Half Yearly Investor Report
6 February 2013
Magellan Flagship Fund Limited

Dear Shareholder

Investment results for calendar 2012 were strong with the portfolio appreciating by approximately a 21.5% pre tax after expenses compared with appreciation in global index measures in AUD terms of approximately 12-13%. For the latest six months the pre tax portfolio appreciation after expenses was approximately 4.4% compared with approximately 6.5-7% for the global index measures in AUD terms[1].

MFF's largest holdings as at 31 December 2012 follow:

Holding	$million	%[2]	Holding	$million	%[2]
Tesco	32.7	9.6	Lowe's	11.5	3.4
McDonald's	24.3	7.1	CME Group	10.9	3.2
Wells Fargo	23.3	6.8	Danone	10.8	3.2
Yum! Brands	21.0	6.1	MasterCard	7.4	2.2
Visa	19.8	5.8	Mondelez (formerly Kraft)	5.2	1.5
Bank of America	18.4	5.4	Apple	5.1	1.5
US Bancorp	17.0	5.0	Unilever Plc	4.8	1.4
HCA Holdings	15.9	4.7	Unilever NV	4.8	1.4
Wal-Mart	15.1	4.4	China Metal Recycling	3.8	1.1
Google	14.6	4.3	American Express	3.5	1.0
Sainsbury J	12.5	3.6	Singapore Technologies	2.0	0.6
State Street	11.8	3.4	Home Depot	1.8	0.5
Bank of New York Mellon	11.6	3.4	SIA Engineering	1.3	0.4

We have changed the portfolio far more than normal over the past 12 months. We are focussed upon quality businesses and perceived values, as well as portfolio construction and risk management. Whilst the investment outperformance in recent years has been satisfactory, we are very conscious of risks despite current favourable conditions. Investment processes and disciplines are crucial, particularly around valuations and macro changes (a focus is on the potential for major policy changes). Risk management is not being rewarded at the moment and low volatility and low interest rates are dangerous for investors and induce confidence and often complacency. If the current economic recovery appears to be sustained and confidence rises generally, particularly if it leads to further asset appreciation, risk management must increase further.

[1] Investment results are after adding the benefit of the 1cent per share dividend paid in November 2012.

[2] Percentages of portfolio plus net cash (excluding effect of accruals and accounting adjustments). Figures are approximate and rounded.

We believe that current conditions and prices are favourable for our equity investments and we have confidence for their medium term business prospects. We reduced cash levels over the past 6 months to now return to being fully invested. Asset price recoveries and business resilience are continuing to benefit our portfolio. However shareholders must note that companies in the portfolio can and will underperform. Apple and Yum! share prices have underperformed, particularly post 31 December 2012 and we get no ongoing credit for having sold out of both profitably at higher prices earlier in 2012; current facts obviously require current assessment.

There is some chance that the central bank activities, which are favourably distorting asset markets and reducing near term downward volatility, will translate into a sustained broad based economic recovery, particularly in the US, with the recovery sufficiently durable to allow a gradual reversal of the settings. Already California state finances are moving from being a fiscal basket case to reasonably projecting that current expenditure will be covered by receipts. However, individual companies and geographies have hugely different profiles. Risks and excess capacity are widespread, and asset prices are far higher than they were at the nadir.

The timing of the unwinding of distorted asset markets is always uncertain, as are consequences. Although we focus on investing in the businesses of companies that we would be happy to hold for decades, we are always nervous about the potential for sustained capital falls and have attempted to anticipate and minimise indirect exposure to the most extended markets. In the medium to longer term, attempts at policy normalisation are more probable than not, with significant implications for asset markets at that time.

We believe that sensibly priced, very high quality companies with sustainable advantages, strong competitive positions and at least reasonable or strong pricing power in both inflationary and deflationary conditions remain better placed than most other asset classes. In the short term they may underperform some of the hot markets, although MFF's weighting in our very high quality financials has been outperforming in recent periods. In the medium term and beyond we are confident that very high probability businesses like Tesco, Wal-Mart and McDonald's will outperform most investor benchmarks from our recent purchase prices. We were delighted to buy large positions in such long term consumer companies on terms that we regard as attractive, and note that they also provide excellent rebalancing for the portfolio.

We have maintained MFF's financials exposure given current prices and our current views on these financials and the portfolio's composition. We favour payments systems, including processors such as Visa and MasterCard which do not provide credit. We also favour banks with sticky multibillion or trillion dollar, low cost deposits and diversified revenue/fee bases and strong capital positions. We also increased MFF's asset management industry exposure over the last 6 months.

We have maintained the effectively short AUD position. At current levels and in current circumstances we will maintain the positions, even though momentum continues to be unfavourable or neutral. We continue to weigh the negative 'carry' cost of about 1 cent per share per annum against the risk management benefits and the probable magnitude of eventual movement.

The deterioration in competitiveness of large sections of the Australian economy is continuing and most likely that deterioration is accelerating. One of the most likely consequences of ongoing deterioration would be downward currency pressure, particularly given the magnitude and duration of portfolio flows to Australian bond markets. The other side of the equation (that the US can sustain a recovery and can improve its structural position) is probable. Returning volatility in global capital flows is inevitable but timing and consequences are unpredictable. Income levels have not yet become severely pressured in Australia.

Markets are complacent about Australian weaknesses in the structural fiscal and household sector borrowing positions, supply and demand for key exports, the narrowness and cyclicality of the overall income base and vulnerability to downward asset price cycles. For example, The Economist survey (published weekly) during January 2013 continued to estimate the 2012 fiscal deficit at 0.9% of GDP although the actual increase in the Australian Federal/State government debt for the calendar year was likely closer to 5% of GDP and the Government accounted Federal deficit was likely closer to 3% of GDP. Through cycle, one trillion dollars of net foreign liabilities, $50 billion structural Federal/State deficits and $50 billion balance of payments deficits are likely to be conservative estimates. Increased Government borrowing for 'worthy' projects is an emerging consensus, not just amongst the infrastructure and construction lobbies, as it has been in Japan, Queensland, the UK and Spain.

MFF continues to release regular portfolio and investment information to the ASX including weekly NTA details as well as monthly NTA updates and commentary.

Yours faithfully,

Chris Mackay
Director
6 February 2013