February 2023, a freight train operated by Norfolk Southern derailed in the quiet town of East Palestine, Ohio. The derailment resulted in the spillage of hazardous chemicals and a large fire that made international news. It was a significant amount of adverse publicity for a business that has otherwise largely stayed out of the headlines. Despite its low profile, Norfolk Southern's rail network, along with the rest of North America's freight railroads, represents a critical piece of infrastructure, responsible for transporting close to 30% of the freight moved in the region.

The core of the North American freight rail network consists of six major (termed class one) rail networks, which are in turn supplemented by regional and short-line railroads. Norfolk Southern is one of the six major class one railroads.

To provide some context around its sheer scale, the company's network, which spans across the eastern states of the US, consists of approximately 19,100 route miles of track infrastructure and is responsible for moving 179 billion tonne-miles (weight x distance of the goods) of freight every year. Norfolk Southern generated over US$12.7 billion in revenue last year.

We believe the adverse share price reaction to the derailment is unwarranted given the cash flow impact of the derailment is likely to be immaterial to the intrinsic value of the franchise. We predicate this view on the basis that: 1) the derailment did not result in any injuries, fatalities or material property damage; and 2) the rail car that was the primary driver of the derailment was not owned by the railroad, providing a potential opportunity for recovery of any damages.

More importantly, the news about the derailment masks the long-term value of the franchise. We view Norfolk Southern as an attractive business to own given:

1. the company operates in a favourable and sustainable duopoly industry structure – akin to its other class one peers; and

2. rail is more cost efficient than truck – the other primary form of land-based freight movement.

The North American class one railroad industry is structured as three sets of duopolies with two covering Canada and the northern US states (Canadian National and Canadian Pacific), two covering the western US states (Union Pacific and BNSF) and two covering the eastern states (Norfolk Southern and CSX). We believe the duopoly between Norfolk Southern and CSX is sustainable due to high barriers to entry and strong network effects. The key barriers to entry are the cost and ability to build a rail network. For context on cost, the value of Norfolk Southern's property, plant and equipment on its balance sheet is ~US$32 billion, albeit the replacement cost would likely be much higher than this. In terms of ability, building a network of tracks is difficult in practice because a new entrant would need to acquire or lease the land, and face potential NIMBY-ism dynamics. Norfolk Southern also benefits from network effects given the incremental cost of shipping a unit of freight is lower than the average cost.

The core reason rail is more cost efficient than truck is because trains are much longer than trucks on average. Most semi-trailers in the US are 20 metres long; by contrast, the typical length of a train is about 1.6 kilometres, with some trains in the US exceeding 4.3 kilometres in length. Longer trains lead to lower per-unit costs of transportation because the fixed cost of labour and fuel (typically 60-70% of operating costs for both trucks and rail) can be spread over more units of goods. In basic terms, the cost of labour for rail is splitting the cost of two train drivers over 1.6 kilometres worth of goods versus trucks splitting the cost of a single driver over 20 metres worth of goods. In terms of fuel, the basic physics associated with how a train moves from point A to point B relative to a truck, means that trains can move three to four times more tonnes per gallon of fuel relative to trucks. This is also beneficial for the environment given freight rail's carbon footprint is up to seven times more efficient than trucking.

These attractive characteristics are reflected in Norfolk Southern's high returns on capital employed and strong pricing power, with rates increasing faster than inflation over the last 20 years.

The major change in Norfolk Sothern's operating model over the last decade has been the implementation of precision scheduled railroading (also known as PSR) in 2019. PSR is a railroad operating model pioneered by the late Hunter Harrison. Mr Harrison first implemented PSR at Illinois Central Railroad in 1993 and went on to implement PSR at several other class one railroads including Canadian National in 1998, Canadian Pacific in 2014 and CSX in 2017.

The core objective of PSR is to reduce the average time it takes to move a customer's rail car from origin to destination. As a result, PSR is a win-win for customers and shareholders.

Customers win because PSR increases the reliability of rail as a transportation method; i.e., the goods arrive at the scheduled time. The proportion of CSX trains that arrived on time increased from 51% in 2015 (prior to PSR implementation) to 75% in 2018 (post implementation of PSR).

We believe the benefits to shareholders are both immediate and enduring. The significant improvements in asset utilisation driven by PSR (moving the same amount of goods with fewer people and locomotives) resulted in a rapid increase in margins over 24 months. CSX's adjusted operating margins increased from 30% in 2015 to 40% in 2018. We believe Norfolk Southern's margins will follow a similar trajectory given its network footprint is similar to that of CSX. The longer-term benefit is increased capture of volumes currently moving by truck as the reliability gap between truck and rail closes. Given these volumes are likely to be added at high incremental margins, we believe that this should lead to profits growing faster than revenues over the long term.