MAGELLAN
FLAGSHIP FUND LIMITED

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Magellan Flagship Fund Limited – 2010 Annual General Meeting
Chairman's Address and CIO's Comments

The Chairman's Address and comments from the Chief Investment Officer to be delivered at this morning's Annual General Meeting are attached.

Yours faithfully,

Leo Quintana
Legal Counsel & Company Secretary

Chairman's Address

To the 2010 Annual General Meeting

Friday 29, October 2010

MFF recorded a profit after tax of $31.1 million for 2009/10. This profit reflects the 'mark to market' of all price movements for the year. For 2009/10, equity price movements for the Company's portfolio were strongly positive whilst the rise in the AUD against other currencies was a partial offset.

The rise in the Company's pre tax net tangible assets of 13 cents per share (a rise of 20.5%) for 2009/10 compares favourably with the rise of approximately 10% for the major global indices (or approximately 3.4% in AUD adjusted terms) and approximately 8.8% for the major Australian indices.

The Company's Portfolio

Our portfolio continues to be more than 90% invested in leading global multinationals. Almost all of these companies are leaders in emerging markets as well as in the more developed markets. In some cases their business leadership extends across dozens of countries and in general, their competitive advantages are increasing.

In 2009/10 the Company maintained its investment focus. There were relatively few sales from the portfolio (less than 10% by value). The underlying business strength of our portfolio companies is evident.

Near term economic conditions are difficult in much of the world and economic, political and regulatory risks continue to be significant, including increased Sovereign Risk

Despite this, our portfolio companies continue to expand their leadership in developed markets as well as emerging markets. We expect that our portfolio companies will likely be disproportionate beneficiaries of the 1 billion or so newly middle class, newly urbanised consumers expected over the coming decades in emerging markets. As a result of their sustainable competitive advantages many of our portfolio companies combine excellent cash flows with above average growth potential.

On Market buy-back

During 2009/10, MFF acquired on-market a further 11.7 million shares at an average price of approximately 57.8 cents per share, which represents a discount to the Company's net assets per share. We intend to maintain the Company's Balance Sheet strength whilst continuing the buyback where it is a positive use of the company's resources. Our investments are in highly liquid shares and we have a modest level of borrowings in comparison with investment assets.

Whilst we consider that the buyback is more preferable for shareholders than paying an unfranked dividend, your Directors wish to pay dividends, subject to there being an accounting profit and the availability of sufficient franking credits.

Richard Warburton AO
Chairman

COMMENTS FROM CHRIS MACKAY
MAGELLAN'S CHIEF INVESTMENT OFFICER
At the Magellan Flagship Fund Limited Annual General Meeting
Friday, 29 October 2010

The Chairman has outlined the investment performance for 2009/10. Our 20.5% pre tax NTA increase was well ahead of market comparables notwithstanding the appreciation of the AUD during the year.

I do not wish to linger on these results and am very happy to take questions on the specifics. I will use the time to provide some data relating to where we are now and our thoughts about the future.

The businesses of our portfolio companies are meeting or exceeding expectations. However this is not reflected in the overall portfolio value or the Company's share price, particularly as the negative currency impact is more than the decline in asset value from the original issue price. Although share prices for most of our portfolio companies have rebounded, we believe that conditions remain very favourable for long term investors and expect that over the longer term the portfolio will rise very materially to reflect the value these businesses are creating. Although the currency headwinds appear well supported by current events and adverse momentum is strong, we do not expect them to be permanent. I will mention some data on this and our portfolio companies shortly.

INVESTMENT PORTFOLIO AND MARKET CONDITIONS

Uncertainty and weak economic conditions in the northern hemisphere mean that investor demand remains low. We believe that conditions [particularly prices] are favourable for longer term investors in high quality companies. Withdrawals from equity mutual funds in the US and Europe have been high, many pension funds have reduced their developed market equity weightings and there have been huge self reinforcing flows of capital to emerging markets, commodities and bonds. Prices for various top quality companies are below their pre 2000 level despite materially improved competitive positions and tripled earnings.

Recent bond issues by Johnson & Johnson, IBM and Wal-Mart produced yields materially below their current dividend yields (which dividends have been increased for decades), and tiny compared with their free cashflow or earnings yields (which are being reinvested by the companies at much higher rates of return). The flight to emerging markets, about which many investors have no idea of the risks, has meant that companies like Nestle, which operates in over 200 countries, trade at far lower multiples of current earnings (let alone free cashflow) of competitors operating in single categories in individual emerging markets. Nestle itself insists on higher margins and higher returns on capital from emerging markets to offset the higher risks.

In this context, the Company's portfolio is more than 90% invested in leading global multinationals. Our portfolio is positioned to benefit for decades as hundreds of millions, if not billions, of emerging market consumers continue to increase their spending power and become urbanised. Many of our companies earn billions of dollars of free cashflow from their market leading positions in some of the most profitable, but legal, categories in North America, Europe and Japan. They have reinvested over decades to establish market leadership in emerging markets all over the world, whilst also increasing their leadership in their more established markets. In almost all cases, these investments are already profitable in all major markets. These companies are improving their competitive positions virtually month to month, via profitable competitive advantages that might sustain for decades. Free cashflow potential is increasing, as operating leverage translates revenue growth into larger profit increases, and the portfolio has strong prospects for ongoing improvements in operating leverage over many years.

There are numerous examples up and down our portfolio, but I will illustrate quickly and simply at the top. Nestle and Yum! Brands are two of our 3 largest holdings. Nestle has been in most emerging markets for a century and is the number one or two food and nutrition company in a clear majority of these markets. In country after country, its operations and brand names have been localised for decades. 35% of sales are from emerging markets and their margins and profitability levels are actually higher overall than in developed markets. Nestle has over $100billion of global sales and over $10billion of annual free cashflow after capital investments across all business lines and regions. Sales in excess of $6 billion in Brazil lead that market, as does their $40 billion of sales in the United States. The best global companies use their knowledge and experience from all around the world to benefit their businesses elsewhere. Nestle has over 30 major research laboratories across the globe to enhance health, nutrition, taste and consumer preference across both emerging and established markets. Nestle is increasing sales and improved margins, whilst reinvesting billions into sourcing, production, distribution, innovation, research and development, as well as undertaking a share buyback program which will approximate $40billion by the end of next year, on terms that are extremely favourable for long term shareholders.

Yum! Brands and McDonalds lead a category which can produce very high returns on capital once critical mass is reached in each individual market. In 2009, Yum earned an operating profit of US$602m (+25%) in China whilst spending capital for infrastructure to support the rollout of 509 restaurants. For the first 9 months of 2010 their operating profit in China has increased by a further 30% to $582million. Yum has moved beyond 3500 restaurants in China since first entering in 1987, and we expect them to materially increase that number for well over a decade. Outside of China, Yum also continues to open about 1000 restaurants each year, with over 50% of earnings coming from emerging markets. The strong cashflow returns have enabled Yum to also undertake a multi-billion dollar share buyback and increase dividends (+ 20%this year) whilst funding this growth without issuing new shares.

There are few companies with the positive characteristics of Nestle and Yum anywhere in the world. It is exceptional for businesses concurrently to achieve early payback of capital invested, to maintain high returning growth on billions of dollars of reinvested capital from internally generated free cashflow, to balance huge exposure to emerging markets with market leadership in established markets. During the Crisis they also increased dividends each year and accelerated share buyback programs on favourable terms whilst maintaining very strong balance sheets.

Being a competitor to one of the best companies in the world is not straightforward, even in very attractive categories. Most competitors are unable to generate sufficient returns to match the leaders' investments in physical assets, innovation, sourcing, distribution, R+D and in price where necessary, and their relative positions weaken over time.

Three examples illustrate (there are many more):

Procter & Gamble is #1 or #2 in 38 major categories in the US with businesses in 74 adjacencies. It is already the #1 FMCG company in China and is growing there from a base of 18 categories, 12 in India and 19 in Latin America. Procter & Gamble's innovation, expenditure and success in terms of awards and patents is more than double its major competitors combined. Growth opportunities are funded from NPAT of around $3billion per Quarter and, by the way, they also bought back over $3 billion of their share on favourable terms in the September Quarter alone.

Kmart improved its in store productivity for over a decade before going into chapter 11 bankruptcy in part because Wal-Mart improved more materially and offers a wider selection at lower prices.

Burger King has again been bought by private equity after its share price was under pressure with their global net profit after tax falling this year, and being less than a third of the operating profit Yum earns from China alone, and less than 1/20th of McDonald's global profits, which continue to increase by double digits.

I won't detail the current performance for each of the individual companies in the portfolio but encourage interested shareholders to look at the source material on the individual company websites.

I will briefly mention American Express, as it is currently our largest holding. We felt that American Express was the #1 ranked of the US based financials in the stress test conducted during the Crisis, and its initial results coming out of the Crisis are ahead of expectations. Its third quarter results released last week showed a 90% earnings per share increase off the low base of the prior year and also showed a mid-double digit increase in spending by card holders. Their member spending levels are back to pre-Crisis levels and American Express has gained market share in the recession. It has now been approved by the Federal Reserve to recommence share buybacks in Q4 (albeit at a relatively modest level of about $600 million at first) as its capital and liquidity are strong. Buybacks are materially value and earnings per share accretive at current prices, in our view. American Express' market price continues to be well below our assessment of the present value of the likely future cashflows, even after the big rise since 2009. Analysts remain concerned about regulatory issues, American Express's increased cost base chasing market share and whether the current consumer deleveraging will continue to reduce loan balances and restrict future growth. Clearly the past is always different to the future, but we note that American Express has profitably grown card member spending from about US$68 billion to US$180 billion per quarter since 2000 whilst materially broadening its business during a period which has involved a range of financial, economic and political challenges.

In terms of portfolio construction, we made few changes during 2009/10. We will continue to assess opportunities based upon opportunity costs.

Current markets are throwing up some interesting opportunities and some attractive categories continue to be under market pressure. Whilst some of our holdings have appreciated materially to levels closer to our assessments of fair value, we believe that market prices of some high quality financials, for example, may provide interesting probability weighted, risk adjusted opportunities as part of the overall portfolio.

Each quarter we will release to the ASX updates of the major holdings. In addition, the commentary will continue with the monthly NTA releases. The September 30 holdings will be included next week with the October NTA announcement and we intend to release the 31 December holdings with that months NTA announcement at the start of January.

CURRENCY MARKETS

Currency is again a headwind and has disguised the portfolio performance. China's superb execution of Keynesian stimulus to offset the collapse in exports was driven by increasing fixed asset investment to almost 70% of GDP which brought forward resources demand. The very loose monetary policy needed to stimulate recovery in the US, Europe and Japan has facilitated unprecedented capital flows to China and other emerging markets in a classic boom cycle which is feeding itself. The loose monetary policy is weakening the USD in particular, as investors chase yield and return differentials. Retail investors also pile into funds targeting the momentum markets.

The AUD has moved slightly ahead of, or in parallel with, broader equity market movements over the past 24 months. We decided to remain fully invested as we regarded equity prices as attractive even though the economic outlook remained uncertain. We felt that the unhedged currency would provide some downside protection in order to maintain this fully invested position. The 20.5% rise in the year reflects benefits from share prices appreciating off the very low base but we gave back on the currency. When equity markets were falling, the AUD was also giving some reduction in volatility.

Hamish has done some detailed analysis on the possible paths to peak steel consumption in China, which is perhaps the most important medium-term variable for the Australian economy and growth rates, and impactful for AUD translations.
We believe that China's fixed asset investment level of approximately 2/3 of its economy is unsustainable and China's peak steel consumption will most likely be reached within 5 years, if 10% pa steel consumption growth rates occur (well below recent growth rates). If China's peak steel consumption is 20 years or so away, the increasing demand for Australia's key commodity exports will slow dramatically.

Already, China's per capita steel consumption is high in comparison with previous fast growing urbanising countries with smaller populations, and absolute consumption is currently about 20x the consumption in the United States. Recent iron ore and coking coal prices are roughly three times their previous averages with the volume of Australian exports and Chinese demand having more than tripled in a decade. Whilst the earth has hundreds of years supply of both commodities, huge capital costs and the impact of the Crisis has impacted the supply response, as have the infrastructure advantages of many of the mining majors which impact on the terms for access to transport for new projects. This appears to be correcting, with projects expected to add at least 1/3 of the World's iron ore capacity having the potential to complete by mid-decade. Equity funding has now been obtained for major projects in Africa, Mongolia, China and Brazil as well as Australia, with Vale, for example, arguing that a major Guinea project would be profitable at iron ore prices of about US$30 per ton (or about 1/5th of current spot prices).

Hamish foresees reasonable prospects of a halving of the prices of Australia's major commodity exports. The recent experiences of Ireland, Spain, the United States, New Zealand and the earlier Asian Crisis have shown that the direct and indirect effects of impacts to important sectors of the economy can reduce overall economic output by 10% or more. Arguably, Australia is currently outperforming underlying economic potential (BHP's recent quarterly production report indicated full capacity production) benefitted by ongoing government stimulus, exploration, heightened money velocity (including increased taxation and royalty receipts and transfer payments), substantial portfolio capital inflows chasing equity and debt returns, and high and rising housing prices relative to sustainable incomes adding to wealth effects.

We will maintain our unhedged position for MFF whilst we believe that it is supported by the data. Currencies can move very quickly, particularly in the current circumstances of huge global flows and capital imbalances. We have always said that the AUD could rise higher and stay there for an extended period, but we don't accept the proposition that "this time is different" and believe that the commodities and terms of trade rallies will eventually reverse as supply and demand adjust. In those circumstances the risk for the AUD is very materially to the downside.

Whilst we expect that the relationship between the AUD and broader equity markets will eventually unwind in favour of outperformance by the highest quality companies, such as those held by MFF, the movements in the meantime might continue to be significant, sustained and adverse.

For example, it is possible that there is dramatic and persistent improvement in Australia's current account from deficit to surplus [despite the very favourable terms of trade, the deficit is still within the top 10 per *The Economist* on both an absolute basis and as a percentage of GDP] and in foreign debt levels [which actually increased in the latest figures with net foreign debt rising to $672 billion notwithstanding the strong equity trade figures and the dramatic translation benefits from the higher AUD].

It is also possible that the considerable economic and political problems in Europe, Japan and the USA worsen, that the growth in the emerging markets, particularly China, continues unabated, and Australia continues to be seen by hedge funds and sovereign investors as a high yielding "safe haven" China exposure.

Shareholders are well aware that the underlying earnings of our portfolio companies are from every corner of the globe with, for example, the earnings of Nestle and Yum! Brands mentioned earlier including material components in the [currently popular] currencies of Brazil, Switzerland and China.

Whilst we do not intend to change MFF's currency positions in current market conditions, we keep decisions on currencies under review and any material changes will be advised to the ASX in the monthly and weekly NTA statements as well as in the formal accounts. Circumstances may again change quickly, particularly given the growing global imbalances and capital flows.

CAPIAL MANAGEMENT

As mentioned by the Chairman, we continue with the share buyback. This benefits sellers because it increases the range of buyers. If the prices are below underlying values, it is also expected to benefit longer-term shareholders, for example, by increasing the underlying NTA. It is analogous to using the current AUD levels to buy MFF's international portfolio.

Returning the value of the company to above its IPO level is a key objective. Franked dividends require the creation of franking credits and this adds to the importance of getting the asset values beyond this level.

CLOSING

Markets can move quickly and dramatically and periodically get it very wrong about asset prices, sometimes for sustained periods. Shareholders may recall that we added modestly to our American Express holding last March at below $10 per share. Based upon American Express's recently announced 9 month results, this price is less than 3x the expected after tax earnings for 2010 and a fraction of any assessment of fair value, either to a corporate purchaser or on the basis of a present value assessment of likely future earnings.

We will maintain our detailed analytical approach, focussed upon Quality and Value. We can see from the business results, cashflows and market share gains of our companies that we hold an increasingly valuable portfolio and we believe that the portfolio is currently attractively priced in local currencies, and more attractive in AUD terms when considered over the medium term.

Thank you