MAGELLAN
FLAGSHIP FUND LIMITED

**Magellan Flagship Fund Limited**
ABN 32 121 977 844

Level 7, 1 Castlereagh Street,
Sydney NSW 2000 AUSTRALIA

General: +61 2 8114 1888
Facsimile: +61 2 8114 1800
Website: www.magellangroup.com.au

**Magellan Flagship Fund Limited ('MFF')**
**Net Tangible Assets ('NTA') per share for February 2012**

MFF advises that its monthly NTA per share as at 29 February 2012 was $0.849 excluding net deferred tax assets[1] of $0.058. These figures are unaudited.

Turnover in the portfolio was again modest. We remain confident about the business prospects of the portfolio companies and valuations range from very attractive to satisfactory, even after recent market recoveries. The small amount of turnover mainly reflected our perception of relative values and business cases. The on-market buy-back continued in February and 1.22 million shares were bought.

Almost all of the portfolio companies have reported December year/half-year/quarter results. Overall, the results exceeded our expectations and business progress was excellent, with strong current results, market share gains and excellent platforms being built for the future. We continue to have considerable opportunities within our portfolio and focus on business quality and value.

In recent months we added to our high quality financials as their share prices lagged their positive business progress. In March, the largest US banks expect to be advised by the Federal Reserve whether they can increase their dividends and share buy-backs.

We remain selective about multinational exposures to economies such as Europe and Japan where financial institutions face forced deleveraging over an extended period. The ECB intervention is likely to have been decisive in providing sufficient liquidity to Europe to prevent a near term uncontrolled disaster. However, the adverse impacts of forced austerity and necessary reductions in bank leverage have a long way to play out. The recent major Japanese export multinational bankruptcy (Elpida) is reflective of broader pressures in that economy.

China's authorities broadly maintained their tight restrictions on property aiming to deflate that bubble without widespread damage. Authorities are also seeking to deal with excessive local government leverage by forcing its extension on uncommercial terms, by domestic financial institutions. The authorities have the policy levers to avoid a hard landing in the short term and are likely to do so, given their very strong incentives and China's predominantly closed capital accounts and controlled lending markets. However, we continue to watch this situation as reactions to the responses of authorities may range between reigniting the speculative boom to wide ranging bankruptcies. There are also pressures on banking deposits in China, as well as in Europe, and this constrains lending capacity.

In the medium term, China's economic growth cannot rely upon a bubble of increasing demand for the (effectively unlimited supply of) commodity like apartments in undifferentiated outer suburbs of hundreds of cities. The thousands of Chinese speculative property developers inevitably will cause an oversupply of commodity housing, given China's low population growth based on demographic policies and profile and negligible immigration. Complacency that the authorities won't allow developers to fail or speculative buyers to lose money would be misplaced in the West. Authorities are severely challenged, as the current mild slowdown is already causing unrest and disquiet and they weigh the risks against the need for economic rebalancing. Given the scale of overbuilding and inventory levels, significant financial distress in the industry is probable, with the timing and scale subject primarily to Government policies including the inevitability of some of the losses being socialised. The debt burdens of even the larger listed developers are high compared with conventional measures, and the industry is continuing to buy, borrow and build in the expectation of a bailout/relaxation of restrictions/new stimulus. The Vietnamese and Dubai property cycles provide recent precedents of the inevitable interaction of unconstrained supply on price/demand in commodity housing markets that are not limited to the US, Spain, Ireland and other more developed economies.

During the month, the AUD remained firm (and closed the month above USD1.08), although, as noted by the RBA and Treasury, terms of trade have recently been flat or declining. Foreign bond buying by central banks, and for the carry trade, strengthened in the month. Business leaders and economists have (so far unsuccessfully) attempted to focus attention on the politically difficult, major economic challenges such as the ‘permanent’ effects on industry and skills of adjustments related to the temporary (but multi-year) high AUD driven by portfolio capital flows and commodity based terms of trade (see the comments by Don Argus and Warwick McKibbin and the IMF paper targeted at emerging market currency policy options).

Many asset markets continue to be inflated by yield seeking and fiscal/monetary stimulus which increases underlying cashflows and reduces the discount rates used to assess those cashflows. Close focus on macro events as well as companies and industries continues to be required, as policies and confidence can change rapidly. Medium term risks are growing, although extremely low interest rates and high liquidity encourage risk taking and complacency. Some cyclical effects may become structural, for example the persistence of an overall declining demand trend for most consumer durables in developed markets. Policy decisions will impact companies and markets, with the Chinese response to the property bubble being opaque and crucial, and also how the US political process responds to the $5 trillion increase in Federal Government debt since the financial crisis.

More than 80% of MFF’s total investment assets by market value are in global multinationals (being entities that generate 50% or more of their revenue and/or have material operations in 15 or more countries outside the domicile of their primary securities exchange), with the balance being predominantly North American focused and about 7.5% being China focussed. The revenue and earnings split for the multinationals average almost 40% USA, about 25% Europe and about 1/3 ROW. The emerging markets’ proportion of underlying revenue and earnings continues to rise.

As at 29 February 2012, MFF had net borrowings of approximately 15.5% of total investment assets. Most of the borrowings are in AUD with small amounts in Euro and Swiss Francs. Cash balances from unutilised sales proceeds and dividends are almost entirely held in a mix of US Dollars, Singapore Dollars and Hong Kong Dollars.

Key currency rates for AUD as at 29 February 2012 were 1.080 (USD), 0.808 (EUR), 0.676 (GBP) and 0.973 (CHF), compared with rates as at 31 January 2012 were 1.063 (USD), 0.812 (EUR), 0.673 (GBP) and 0.977 (CHF).

Yours faithfully,

Chris Mackay
Director

Leo Quintana
Legal Counsel & Company Secretary

2 March 2012

[1] Deferred tax assets less deferred tax liabilities.