Strategy Update: 31 March 2019

MFG Global Plus (USD)

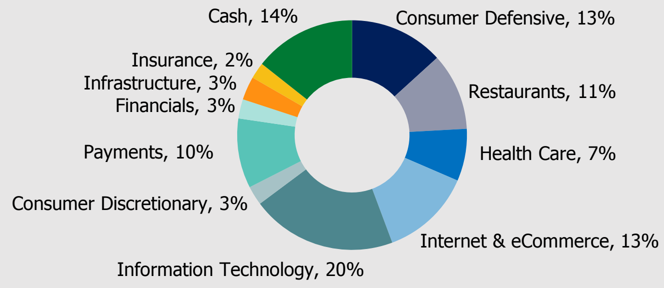
Portfolio Manager	Strategy Inception Date	Total Strategy Assets	Total Global Assets[1]
Hamish Douglass	1 July 2013	USD $7,396.6 million	USD $42,061.9 million

Objective	Approach
Capital preservation in adverse markets Pre-fee return of 10%p.a. through the economic cycle	High conviction (20-40 securities), high quality focus Dual-sleeve portfolio construction with dynamic allocation to cash (max 20%) Combined Risk Ratio cap of 0.8^

Strategy Fundamentals[2]	Strategy	Index
Number of Holdings	23	1,635
Return on Equity	28	16
P/E Ratio (1 year forward)	19.8	15.3
Interest Cover	13	11
Debt/Equity Ratio	53	52
Active Share	87	n/a
Weighted Average Market Cap (USD million)	294,392	n/a

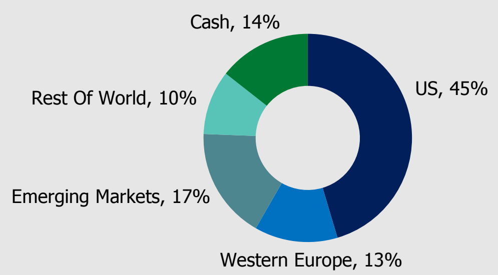
Top 10 Holdings[2]	Sector[2]	%
Microsoft Corp	Information Technology	6.8
Alphabet Inc	Internet & eCommerce	6.6
Facebook Inc-A	Internet & eCommerce	6.2
Visa Inc	Payments	5.7
Apple Inc	Information Technology	5.5
Starbucks Corp	Restaurants	5.5
MasterCard Inc	Payments	4.2
SAP SE	Information Technology	4.1
Oracle Corp	Information Technology	4.0
HCA Healthcare Inc	Health Care	4.0
	TOTAL:	52.6

Sector Exposure[2]



Capital Preservation Measures[3]	3 Years	5 Years	Since Inception
Adverse Markets			
No of observations	7	17	17
Outperformance consistency	86%	94%	94%
Average return – Strategy	-2.8%	-1.9%	-1.9%
Average return – Benchmark	-4.7%	-4.3%	-4.3%
Down Market Capture	0.6	0.4	0.4
Drawdown			
Maximum Drawdown - Strategy	-9.2%	-9.2%	-9.2%
Maximum Drawdown - Index	-13.4%	-13.4%	-13.4%

Geographical Exposure[2]



Cumulative Performance[4]	3 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	Since Inception (% p.a.)
Composite (Gross)	11.6	13.1	13.2	10.0	11.2
Composite (Net)	11.4	12.2	12.3	9.1	10.3
MSCI World NTR Index	12.5	4.0	10.7	6.8	9.0
Excess (Gross)	-0.9	9.1	2.5	3.2	2.2
MSCI World Qual. Mix NTR	12.3	6.1	10.4	8.1	9.8
MSCI Min. Vol. NTR	10.6	9.7	8.8	9.4	10.0

Annual Performance[4]	CYTD (%)	2018	2017	2016	2015	2014	2013*
Composite (Gross)	11.6	0.3	25.6	4.3	3.9	6.6	13.4
Composite (Net)	11.4	-0.5	24.6	3.4	3.0	5.8	12.9
MSCI World NTR Index	12.5	-8.7	22.4	7.5	-0.9	4.9	16.8
Excess (Gross)	-0.9	9.0	3.2	-3.2	4.8	1.7	-3.4
MSCI World Qual. Mix NTR	12.3	-6.5	21.5	7.9	1.6	7.3	14.3
MSCI Min. Vol. NTR	10.6	-2.0	17.3	7.5	5.2	11.4	7.9

Supplementary Statistical Measures[5]	3 Years	5 Years	Since Inception
Beta	0.8	0.8	0.8
Tracking Error (% p.a.)	4.7%	4.5%	4.3%
Standard Deviation – Strategy	9.2%	9.8%	9.9%
Information Ratio	0.5	0.7	0.5

[1] Comprised of all Global Strategies.
[2] The data is based on a representative portfolio for the strategy. The representative portfolio changed in July 2017 due to the closure of the former representative portfolio. 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. The Index is the MSCI World NTR Index. Refer to the Important Notice below for further information.
[3] Risk measures are calculated before fees and in USD. An adverse market is defined as a negative quarter, rolled monthly, for the MSCI World Net TR USD Index, whilst drawdown measures are measured monthly.
[4] Returns are for the Global Plus 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. 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.
[5] Supplementary Statistical Measures Beta, Tracking Error and Information Ratio are calculated in USD using the MSCI World NTR Index.
^ Combined risk ratio is a measure of relative beta and relative drawdown to MSCI World NTR USD Index. Please contact MFGAM should you wish for further details on the calculation.
* Returns are only for part year.

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 portfolios 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 Plus composite is a concentrated global equity strategy investing in high quality companies (typically 20-40 stocks). High quality companies are those companies that have sustainable competitive advantages which translate into returns on capital materially in excess of their cost of capital for a sustained period of time. The investment objectives of the Global Plus strategy are to earn superior risk adjusted returns through the business cycle whilst minimising the risk of a permanent capital loss. The minimum market capitalisation for a stock to be included is US$25 billion. The composite was created in July 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

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.

Market Commentary

Global stocks staged their best quarterly performance in more than eight years in the three months to March after the Federal Reserve signalled that it no longer held to forecasts it issued in December when it indicated it expected to conduct two rate increases in 2019, the US government delayed increasing tariffs on Chinese imports and reports showed the US economy was expanding at a fast-enough pace. The surge overcame rising doubts over the eurozone economy and uncertainty over the UK's departure from the EU. During the quarter, all 11 sectors rose in US-dollar terms. IT (+20%) and real estate (+16%) rose the most while healthcare (+8.1%) rose the least. The Morgan Stanley Capital International (MSCI) World Index rallied 12%, its best performance since 2010.

US stocks rose after the Fed repeatedly signalled it didn't expect to pursue the two rate increases it predicted in December that it would enact in 2019. In another shift that was a boost for stocks, the Fed said that by the end of September it would stop reducing its balance sheet that was swollen by three spurts of quantitative easing or asset buying since the financial crisis of 2008. Previously, the Fed said it would reduce its balance sheet to a set timetable. Concerns about trade tensions between China and the US eased after US President Donald Trump said trade talks with China had progressed enough for him to meet Chinese President Xi Jinping to "conclude an agreement". An economic report showed the US economy expanded at an annualised pace of 2.2% in the fourth quarter. In political news, the investigation into Russian interference in the 2016 election headed by Special Counsel Robert Mueller III found that Trump had not colluded with Russia's meddling during the campaign, according to a synopsis that Attorney-General William Barr sent congress. The S&P 500 Index added 13%, its biggest quarterly gain since 2009.

European stocks rose after the European Central Bank indicated it could aid the economy if needed and the central bank announced new cheap loans for banks. Another boost came when the EU granted the UK an extension on its March 29 deadline for leaving the EU so it had more time to work through its divorce. Economic reports showed the eurozone economy is tepid. A key report showed the eurozone economy only grew 0.2% in the fourth quarter, meaning the euro area expanded 1.8% in 2018. The Euro Stoxx 50 Index gained 12%.

In Asia, Japanese stocks rose after a report showed Japan's economy returned to growth in the fourth quarter, when it expanded at an annualised rate of 1.4%. Chinese stocks surged after the People's Bank of China cut reserve requirements for commercial banks to encourage lending, the government applied some fiscal stimulus and trade tensions eased (and on a decision that the MSCI China Index would hold a greater weighting in world indices). Japan's Nikkei 225 Index rose 8.4%. China's CSI 300 Index soared 30%. The MSCI Emerging Markets Index added 10%.

Movements in benchmark indices are in local currency unless stated otherwise.

Strategy Commentary

The strategy recorded a positive return for the March quarter. The biggest contributors included the investments in Facebook, Apple and Microsoft. Facebook surged after higher-than-expected revenue numbers for the fourth quarter of U$16.9 billion showed users and advertisers were sticking with the social media company even though it has been troubled by privacy and other scandals. Apple gained after a sell-off triggered when key suppliers in late 2018 downgraded earnings and cast doubt on demand for Apple products was judged an overreaction. Microsoft rose after releasing quarterly earnings that showed strong growth in cloud revenues.

The two detractors were the investments in Kraft Heinz and Berkshire Hathaway. Kraft Heinz plummeted after the packaged-goods company wrote down the value of underperforming brands by US$15.4 billion, reported earnings that fell short of expectations due to higher costs, and said it was subject to a probe by regulators. Berkshire Hathaway edged down after some of the company's biggest investments lowered revenue expectations.

Stock story: Yum! Brands

Yum! Brands: The force behind the KFC, Pizza Hut and Taco Bell fast-food juggernauts.

In the 1930s, Harland Sanders started cooking for travellers at his service station and motel in Kentucky. In 2017, the company that the honorary Colonel founded sent a chicken sandwich into space to promote KFC outlets, which already attract eight million people a day in the US. In 1958, two brothers borrowed US$600 from their mother and opened a Pizza Hut in Kansas. The chain is now the official pizza sponsor of the NFL and on Super Bowl day this year it sold enough pizzas in the US to cover 41,000 gridiron pitches. In 1962, a Taco Bell opened in California. In 2018, the Mexican-style chain, which publicised its arrival in London by projecting its bell logo over a scaffolded Big Ben and sending out chimes for the under-repair clock, sold 53 million servings of 'nacho fries' in a three-month promotion.

Behind the success of the world's most famous quick-service chicken restaurant, the world's biggest pizza chain and the US's leading Mexican-style franchise sits Yum! Brands. In 2018, the Kentucky-based business generated US$5.7 billion in revenue, mainly from licence fees, from the 48,000 or so KFC, Pizza Hut and Taco Bell restaurants that it franchises, licenses and operates around the world. (These outlets sold about US$49 billion worth of chicken, pizza, tacos and other eatables last year.)

The variety of foods Yum! Brands offers across its three chains mean its outlets can appeal to more customers in different segments than can most single-concept operators – Pizza Hut caters more for restaurant outings while the others are more geared towards takeaway. Another reason for the Yum! Brands success is that 20,500 of its outlets are in fast-growing emerging markets. This number includes 8,200 licensed outlets in China, where 'finger lickin' good' translates into 'eat your fingers off'.

Bold expansion plans and skill at managing franchisees on top of Yum! Brands's marketable and valued brands and worldwide reach mean the company is likely to hold a dominant position in the global fast-food market for years to come. That's what makes it such a promising investment.

Yum! Brands has challenges, of course. Fast food is a competitive industry and Yum! Brands has rivals in every segment. Pizza Hut sales are lagging due to competition from Domino's and Papa John's. It's not easy overseeing such a large business of franchisees either. KFC outlets embarrassingly ran out of chickens in the UK in 2018 when the Yum! Brands supply system failed. The occasional food poisoning issue erupts. A long-lasting challenge that shows no sign of abating is the trend towards healthier eating, which prompted the name change from Kentucky Fried Chicken to KFC as long ago as 1991. Yum! Brands holds a fair bit of debt too.

But Yum! Brands is a solid business with formidable growth opportunities and one that is always striving to appeal to customers and keep franchisees happy. Satisfied patrons and profitable franchisees make for robust returns for the company's investors. The shares of Yum! Brands have set fresh record highs so far in 2019.

Running franchisees

KFC, Pizza Hut and Taco Bell came to be grouped in the same business because soft-drinks giant Pepsi wanted to reduce its reliance on beverages. Accordingly, Pepsi bought Pizza Hut in 1977, Taco Bell the next year and KFC in 1986. In 1997, Pepsi sold (via a listing) its restaurant franchises that went under the name of Tricon before the switch to Yum! Brands in 2002.

Yum! Brands, which has 98% of outlets operating under franchise, sees much growth in the decades ahead. The company's long-term plan is to have 126,000 KFC, Pizza Hut and Taco Bell outlets globally, which would be nearly triple today's number. (The targeted spilt is 60,000 KFC, 48,000 Pizza Hut and 18,000 Taco Bell outlets compared with 23,000, 18,000 and 7,000 outlets respectively today.)

Under a capital-light franchise model that reduces risks associated with higher labour and commodity prices, the success of Yum! Brands is based on sales growth rather than the earnings of outlets. Franchisees can be individual stores or small and larger groups of stores such as Yum China, a US-listed business spun out of Yum! Brands in 2016.

Franchisees rule over their restaurants. They get to set prices, hire staff and manage the supply chain. If successful, franchise operators tend to add more outlets, which boosts the revenue of Yum! Brands. As the franchiser, the role of Yum! Brands consists of day-to-day tasks such as checking on the franchisees. Yum! Brands, for instance, ensures that the décor in the restaurants, the speed of service and the quality of the food meet the required standards.

More-overarching roles include that Yum! supervises menu changes such as Taco Bell's expansion of vegetarian. Others are that Yum! Brands negotiates certain agreements on behalf of franchisees. An example of this includes the recently announced partnership with GrubHub to deliver KFC and Taco Bell in the US. A prominent role is that Yum! Brands in 2018 spent US$131 million to support the brands – the stores paid for another US$1 billion in marketing. Some of what Yum! Brands has spent on marketing in recent years has been directed at the bizarre. KFC, for instance, promotes faux bearskin floor rugs featuring Colonel Sanders's face and markets fire logs that burn with the aroma of KFC fried chicken.

Yum! Brands has a long-term sales growth target of 7% p.a. for systemwide sales, a measure that includes store growth and same-store-sales growth. That's achievable given Yum! Brands's three-pronged strategy to mass market well-known brands enjoyed by millions the world over each day.

Sources: Company filings, Company website and Bloomberg.