

# Magellan Infrastructure Fund

ARSN: 126 367 226

## Fund Facts

Portfolio Manager	Gerald Stack
Structure	Global Listed Infrastructure Fund, A\$ Hedged
Inception Date	1 July 2007
Management Fee <sup>1</sup>	1.05% per annum
Buy/Sell Spread <sup>1</sup>	0.15%/0.15%
Fund Size	AUD \$2,995.9 million
Distribution Frequency	Semi-annually
Performance Fee <sup>1</sup>	10.0% of the excess return of the units of the Fund above the higher of the Index Relative Hurdle (S&P Global Infrastructure Net Total Return Index (A\$ Hedged)) and the Absolute Return Hurdle (the yield of 10-year Australian Government Bonds). Additionally, the Performance Fees are subject to a high water mark.

<sup>1</sup>All fees are inclusive of the net effect of GST

## Fund Features

- Benchmark-unaware exposure to global listed infrastructure
- Conservative definition of core infrastructure
- Relatively concentrated portfolio of typically 20 to 40 investments
- Seeks to substantially hedge the capital component of the foreign currency exposure back to Australian dollars
- Typical cash exposure between 0% - 20%
- \$10,000 minimum investment amount.

## 3 Year Rolling Returns (measured monthly)<sup>^</sup>\*

Against Global Infrastructure Benchmark <sup>+</sup>	1 Year	3 Years	5 Years	Since Inception
No of observations	12	36	60	139
Average excess return (% p.a.)	1.0	2.6	3.0	3.9
Outperformance consistency	92%	92%	95%	96%

## Fund Performance<sup>^</sup>

	Fund (%)	Index (%) <sup>+</sup>	Excess (%)
1 Month	7.3	5.7	1.6
3 Months	8.3	4.5	3.8
1 Year	15.2	13.7	1.5
3 Years (p.a.)	8.5	7.8	0.7
5 Years (p.a.)	8.3	6.0	2.3
10 Years (p.a.)	11.3	8.7	2.6
Since Inception (p.a.)	8.0	5.4	2.6

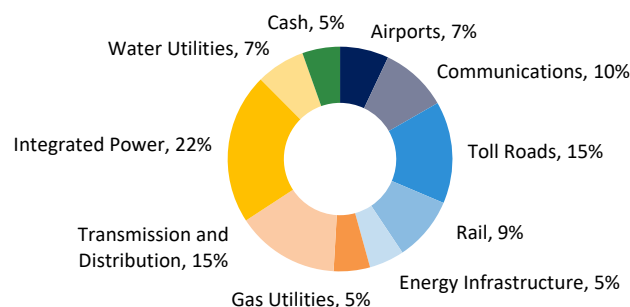
## Fund Risk Measures<sup>\*\*</sup>

	5 Years	Since Inception <sup>+</sup>
Upside Capture	0.6	0.6
Downside Capture	0.5	0.5

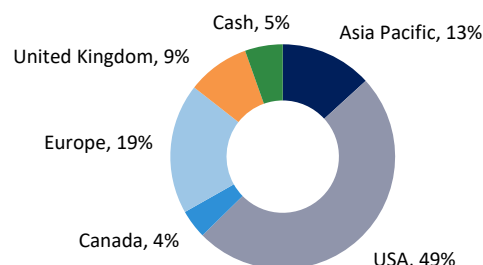
## Top 10 Holdings

	Sector <sup>#</sup>	%
Transurban Group	Toll Roads	6.8
American Tower Corporation	Communications	4.9
Crown Castle International	Communications	4.8
Sempra Energy	Integrated Power	4.6
Vinci SA	Toll Roads	4.6
Eversource Energy	Transmission and Distribution	4.4
Red Electrica Corporacion	Transmission and Distribution	4.2
Enbridge Inc	Energy Infrastructure	4.1
Dominion Energy Inc	Integrated Power	3.9
Xcel Energy Inc	Integrated Power	3.9
TOTAL:		46.2

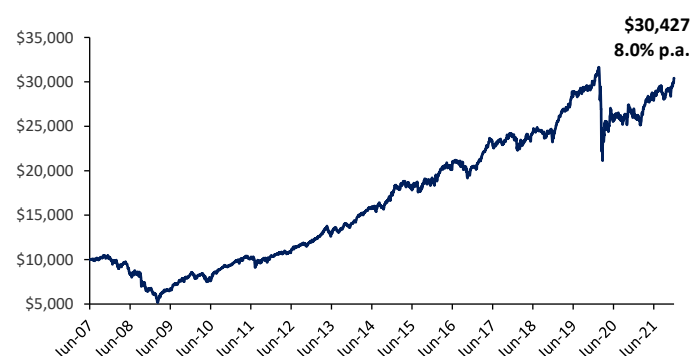
## Sector Exposure<sup>#</sup>



## Geographical Exposure<sup>#</sup>



## Performance Chart growth of AUD \$10,000<sup>^</sup>

<sup>^</sup> Calculations are based on exit price with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable). Fund Inception 1 July 2007.<sup>\*</sup> 3-year returns are calculated and rolled monthly in AUD, with the outperformance consistency indicating the percentage of positive excess returns since inception.<sup>+</sup> S&P Global Infrastructure Net Total Return Index (A\$ Hedged) spliced with UBS Developed Infrastructure and Utilities Net Total Return Index (A\$ Hedged) prior to 1 January 2015. Note: as the UBS Developed Infrastructure and Utilities Net Total Return Index (\$A hedged) ceased to be published from 31 May 2015, it was replaced by Magellan on 1 January 2015 with the S&P Global Infrastructure Net Total Return Index (A\$ Hedged).<sup>\*\*</sup> Upside/downside capture shows if a fund has outperformed the global market during periods of market strength and weakness, and if so, by how much. The MSCI World Net Total Return Index (A\$ Hedged) has been used as the representative of the global market to calculate this risk measure.<sup>#</sup> Sectors are internally defined. Geographical exposures are by domicile of listing. Cash exposure includes profit/loss on currency hedging. Exposures may not sum to 100% due to rounding.

## Fund Commentary

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The portfolio recorded a positive return in the December quarter. Stocks that contributed the most included the investments in Crown Castle International, Norfolk Southern and CSX Corp of the US. Crown Castle gained after the tower operator announced it had increased its dividend by an annualised 11% a share when it delivered healthy third-quarter earnings. Norfolk Southern climbed after the Atlanta-based railway operator's third-quarter report showed railway operating revenues increased 14% to US\$2.85 billion. CSX rose after the Florida-based railroad and transport company's third-quarter report showed revenue rose 24%, driven by growth across all business lines.

The stocks that detracted the most were the investments in Aena of Spain, Transurban of Australia and Royal Vopak of the Netherlands. Aena, the world's largest operator of airports, declined as the new covid-19 variant disrupted travel. Transurban fell as investors worried about the potential impact of the surge in covid-19 infections in New South Wales, priced in interest rate rises sooner than had been flagged previously by the Reserve Bank of Australia after a report showed inflation reached 3% in the 12 months to September, the ceiling of the central bank's target, and the company reached a settlement with the Victorian government and its contractors regarding the allocation of cost overruns on its West Gate Tunnel project that was larger than investors expected. Royal Vopak slid as the backwardation in oil markets continued, even as the storage terminal operator reported a solid third-quarter result that topped expectations.

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

## Stock Story: Dominion Energy

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Dominion Energy, a US regulated electricity and gas company, first invested in solar power in 2013. Now the utility that services nearly seven million customers in 16 US states has, at 2,300 megawatts, the third-biggest solar generation capability in the country. In home state Virginia, Dominion is building a further 3,700 megawatts of solar capacity as part of a drive to create another 16,000 megawatts of this renewable source of power by 2035.

Commencing in 2023, the company is spending US\$10 billion to build wind turbines more than 40 kilometres out to sea off the Virginia coastline. By generating 2,640 megawatts of power, the offshore wind farm is expected to power 650,000 homes and businesses.

Such steps and others are part of Dominion Energy's commitment to achieve net-zero emissions by 2050. The

company, which earned US\$14.2 billion in revenue in fiscal 2020, has already reduced its carbon footprint by 42% over the past decade or so.

The other relevant timeline that helps explain why Dominion Energy has come on to Magellan's investment radar is a shorter one, that shows how a company owning regulated and unregulated power assets largely turned itself into a highly regulated utility company. This was done through two mergers with utilities and by selling most of the unregulated assets.

The metamorphosis started in 2016 when Dominion Energy came together with Utah-based natural-gas utility Questar. Three years later, Dominion Energy fused with South Carolina-grounded electricity and natural-gas utility SCANA. The sale of the company's merchant generation and gas transmission and storage assets has taken place over the past five years.

The result is that 88% of Dominion Energy's operating earnings now come from state and federally regulated utility subsidiaries compared with 40% in 2006. The remaining 12% of earnings flow from zero-carbon, long-term contracted power-generation assets; namely, from Dominion's nuclear power plant in Connecticut, its interest in a liquified natural-gas facility on the Virginia side of Chesapeake Bay, and a portfolio of solar-generation assets.

To see why Dominion Energy's shift to being a regulated utility with a focus on sustainable energy is of interest to investors, it helps to understand how utilities are regulated.

The key feature of utilities is they are monopolies in their vicinities. To stop utilities using this power to overcharge their customers, governments and utilities have developed a 'regulatory compact'. Under this deal, monopoly utilities must invest the money required to provide the essential service in a safe and reliable manner. In return, utilities are allowed to recover their costs and earn a 'fair' return. The amount invested on which a utility can earn a fair return is driven by the capital invested and is known as its 'rate base'. As approved capital spending drives their long-term earnings, utilities seek to maximise the amount of regulator-approved investment as defined by the rate base, while also managing customer bill impacts.

Under this regulatory framework, Dominion Energy is a promising investment for two reasons. First, given the legacy of unregulated assets, the company's stock trades at a discount to other highly regulated peers. We expect this discount to close over time as investors come to appreciate the predictable income stream from its regulated assets that in rate-base terms are valued at about US\$42 billion. (About 77% of rate base is attributable to the electricity utility and the rest to gas, while Virginia and South Carolina subsidiaries account for a significant majority of regulated operations – representing about 52% and 20% respectively.)

The other reason Dominion Energy is a promising investment is the long-term relatively low-risk earnings growth we expect from the company's assets. This is being supported by

regulators and legislators who are pushing utilities to invest in renewable forms of power generation because they help governments meet their decarbonisation goals and lower bills for users. The total cost of electricity of the solar farms being installed by Dominion Energy, for example, is lower than the variable costs of the coal power plants they are replacing.

The company thus has the regulatory ok to boost its rate base by spending a lot of money on green energy, which provides the company with strong capital growth prospects. Over the next five years, Dominion Energy intends to spend US\$26 billion in emissions-reducing capital. By 2035, the utility could spend as much as US\$72 billion to achieve regulatory-approved environmental goals.

The company's capital investment plan is expected to drive long-term earnings growth of 6.5% per annum. The combination of such capital and earnings growth on top of the predictability of the company's income stream are why we hold Dominion Energy in the infrastructure fund.

Now to the risks. The biggest one for utilities is that regulators regularly reassess their allowed rates of returns. But Dominion Energy has largely settled its allowed return for its Virginia and South Carolina electricity subsidiaries for the medium term. Execution is another risk, especially given the magnitude of Dominion Energy's investment plan. Some plans might never happen. Dominion Energy, for example, was recently forced to abandon its joint-venture Atlantic Coast Pipeline project due to delays from never-ending legal challenges that nearly doubled the cost of the project in the six years since it was announced. But that venture was peripheral to the company's regulated utility business.

The risks thus appear contained. To the benefit of investors, Dominion Energy has changed much since it first invested in solar power in 2013. The utility promises to transform itself much more in coming years, most likely for the benefit of investors as well as society.

*Source: Company filings and website.*

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