Important Notice

Chairman's Address
to the 2013 Annual General Meeting
Wednesday, 16 October 2013

MFF recorded a net profit after tax of $80.82 million for 2012/13. This result reflects realised gains during the year as well as the 'mark to market' of all price movements for the year. The Company recorded an investment return of approximately 35% for the year predominantly reflected in the rise in net tangible assets (NTA) per share (pre tax) to $1.263 per share as at 30 June 2013 compared with 95.4 cents per share as at 30 June 2012.

In 2012/13 strong portfolio gains were achieved and there were also positive currency movements, reflected in the USD appreciation against the AUD by approximately 12% over the year from approximately 1.0251 to 0.9154 USD for each AUD.

During the past twelve months your Company was active in addition to recording these investment returns. Capital allocation and capital management are very important to your Board. The 2017 MFF options were issued for no cash outlay to shareholders on a 1:3 basis. We believe that they have benefitted shareholders. There has been an active market in the options and approximately 5.0 million have already been exercised.

We also believe that shareholders have benefitted from the share buybacks we have conducted in recent years.

During the year, your Directors negotiated to improve the terms of the management agreement with MFG and after year end the Company employed Chris Mackay as Managing Director and Portfolio Manager and further revised the arrangements with MFG. As a result, your Company now operates with MFG under agreements whereby MFG provides investment research and services to MFF but is no longer the investment manager. The financial arrangements are effectively the same as previously, with the amounts paid reduced to reflect Mr Mackay's employment by MFF.

The changed arrangements do not change your Company's strategy; your Company will continue to seek to maximise risk adjusted returns by investing in a portfolio of at least 20 investments. As Portfolio Manager, Mr Mackay's primary focus will continue to be to target companies which he perceives to be at the intersection of Quality and Value, as he did for MFF whilst employed by MFG as the portfolio manager for MFF.

At our Board meeting today, your Board agreed with Mr Mackay's recommendation that the Company continue to focus on MFF's existing strategies and opportunities. Mr Mackay will talk about current risks and opportunities in his remarks shortly.

The Company's Portfolio

Last year I said that "MFF has 3 core positions (high quality equities, substantial net cash and MFF is effectively short the AUD)" and that "[W]e feel that each has a reasonable probability of enabling value to be added in future years". This continues to be the case.

Investment returns drive shareholder outcomes. Last year I said that "MFF achieved pre tax returns, after expenses, in base currencies of approximately 29% (2010), 18% (2011) and 20% (2012) over those 3 years". The 2013 returns, on this basis, were approximately 23%.

We believe that caution is warranted. We consider that MFF's equity positions are world class and the Portfolio Manager considers that they offer quality and value in comparison with equities in general, compared with portfolio opportunities in the domestic markets, and in comparison with other asset classes. However, markets generally have risen strongly in recent years.

MFF provides diversification benefits for Australian and New Zealand investors in terms of companies, currencies and business geographies. Despite the benefits of diversification and the currency benefits this year, currencies have been an important negative since inception.

Dividends

The Directors have declared a dividend of 1 cent per share, to be paid on 15 November 2013. This dividend will be unfranked as was the 1 cent per share interim dividend. The Directors' preference is for a regular 6 monthly dividend at 1 cent per share, subject to corporate, legal and regulatory considerations. The Dividend Reinvestment Plan remains in operation in respect of this dividend payment with a zero discount to the applicable market price. We acknowledge that many shareholders prefer to receive regular cash dividends, even if they are unfranked, rather than have the company retain those funds for reinvestment, notwithstanding that dividends have tax consequences for shareholders.

I now invite Chris Mackay to make some remarks and we look forward to your questions.

Richard Warburton AO LVO
Chairman

Comments from Chris Mackay
Managing Director and Portfolio Manager
At the Magellan Flagship Fund Limited Annual General Meeting
Wednesday, 16 October 2013

The MFF portfolio gained about 35% (pre tax, after costs) in the 12 months to 30 June 2013. This was about 2/3 from increases in the stock portfolio and 1/3 from currency benefits. Although this result is positive, caution is warranted; whenever market prices rise strongly, risks also rise. We are in a phase of unknown duration where a majority of professional investors are now chasing performance as well as stretching for yield in sovereign and corporate bond markets and in equities. In aggregate, investors are not allocating capital or managing risks on the basis that overall medium term annual market return expectations should be no more than mid single digits.

There is more than usual to cover today. I will touch on 4 Topics and allow plenty of scope for questions:

- What do the recent structural changes mean for MFF?
- What is MFF's future strategy?
- Risks and Opportunities.
- MFF's Portfolio.

MFF Structural Changes

My change of employment from Magellan to MFF means that I report to the MFF Board. Our goal is simple to state (but far more difficult to achieve): seek to maximise per share shareholder returns, principally by way of investment performance, with risks at or below current levels. The Board and I have agreed that my primary focus is absolutely unchanged. I will continue to assess investments, focussed principally upon the intersection between Quality and Value, and continue to have the benefit of the MFG's investment research. Distractions are minimised. MFG's excellent research team is world class, and we rely upon MFG's very professional services team led superbly by Nerida Campbell. Notwithstanding this access to excellent research services, I will continue to have responsibility for the decisions relating to purchase or sale of stocks in the portfolio.

The Board today also reaffirmed MFF's portfolio controls and risk parameters including 20 stock minimum portfolio, 20% borrowing limit and 10% individual stock limit(at cost) except with board approval; at the moment there are a small number [two] 12% position limits approved by the Board (Wells Fargo is the only current position where this approval has been active).

MFF's Future Strategy

MFF has an unchanged focus as a listed investment company. The Board and I believe that focussed exposure, concentrated upon high quality companies, should produce satisfactory shareholder returns over time, if they are acquired on attractive terms. The focus remains on Quality and Value. My assessment of investment opportunities emphasises their business characteristics, and our opportunity cost review of alternatives starts with our existing investments.

Your Board and I support this focussed strategy. Obviously there are real risks in businesses and in markets, and we are cautious about chasing possible returns from new businesses or diversifications. Markets have risen strongly. However, inevitable stresses and market fluctuations are very likely to give us interesting opportunities over time, in the search for pockets of significant market inefficiency and value.

Risks and Opportunities

Any decision involves risks, including a decision to do nothing. An investment in MFF, obviously carries risks as well as opportunities. In the Annual Report, we attempted to spell out both risks and opportunities. We provide commentary monthly with the NTA updates which discuss up to date factors, and we also release weekly NTAs.

Our primary risk management tools are our primary focus on business Quality and Value, and we seek secondary risk management benefits from currency positions, from managing cash levels and from a willingness to buy into out of favour situations (which are cheaper) and to ignore much volatility in market prices.

Overall markets are uncertain, but this is always the case, and risks are present whether or not they are broadly recognised. Low purchase prices and growing competitive advantages are the goals we aim for. Real cash earnings are the key to investment performance and most simply this requires either revenue growth or cost control or both. Overall margins are currently very elevated, technological changes, competition, pressured pricing power and the distorted unreality of official stimulus are factors for businesses and industries everywhere.

Although the economic world appears to be in a very uneasy equilibrium, with the implications of a slowdown in monetary stimulus yet to be felt, we feel better about our portfolio than about markets in general. Particularly in AUD terms, the medium term probabilities currently remain at least satisfactory, in our assessment. However, the portfolio lacks the same combination of extraordinarily low price, extraordinarily high quality companies we talked about in 2008/09 (as prices have increased materially).

In the Annual Report we said that investors should not extrapolate from either the strong investment returns in the year or from the favourable currency movement, but instead should exercise caution. In the 3 months to 30 September, 2013 the currency movement was unfavourable and the investment returns well below last year's annualised levels, and pre tax NTA rose about 4.3% in the Quarter (quarterly results are not a focus).

In terms of currencies we highlight that we are effectively short the AUD as we have borrowings in AUD against cash and shares in offshore assets. We believe that this offers some risk management benefits as the AUD has typically fallen at the time of material equity price declines. However this may add to risks, for example when China spent trillions on restarting their economy coming out of the Crisis and the AUD rose strongly. We also fund our positions via a prime brokerage arrangement with Merrill Lynch (now owned by Bank of America) which also involves various counterparty risks. The details are in the Annual Report.

Specific investments carry risks. MFF targets a minimum of 20 investments and at the moment the highest exposure is to financials, which include credit based financials which carry numerous risks. High Quality companies can become overpriced, they can lose their way and be impacted by competition and changes in technology. Growth may be much harder to achieve than was expected a few years ago when they were gaining market share in developed markets and expanding rapidly in the newly emerging economies. In the Annual Report we detailed how we wrote down an investment to zero, in China Metal Recycling. No excuses but real losses; even though I was conscious of risks, including China risks and the risk of fraud, in going into and in sizing this investment.

MFF's Portfolio

MFF has an extremely high quality portfolio of companies which have sustainable advantages; those advantages have improved in recent years. We continue to look for high cash returns on capital, pricing power and improving competitive positions. Our core mandate is to buy quality companies when they are out of favour (and hopefully relatively inexpensive) and to hold them whilst valuations and risk assessments remain favourable, subject to overall opportunity cost assessments in relation to the portfolio. Value traps are an important risk with this approach, as we have discussed previously.

The investment focus for MFF narrowed somewhat in calendar 2013 as market prices and consequentially investment risks rose; we have had reasonable luck with some extensions of our circle of competence, but some of our sales in 2013 reflect caution whether prices include true margins of safety in comparison with risks, including various risks in Emerging Markets and in some businesses most affected by technology.

We currently have cash levels of about 11% and retain the 20% borrowing capacity. In this low growth, high regulatory risk environment, with prices enhanced by monetary and fiscal stimulus, we have found more to sell than we would expect customarily. The flexibility of our cash has allowed us to acquire a few shares this year, particularly in existing holdings, where the medium term probabilities of positive outcomes appear greater than our assessment of the likely business risks. The longer duration of our investment horizon remains an important advantage, as time favours the highest quality businesses. We do not need to feel any pressure to do anything or be anywhere.

Currency was a positive for the year but remains negative from our inception. We continue to urge patience and caution regarding currency but our views remain firm regarding the fundamental overvaluation of the AUD. We believe that the probabilities, and likely materiality, of a sustained correction increased further over the last 12 months. However, our position carries risks; for example if China initiates another multi trillion dollar stimulus programme. Currency decisions remain secondary to portfolio selection, particularly over longer periods.

The largest investments (above A $1.5 m) as at 30 September 2013 are shown on the screen at the front of the room.

Holding	%	Holding	%
Wells Fargo	11.2	Bank of New York Mellon	4.4
Visa	10.0	Lloyds Banking Group	4.4
Apple	9.6	State Street	4.0
Bank of America	7.7	Tesco	3.9
HCA Holdings	6.1	Home Depot	2.9
Lowe's	5.7	Sainsbury J	2.9
MasterCard	5.1	Singapore Tech Engineering	0.5
Wal-Mart	4.5	SIA Engineering	0.3

The proportion of global multinationals is lower than in previous years and domestics higher. Wells Fargo remains the largest holding, and it has grown its $1 trillion of deposits over the past year and reduced its annual average deposit funding cost to 0.12% (September Quarter, down from 0.18% PCP). We are reluctant to pay up much for perceived growth, and we get seriously concerned about valuation and risk issues.

Volatility has always been a feature of asset markets, as human nature on average exaggerates both positives and negatives, particularly at times of stress or excitement. The explosion in types and uses of derivatives since at least the early 1980s has contributed to well over 50% of all market trades now being algorithmic or computer driven. The combined efforts of [hedge] funds with short term measurement criteria, computer assisted momentum or trend traders and index funds or funds which closely mirror indices, together represent well over 75% of market trades. Fundamentally driven investors, particularly long term oriented pension funds and individuals, are now a much smaller fraction of the market.

This should be to the advantage of disciplined long term oriented value based investors. Although it is logical to expect that the high liquidity and multiple computer programmes may actually work to reduce volatility in most circumstances (in part because of the significant liquidity), the non fundamental, correlated, return chasing and leveraged nature of many of these derivatives and similar instruments almost certainly operate to exaggerate the extremes. Many of the programmes are based upon the hypotheses of efficient markets and of sufficient liquidity, which are incorrect at extremes when human emotions and leveraged programmes combine. This backdrop does not inspire confidence for the latest current investor chases of recent performance and for yield.
We would repurchase almost all of the companies sold in recent years, on the right terms.

I will hand back to the Chairman and we would be happy to address questions later in the meeting.