Fund Update: 30 September 2020

# 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[1] | 1.05% per annum |
| Buy/Sell Spread[1] | 0.15%/0.15% |
| Fund Size | AUD $2,312.1 million |
| Distribution Frequency | Six Monthly |
| Performance Fee[1] | 10.0% of the excess return of the units of the Fund above the higher of the Index Relative Hurdle (S&P Global Infrastructure Index A$ Hedged Net Total Return) and the Absolute Return Hurdle (the yield of 10-year Australian Government Bonds). Additionally, the Performance Fees are subject to a high water mark. |

[1]All fees are inclusive of the net effect of GST

## Fund Risk Measures^

| | 5 Years | Since Inception* |
|---|---|---|
| Upside Capture | 0.5 | 0.6 |
| Downside Capture | 0.3 | 0.4 |

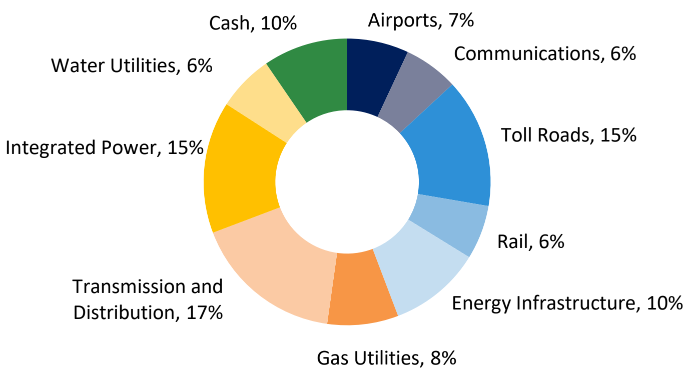
## Top 10 Holdings

| | Sector# | % |
|---|---|---|
| Transurban Group | Toll Roads | 6.3 |
| Atmos Energy Corporation | Gas Utilities | 5.5 |
| Red Electrica Corporacion | Transmission and Distribution | 5.0 |
| Eversource Energy | Transmission and Distribution | 4.6 |
| Sempra Energy | Integrated Power | 4.5 |
| Vopak NV | Energy Infrastructure | 4.4 |
| Enbridge Inc | Energy Infrastructure | 4.3 |
| Crown Castle International | Communications | 4.2 |
| Xcel Energy Inc | Integrated Power | 4.0 |
| American Water Works | Water Utilities | 3.9 |
| | TOTAL: | 46.7 |

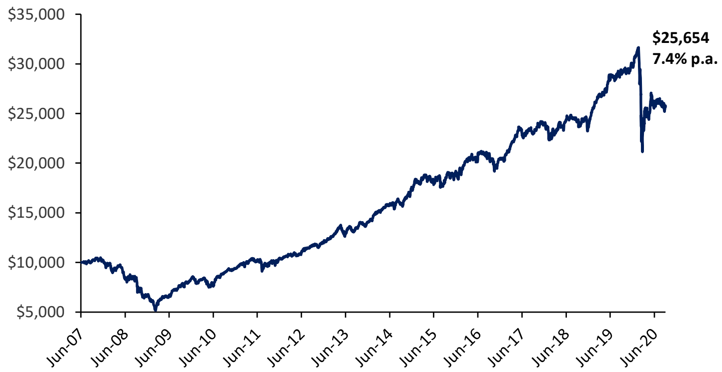
## Fund Features

- 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.

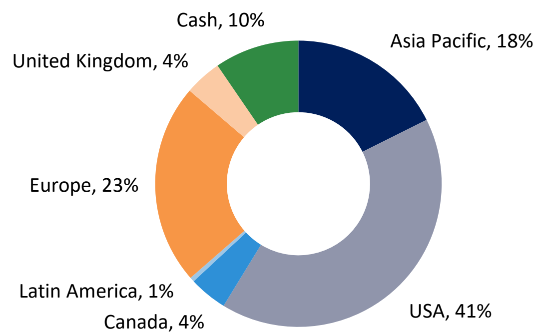
## Sector Exposure#




## Performance Chart growth of AUD $10,000*




## Geographical Exposure#




## Fund Performance*

| | Fund (%) | Index (%)** | Excess (%) |
|---|---|---|---|
| 1 Month | -0.6 | -1.8 | 1.2 |
| 3 Months | -0.8 | -0.6 | -0.2 |
| 6 Months | 6.2 | 10.0 | -3.8 |
| 1 Year | -12.8 | -18.6 | 5.8 |
| 3 Years (% p.a.) | 3.7 | -2.1 | 5.8 |
| 5 Years (% p.a.) | 7.0 | 3.6 | 3.4 |
| 7 Years (% p.a.) | 9.7 | 5.5 | 4.2 |
| 10 Years (% p.a.) | 11.1 | 7.1 | 4.0 |
| Since Inception (% p.a.) | 7.4 | 4.1 | 3.3 |

^ 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 AUD Hedged has been used as the representative of the global market to calculate this risk measure.
# 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.
* 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.
** S&P Global Infrastructure Net Total Return Index (A$ Hedged) spliced with UBS Developed Infrastructure and Utilities Net Total Return Index (A$ Hedged). 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)

## Fund Commentary

The portfolio recorded a negative return for the quarter. Stocks that detracted included the investments in FirstEnergy of the US, Vinci of France and Atlas Arteria of Australia. FirstEnergy plunged after the US Attorney's Office of Ohio charged House Speaker Larry Householder and five others with bribery and money-laundering charges tied to a bill that effectively was a US$1.5 billion bailout of a former subsidiary of FirstEnergy's nuclear plants in the US state. Vinci dived after the economic blow associated with the pandemic reduced the first-half revenue of the concessions and construction company by 15%. Atlas Arteria fell over the quarter as surging infection rates in France, the location of its largest asset, led to concerns regarding greater mobility restrictions.

Stocks that contributed the most included the investments in Xcel Energy of the US, American Water Works and CSX and Union Pacific, two North American railroad companies. Xcel Energy rose after the monopoly provider of electricity and gas services across eight mid-western US states announced a higher-than-expected jump of 18% in earnings-per-share growth for the second quarter and management reiterated its 2020 and long-term earnings guidance. American Water Works, the largest listed water utility in the US, rose as investors appeared to continue to favour its low-risk business model. CSX and Union Pacific, which are regarded as bellwethers of economic activity in North America, rose as US states relaxed pandemic-related restrictions.

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

## Stock Story: Spark Infrastructure

About 15 gigawatts or 63% of Australia's coal-fired power generation will reach the end of its technical life and is likely to be retired by 2040, according to Australian Energy Market Operator, the body that oversees the country's energy markets. Replacing this much coal-fired generation will require more than twice the volume of renewable generation capacity, given the vagaries of renewables. The replacement of the existing coal-fired fleet with renewables will require meaningful investment in transmission networks, as the existing network has an estimated connection capacity of only 13 gigawatts when it comes to renewable resources.

Across about A$13 billion worth of likely renewables projects sits TransGrid, the monopoly operator of the biggest transmission network by volume in Australia's National Electricity Market. TransGrid delivers power to more than 3.6 million homes and businesses within NSW and the Australian Capital Territory. TransGrid is 15% owned by Spark, an ASX-listed investment fund that owns four major energy assets, of which TransGrid has by far the best growth prospects.

SA Power Networks is the only operator of South Australia's distribution network. The utility distributes power to about 887,000 residential and business customers across the state. SA Power is 49% owned by Spark.

CitiPower and Powercor form Victoria Power Networks, which distributes power to about 330,000 customers in Melbourne and another 810,000 clients in the central and western parts of the state. Victoria Power is 49% owned by Spark. Spark's other, lesser, asset is the 2019-purchased and newly built Bomen Solar Farm that will produce enough renewable energy to power 36,000 homes a year.

These four assets that service about five million clients worth about A$18 billion form the core, or perhaps springboard, of Spark's 'growth plus yield' strategy. To comprehend the basis for this strategy, it can help to understand that the core business model of utilities is that they own a monopoly right to provide their services in a defined territory but the return on their capital spending is limited to ensure that they provide affordable services to customers. The way, therefore, for a utility to increase gross earnings is to spend more on approved capital works while earning a return on its asset base, a term for the amount of capital on which regulators can earn a regulated return.

The yield part of Spark's strategy is that its share of its Victorian and South Australian distribution assets and its stake in TransGrid give Spark an effective regulated asset base of A$6.6 billion. In (fiscal) 2019, the regulated return comprised 86% of Spark's revenue of A$1.2 billion, an increase of 3.3% from 2018.

The growth part of Spark's strategy is about investing more to increase the asset base of its three regulated assets and investing in renewable energy, which often falls outside of the regulated sphere. The NSW government, for example, forecasts A$8 billion worth of investment will be needed over the coming decade to power the state, divided between regulated and unregulated assets. TransGrid, for example, is considering a joint bid to build a 900-kilometre interconnector between Wagga Wagga and Robertson in South Australia that will enable more renewable energy to be injected into the national grid. This is just one of the plans that could see TransGrid's regulated asset base double in the next decade.

Another leg of Spark's strategy is to enhance the assets it owns; that is to say, make them more efficient so it has more capital to grow its business, something it does well. (Spark calls this its 'value enhance, value build and value acquire' strategy.)

Spark's portfolio of regulated and renewable assets and their potential to expand has helped the company be one of the most resilient stocks over 2020. Many people have seen that Spark offers what investors generally seek when they invest in essential services: growth plus income.

To be sure, Spark faces the challenge of all the regulatory and political uncertainty that surrounds Australia's energy market. Regulators are trimming some of its regulated returns. Spark's plan to invest in solar, wind and storage projects in coming years come with the risk that management might make poor investments.

Even allowing for these risks, though, Spark is likely to deliver on its growth plus yield strategy in the coming years as solar panels, wind farms and other renewable sources of energy become a more important source of power for Australia.

*Sources: Company filings.*