Magellan Sustainable Fund (Managed Fund)

MAGELLAN ASSET MANAGEMENT

TICKER: MSUF | APIR: MGE4669AU | ARSN: 645 516 187

AS AT 30 SEPTEMBER 2024

PORTFOLIO MANAGER ALAN PULLEN

INVESTMENT PHILOSOPHY

To invest in outstanding companies at attractive prices within a framework that considers environmental, social and governance risks, while exercising a deep understanding of the macroeconomic environment to manage investment risk.

OBJECTIVES

To achieve attractive risk-adjusted returns over the medium to long-term while reducing the risk of permanent capital loss. This incorporates consideration of environmental, social and governance risks and the application of a proprietary low carbon framework.

PORTFOLIO CONSTRUCTION

High conviction (20 - 50 securities), with high quality focus. Integration of ESG screens and risk assessment together with a proprietary low carbon framework overlay.

Typical cash and cash equivalents exposure between 0 - 20%.

INVESTMENT RISKS

All investments carry risk. While it is not possible to identify every risk relevant to an investment in the fund, we have provided details of risks in the Product Disclosure Statement. You can view the PDS for the fund on Magellan's website www.magellangroup.com.au.

ENVIRONMENTAL, SOCIAL, GOVERNANCE AND LOW CARBON

The fund excludes companies whose activities in our view may have wide-ranging detrimental impacts on society for example tobacco production, controversial weapons and mining of coal[^]

Companies are reviewed and scored for the materiality of their exposure to environmental, social and governance factors.

Exposures to industry exclusions is assessed by reference to the total (gross) revenue[+] of the company provided by MSCI ESG Manager.

We overlay our proprietary low carbon framework to deliver a portfolio with meaningfully lower carbon intensity than broader equity markets[++].

MAGELLAN SUSTAINABLE FUND (MANAGED FUND): KEY PORTFOLIO INFORMATION

TICKER	FUND SIZE	BUY/SELL SPREAD[1]	MANAGEMENT AND PERFORMANCE FEES[2]	INCEPTION DATE
MSUF	AUD $8.6 million	0.07% / 0.07%	1.36% p.a. and performance fee of 10% of dual hurdle excess return[^^]	11 December 2020

[^^] 10.0% of the excess return of the units of the Fund above the higher of the Index Relative Hurdle (MSCI World NTR Index (AUD)) and the Absolute Return Hurdle (the yield of 10-year Australian Government Bonds). Additionally, the Performance Fees are subject to a high water mark.

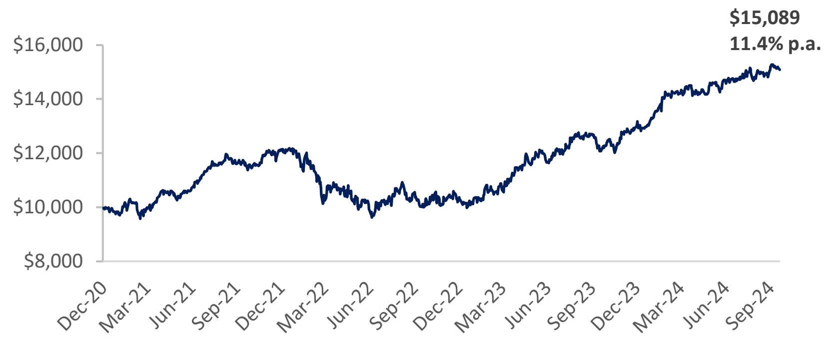
PERFORMANCE[3]

	1 MONTH (%)	3 MONTHS (%)	6 MONTHS (%)	1 YEAR (%)	3 YEARS (% p.a.)	Since Inception (% p.a.)
MSUF	1.0	3.0	4.0	25.0	9.4	11.4
MSCI World NTR Index (AUD)*	-0.4	2.4	2.7	23.2	10.6	13.7
Excess	1.4	0.6	1.3	1.8	-1.2	-2.3

CALENDAR YEAR RETURNS	CYTD (%)	2023 (%)	2022 (%)	2021 (%)	2020 (part year)
MSUF	16.3	29.5	-17.1	22.3	-1.2
MSCI World NTR Index (AUD)*	16.9	23.0	-12.2	29.3	-0.3
Excess	-0.6	6.5	-4.9	-7.0	-0.9

Past performance is not a reliable indicator of future performance.

PERFORMANCE CHART GROWTH OF AUD $10,000[3]



30 September 2024[#]	FUND	INDEX*
CARBON INTENSITY (CO_2T/US$1M REVENUE)	28	101

[#] Carbon intensity data available on a quarterly basis.
Source: MSCI. Reproduced by permission.
The Fund's carbon intensity score is calculated using MSCI data. In a limited number of circumstances, where data is not available or Magellan deems it appropriate, manual adjustments are made to the MSCI carbon intensity score for certain investments held by the fund.

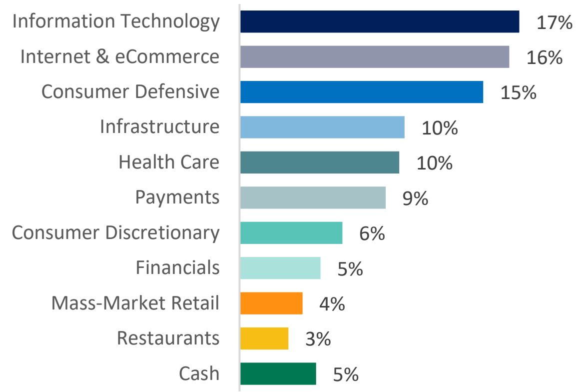
Past performance is not a reliable indicator of future performance.

[^] Please see the PDS for a full list of industry exclusions and revenue thresholds for exclusion.
[+] Net revenue or an estimate of gross (or net) revenue will be used where gross revenue is not available.
[++] Our low carbon framework aims to limit the carbon intensity of the portfolio to one-third of the weighted average carbon intensity of the MSCI World Index, as reported by MSCI. Please see the PDS for further detail.
[1] Only applicable to investors who apply for units directly with the Responsible Entity.
[2] Transaction costs may also apply – refer to the Product Disclosure Statement. All fees are inclusive of the net effect of GST.
[3] 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). Returns denoted in AUD.
* MSCI World Net Total Return Index (AUD). 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.magellangroup.com.au/funds/benchmark-information/

TOP 10 HOLDINGS

STOCK	SECTOR[4]	%
Microsoft Corporation	Information Technology	6.9
Nestlé SA	Consumer Defensive	6.9
Amazon.com Inc	Internet & eCommerce	5.8
Alphabet Inc	Internet & eCommerce	5.6
Booking Holdings Inc	Consumer Discretionary	4.2
Taiwan Semiconductor - SP ADR	Information Technology	4.1
Meta Platforms Inc	Internet & eCommerce	4.1
Reckitt Benckiser Group	Consumer Defensive	4.0
UnitedHealth Group Inc	Health Care	3.9
SAP SE	Information Technology	3.9
	TOTAL:	**49.5**

SECTOR EXPOSURE BY SOURCE OF REVENUE[4]

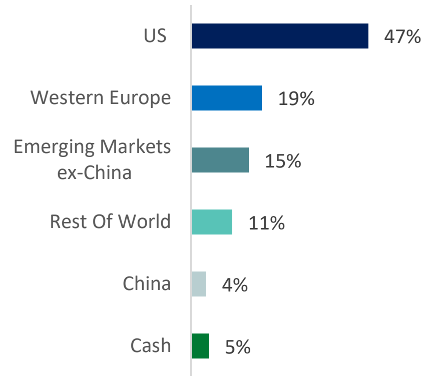


TOP CONTRIBUTORS/DETRACTORS 1 YEAR[5]

TOP 3 CONTRIBUTORS	CONTRIBUTION TO RETURN (%)
Meta Platforms Inc	3.1
Taiwan Semiconductor - SP ADR	2.6
Microsoft Corporation	2.3

TOP 3 DETRACTORS	CONTRIBUTION TO RETURN (%)
Nestlé SA	-1.1
Reckitt Benckiser Group	-0.4
Zimmer Biomet Holdings Inc	-0.02

GEOGRAPHICAL EXPOSURE BY SOURCE OF REVENUE[4]



[4] Sectors are internally defined. Geographical exposure is calculated on a look through basis based on underlying revenue exposure of individual companies held within the portfolio. Exposures may not sum to 100% due to rounding.

[5] Shows how much the stock has contributed to the fund's gross return for the period in AUD. Excludes non-disclosed positions established in the latest quarter.

Market Commentary

The September quarter saw a wild ride in markets. The MSCI World Index gained 6.4% in USD and 2.4% in AUD. Markets globally diverged from recent trends and from each other with returns being driven by differing actions by central banks and governments. Slowing inflation gave way to interest rate cuts by many central banks while the 50bp rate cut by the Federal Reserve gave China's government room to finally deliver a much-needed stimulus package and signal more would follow. The surge in Technology stocks ended as investors became more cautious about the length of time before profits would benefit from productivity solutions unlocked by Generative Artificial Intelligence. This was reinforced by regulatory scrutiny of the Technology sector. Overall, the MSCI sectors of Utilities (+15.7%), Real Estate (+15.3%), Financials (+8.5%), Materials (+7.6%) and Industrials (+7.5%) led markets in local currency terms in the quarter given sensitivity to falling rates. In contrast, Information Technology (+0.8%) and Communication Services (+1.8%) (by far the strongest sectors in the June quarter) were lagged only by the fall in Energy (-3.8%).

Regionally we saw the S&P 500 rise 5.5%, the Nasdaq Composite rise 2.6% and the Stoxx 600 rise 2.2% while China's CSI 300 rose 16% in CNY (21% in September alone) and Japan's Nikkei 225 fell 4.2% with a bout of material volatility in August. Australia's S&P/ASX 200 gained 7.8%, helped by linkages to China and the AUD gained 3.9% against the USD.

The 50bp rate cut by the Federal Reserve was the first since 2020, and alongside US economic growth data points, saw a 55bp fall in the 10-year US Treasury yield to 3.8%. This decline came despite expectations that deficits would rise under either Harris or Trump, a situation that would place upward pressure on bond yields. The Chinese Government's stimulus appeared designed to reduce the likelihood of current challenges in the housing markets and improve weak consumer and business confidence. Towards the end of the quarter, Israel undertook preparatory attacks on Hezbollah, raising the risk of higher energy prices, inflation and interest rates, as well as slower growth. These are all risks we are monitoring closely.

Fund Commentary

The portfolio delivered strong returns over the quarter, both in absolute terms and relative to the benchmark. Key contributors for the quarter included AIA Group, American Tower and Eversource. AIA Group delivered a strong performance for the quarter as Chinese policymakers announced that monetary and fiscal stimulus would be undertaken to stabilise the economy. American Tower outperformed due to the decline in the US 10-year treasury yield, which was seen as supportive of TowerCo valuations. Furthermore, American Tower closed the sale of its Indian operations to Brookfield. Eversource, a low-risk regulated utility, also benefited from the decline in interest rates as well as the finalisation of the sale of its three offshore wind farms.

Key detractors included Dollar General, Nestlé and Alphabet. Dollar General reported a disappointing result in the quarter with weak consumer spending and increased promotions leading to lower operating margins. We view the company as well placed to stabilise margins over the near term given operational improvements already underway. Nestlé underperformed following an unexpected CEO change, driven by the company's slowing growth and a more cautious outlook on profits. The competitive landscape within the packaged food sector has become increasingly intense, while elevated agricultural commodity costs continue to present challenges. We view these factors as temporary and remain confident Nestlé will return to more normalised growth levels in the near term. Alphabet has been affected by negative sentiment surrounding two high-profile antitrust cases, as well as continued concerns regarding the impact of Generative Artificial Intelligence on search growth durability. We view these risks as adequately discounted in the share price.

Index movements and stock contributors/detractors are based in local currency terms unless stated otherwise.

Developments in Sustainability

Magellan named a Responsible Leader in 2024 by the Responsible Investment Association Australasia (RIAA): RIAA announce the Responsible Investment Leaders in the annual Responsible Investment Benchmark Report 2024. Responsible Investment Leaders are asset managers who demonstrate a commitment to responsible investing; the explicit consideration of environmental, social and governance (ESG) factors in investment decision-making; strong and collaborative stewardship; and transparency in reporting activity. Responsible Investment Leader is the highest rating for asset managers.

New York City Climate Week was held in September 2024 bringing together companies, policymakers and other stakeholders. Business leaders shared their insights on sustainability initiatives and strategies for addressing climate change. A key theme was the increasing role of the private sector in driving climate solutions. Microsoft provided examples of how artificial intelligence (AI) is being used to optimise energy use and improve climate modelling. This is balanced with ensuring their data centres are using more renewable energy and improving energy efficiency. L'Oréal commented on their commitment to innovate to reduce the carbon footprint of their products. Mastercard is focused on advancing sustainable commerce through partnership and innovation; for example, integrating a carbon calculator into its network. Geopolitical challenges, particularly between the US and China, were frequently discussed with expectations for broader export controls and sanctions likely across the renewable supply chain.

EU Deforestation laws: The European Commission has proposed to delay the Deforestation-free products regulation (EU DR) by a year to December 2025. The law was put in place in May 2023 and was expected to come into effect at the end of calendar year 2024. The law relates to products such as cattle, cocoa, coffee and palm oil sold in the EU. The onus is on the companies to demonstrate that their products are not produced on land that was deforested or degraded (from December 2020) and the commodities are produced in accordance with the laws of the country of production respecting human rights and indigenous rights. Companies with global supply chains have been preparing for this regulation; however, there are challenges to implementation and concerns around additional costs which if passed onto consumers could add to inflation or affect consumer behaviour.

UK regulator Green Claims Code: The UK's Competition and Markets Authority (CMA) announced in September a compliance guide for fashion brands and retailers when making environmental claims about their products and services. Concerns relate to claims made by companies on the use of recycled material. CMA has written to 17 brands and noted it will have a new capability to fine businesses up to 10% of worldwide revenue if they break consumer law. These penalties are part of efforts to ensure that companies are transparent and honest about their environmental practices, helping consumers make more informed choices.

Outlook

The economic balance of risks improved in the quarter as the US Federal Reserve cut interest rates by a larger-than-expected 50bp and US employment data surprised to the upside. In addition, China's economic stimulus reduced downside risks to that economy. Nonetheless, market valuations remain stretched and numerous uncertainties remain, including the US election, geo-political tensions, and the sustainability of US economic growth. Consequently, we maintain a conservative portfolio positioning for the time being. Over the longer term we remain confident in the quality of the companies in the portfolio. These companies' strong competitive advantages add to their resilience in any downturn and see them well placed to deliver strong earnings over the long term.

Stock Story – Booking Holdings

(Lucina Martin – Investment Analyst)

Booking Holdings, owner of incumbent online travel agent (OTA) brands including Booking.com, Priceline and Agoda, has been instrumental in the digitalisation of the travel industry over the last 20 years.

Travel is a large and growing industry. Since 2010, the travel industry has exhibited attractive +4% growth, driven by both hotel and airline sub-industries, as well as accelerated +10% growth in short-term rental accommodation due to the popularity of Airbnb. Currently, consumers globally spend a staggering US$2.5t a year on travel and this trend is set to continue, fuelled by favourable demographics such as the rise of middle-income consumers as well as changing societal norms where consumers increasingly favour experiences over physical possessions.

In 1997, Booking launched Priceline, one of the first OTAs for hotels, and quickly recruited thousands of independent and unbranded hotel owners to the platform. To build scale, the company acquired Booking.com and agoda.com, which allowed the company to establish an early foothold across major developed markets. Shortly after this, Booking added new travel verticals including car rentals and flights to provide guests with a more holistic travel offering.

Scale is paramount for this business model. Guests will visit an OTA platform if they trust they will find a suitable hotel anywhere in the world and, equally, hotel owners will list their property on a large OTA platform knowing they gain access to the most prospective leisure guests. Booking monetises its platform by charging hotel owners a ~15% revenue commission fee for each filled room. Booking drives additional customer traffic to hotel listings by purchasing advertising placements on Google Hotels or other metasearch platforms such as TripAdvisor. Booking's scale, industry-leading data and tools allow it to advertise at a lower cost compared to an independent hotel owner.

Increased mobile usage quickly shifted bookings online. OTA bookings currently account for ~70% of total intermediary bookings, up from ~40% in 2009. Booking will continue to benefit from this shift online in Europe and North America where there are residual opportunities, as well as new Asia-Pacific markets where online usage is more nascent.

Due to its immense scale, Booking has successfully established a dominant two-sided marketplace by connecting millions of small, independent hotels across the world with millions of leisure travellers. This has solidified its dominant ~40% share of the global OTA market, including up to ~75% share in certain Western European markets. Maintaining quality customer service for a fragmented network of hotel owners is costly; however, importantly, this creates a meaningful financial barrier to entry and has helped protect against competitive threats from similar OTAs and disruption from large technology players such as Google. Booking also benefits from scale advantages in IT infrastructure, data engineering capabilities and brand marketing compared to smaller, less-profitable OTAs.

Undoubtedly, the pandemic was a major disruptive event for the entire travel industry. However, Booking's management team used this crisis to build its dominance. Notably, the company accelerated its offering in flights, car rentals and short-term rentals to increase its competitiveness against larger peers, Expedia and Airbnb. Booking is quickly becoming the one-stop shop for all your travel needs. These initiatives have increased customer retention metrics and direct traffic to Booking's website and mobile app, together representing an impressive ~55% of its total bookings. Combined, these initiatives are creating more loyal and higher-value customers for Booking. This manifests as lower advertising expenses, higher company profitability, higher returns for shareholders and a stronger competitive moat. Booking has further bolstered its value proposition via the rapid expansion of its Genius loyalty program across all brands to offer competitive discounts to guests who book frequently on the platform. It is remarkable what Booking and its management team have delivered during a period of extreme volatility.

The future of the travel industry is exciting. How consumers seek travel inspiration, search for their next dream destination and complete their final booking transaction will continue to evolve. One day it may be possible to book all your travel needs seamlessly on one platform, augmented by a personalised AI travel assistant. While it is still early stages, Booking is already trialling AI assistant tools in the US and UK to improve the user experience. Booking's market dominance and innovative, consumer-centric culture have been critical to its success to date and place it at the forefront of industry change over the coming decade.

Sources: Company filings, Euromonitor.