MFG ASSET MANAGEMENT

Annual Investor Report 2017

MFG Asset Management Core Infrastructure Strategy

Dear investor,

For the year ended 30 June 2017, the MFG Asset Management Core Infrastructure Strategy delivered a return of +7.84% gross in US dollars (net +7.09%). This was 3.89% below the benchmark's return of +11.73%.

Portfolio strategy

Our investment philosophy has not changed since we launched the strategy in 2009. We seek to build a portfolio of outstanding infrastructure and utility companies that deliver reliable returns through the economic cycle.

The types of infrastructure assets in which the strategy invests are generally natural monopolies that provide an essential service to the community. Infrastructure assets offer investors protection against inflation because their earnings generally have some direct linkage to inflation. Over time, the stable revenue or cash-flow streams derived from infrastructure 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. We want to limit our investment universe to stocks that provide investors with predictable, through-the-cycle, inflation-linked returns. 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:

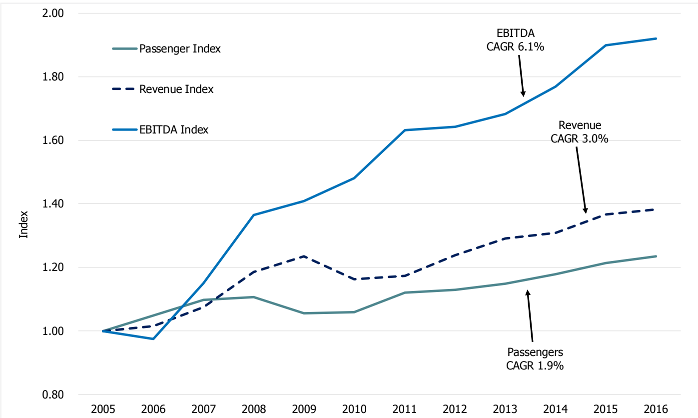
- Regulated utilities, which includes energy and water utilities. We estimate that utilities comprise about 62% of the strategy. Utilities are typically regulated by a government-sponsored entity. Such regulation requires the utility to efficiently provide an essential service while allowing the utility 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.

A key feature of the portfolio-construction process for our Core Infrastructure strategy is the application of what we call "the 75% rule". This relates to those companies whose assets are a mixture of assets that we classify as infrastructure and those assets that do not meet our strict requirements. In those circumstances, we require at least, and on a consistent basis, 75% of the company's earnings to be derived from the assets that meet our definitional requirement before it can be included in the Core portfolio.

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 are more reliable than those for a typical industrial company and generally enjoy inherent protection against inflation. Consider it the triumph of cash flow, as the following examples show.

Aeroports de Paris (ADP) owns the major airports in Paris. Over the past decade, aviation has been subject to demand shocks that include the global financial crisis and terrorist strikes, and ADP has not been immune. The chart, however, shows that the company's underlying financial performance has progressed in a reliable manner. The combination of long-term passenger growth at ADP's airports, price increases for ADP's services and cost-saving measures has led to measured but consistent growth in cash flows and earnings (as measured by earnings before interest depreciation and amortisation or EBITDA).

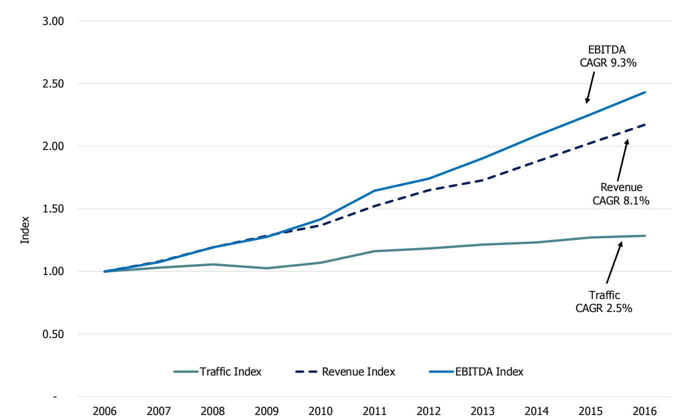
Chart 1: ADP – Passenger, revenue, EBITDA (2005-15).



Source: Aeroports de Paris, MFG Asset Management.

CityLink in Melbourne is the original asset for which Transurban was founded in 1995 to develop and operate. Traffic on the road has grown at a modest but consistent rate over time. When combined with toll increases and stable operating costs, this cash flow or revenue growth has led to reliable and consistent EBITDA growth over time. Just as for ADP, the vital nature of the service delivers for investors over time.

Chart 2: CityLink – Traffic, revenue, EBITDA (2006-16).



Source: Transurban, MFG Asset Management.

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 that undermine the contractual position or potential earnings of a company can be made easily. We invest only 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 from our universe for this reason.
- Leverage risk – We avoid businesses with excessive debt or that might struggle to pay their interest bills.

Portfolio review 2016-17

Changes in interest rates during the past 12 months affected the performance of the strategy and led to its underperformance over the period, although it is worth noting that over the period the strategy met its stated objective of achieving a CPI +5% real return through the cycle. In the first half of fiscal 2017, a rise 10-year US government bond yields subdued the strategy's returns. Performance improved in the second half of the fiscal year when investors refocused on the reliability of the earnings and cash flows that infrastructure companies and regulated utilities generate.

Looking back over the 12 months, the key theme was the outperformance of European infrastructure. Within the portfolio, eight of the top-10 performing stocks (measured by total shareholder return) were European infrastructure companies, including four airport operators. On the other side, five of the worst-performing stocks in the portfolio were European and UK utilities – in fact, over the period, 17 of the bottom 20 stocks were utilities. The strategy's best-performing stocks for the year to June 2017 included:

- European airport companies ADP, Aena, Flughafen Zuerich and Fraport, which enjoyed passenger growth.
- Satellite companies SES and Eutelsat, which experienced something of a recovery after their respective share prices fell dramatically in the prior year. While neither company's share price has fully recovered, their financial results have stabilised.
- Italian toll-road operator SIAS, which benefited from more traffic and better investor sentiment.
- Spanish toll-road operator Abertis, which is the takeover target of Italian peer Atlantia. The outcome is still undecided.

The strategy's worst-performing stocks included:

- UK utilities including National Grid, United Utilities and Pennon, which were viewed by investors as havens in the final weeks of fiscal 2016 amid the uncertainty created by the UK vote to leave the EU. While operating performance has been solid for these companies in the past year, the gains in share price in the prior 12 months led to subdued performance over the past fiscal year.
- European gas utilities Snam and Enagas, which like the UK utilities saw a reversal of the strong-performance over the prior year.
- Enbridge and Vopak, which provide infrastructure to the energy industry. Enbridge essentially transports oil and gas across North America while Vopak stores oil and chemicals around the world.

On 30 June 2017, the Core strategy held 87 stocks. Over the past 12 months, seven stocks were added to the portfolio and seven were removed.

Stocks added:

- US utilities Black Hills and DTE Energy were added after meeting the 75% regulated earnings threshold.
- Italian air traffic control company ENAV and Canadian-based electric utility Hydro One were added subsequent

to their IPOs and reviews of the business operations.

- InfraREIT was added after confirming its asset base and capital structure would provide the sufficient stability in earnings required for the strategy.
- Italian gas distribution company Italgas was added after it was spun out of its parent Snam.
- US tower operator SBA Communications was added after it successfully converted to a REIT structure, the confirmation of which lowered investment risk.

Stocks deleted:

- The Australian regulated gas and electric utility DUET Group was acquired and delisted over the period.
- A number of US electric and gas utilities were acquired by other companies over the period including: Empire District Electric, ITC, Piedmont Natural Gas, Questar and TECO Energy.
- Flughafen Wien was removed after the free-float in the company was reduced below acceptable levels.

Two stocks are in the process of being removed from the strategy, which will reduce the number of stocks to 85.

Outlook

We expect global monetary conditions to become less accommodative in coming years, which means that 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. 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 restricted universe to remain reliable and predictable. Ultimately, the value of the companies in our portfolio reflects 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.

Overall in terms of our outlook, 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

25 July 2017

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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 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 Index Net Total Return 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.

The Global Core Infrastructure composite is a global strategy investing in strictly defined or "pure" infrastructure companies (typically 80-120). 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 was created in February 2012.

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.

Gross composite returns (includes the reinvestment of dividends and capital gain distributions), are net of transaction costs, withholding taxes and direct expenses, but before management fees, custody and other indirect expenses. Net composite returns are prepared by subtracting from the monthly gross returns one-twelfth of the maximum applicable to institutional investors (0.70% p.a.). 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

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.

MFG Asset Management

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

MLC Centre, Level 36

19 Martin Place, Sydney NSW 2000 Australia

www.magellangroup.com.au

+61 2 9235 4888

info@magellangroup.com.au