

2014



[ANNUAL FINANCIAL REPORT]

FOR THE FULL YEAR ENDED – 30 JUNE 2014

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MAGELLAN FLAGSHIP FUND LIMITED

CHAIRMAN'S LETTER

for the year ended 30 June 2014

Dear Shareholder,

I am pleased to write to you in the 2013/14 Annual Report for Magellan Flagship Fund Limited ("MFF"). Please also take the time to read the financial statements and our Portfolio Manager's Report which follow.

Financial Results

MFF recorded a net profit after tax of \$49.34 million for the year ended 30 June 2014. The 2013/2014 result principally reflects the net appreciation in the underlying market values of MFF's investments as well as realised gains from disposals over the period. The result also reflects some net negative impacts in the year from the strengthening Australian dollar, particularly compared with the US dollar. The AUD rose against the USD by approximately 3.1% over the year, from AUD/USD 0.9154 to 0.9439, with the rise concentrated in the second six months of the year (from 0.8947 AUD/USD as at 31 December 2013).

MFF recorded a rise in net tangible assets (NTA) per share (excluding net tax assets/liabilities) of approximately 13.0% to \$1.427 per share as at 30 June 2014 compared with \$1.263 per share as at 30 June 2013. The overall investment result for the portfolio was approximately 15.5% pre-tax after expenses. Although we regard this as a strong result and it is consistent with MFF's risk positioning, the investment result trailed the (approximately 20% in AUD terms) gain in many broad global market measures. The result exceeded the gain in some very large capitalisation indices, such as the Dow Jones Industrials Index.

MFF's Portfolio

The Portfolio Manager's Report includes details of MFF's holdings and markets and commentary about them. During the year MFF continued to be substantially invested and finished the year with a net debt position of 5.9% of investment assets (compared with a net cash position of approximately 1.0% of investment assets as at 30 June 2013). A number of holdings were increased as MFF "bought on the dips" during the year. However there was no general market pull back during the year to provide lower prices for additional opportunities. MFF's effective "short AUD" position, continues to provide some risk protection if a substantial market decline occurs and the AUD declines, as well as appearing to be sensible on fundamentals for the medium term.

MFF's stock and portfolio decisions are considered within a framework of valuations, quality and portfolio mix assessments and are focussed on seeking out investments in advantaged companies at attractive prices. During the year, your Board reviewed and reaffirmed the risk control parameters, including the 20% overall borrowing limit, the AUD borrowing limit, the 10% individual stock position limits, the two Board approvals for 12% limits, as well as the currency positions risk and control aspects. We continue to believe that these controls appropriately balance risk and return opportunities in respect of MFF, which operates as a listed investment company. The Board expects to continue to make periodic adjustments.

The portfolio currently continues to include a significant weighting to leading financial institutions. These include credit providing institutions such as Wells Fargo, the largest holding, and transaction processors (which are not lenders), such as Visa, the second largest holding. Your Board continues to be regularly updated by the Portfolio Manager/Managing Director on his assessment of the risks and potential upside for the holdings, and potential holdings.

Although we are pleased with the composition of the portfolio, obviously there can be no guarantees that these (or any other) holdings will provide investment out performance or even positive performance. The Board is also updated in relation to other risks in the portfolio construction, including investment areas not currently emphasised (including the lower current exposures to global multinationals, to less developed markets, to Japan and to sectors such as energy).

The Portfolio Manager's Report also discusses currency positions. An effective "short AUD" position has been held by MFF throughout the year and MFF continues to favour the partial risk hedging and diversification aspects that this provides for the investment portfolio.

MAGELLAN FLAGSHIP FUND LIMITED

CHAIRMAN'S LETTER

for the year ended 30 June 2014

Dividends

The Directors have declared an unfranked dividend of 1 cent per share, to be paid in November 2014. The Directors' preference is for a regular six monthly dividend at 1 cent per share, subject to corporate, legal and regulatory considerations. Although we note and respect the desire of some shareholders for higher dividends, we also note that MFF's retained funds continue to be put to good use with strong medium term returns. MFF remains small compared with both its cost base and investment universe, and shareholders who need or want higher levels of immediate income from their MFF holdings in the context of their overall portfolios have ready markets in both the MFF options and shares (which have recently been trading above underlying asset value).

MFF does not incur current year tax in relation to unrealised gains, and the portfolio is focussed upon holdings which appear to have potential for further appreciation over the medium term and beyond. The current tax liability for the most recent financial year was \$95,000 compared with the deferred tax liability of \$42,340,000. \$1,085,000 was deducted by overseas jurisdictions from dividend payments received (and this amount does not earn Australian franking credit benefits).

Bonus Issue of Options and Capital Structure

A bonus issue of options was undertaken in October 2012 on a 1:3 basis to shareholders and the bonus options are quoted on the ASX (Code: MFFO). The strike price of the options is \$1.05 and the expiry date is 31 October 2017. Some options have been exercised early, a liquid market continues to be available to holders and your Board's feedback continues to be that shareholders appreciate the intended shareholder benefits of this issue.

MFF's capital structure has an advantage that in times of stress, MFF is not forced to sell investments to meet redemption requests. However, MFF has not had the very material benefit of steady inflows in the generally rising markets. Instead, MFF has had to sell existing investments to fund new investments. MFF's opportunity cost is high when selling high quality existing investments thereby incurring tax on accrued gains, in order to buy replacement investments.

We do not currently have any plans to raise new capital or alter MFF's overall capital structure. Obviously this will be reviewed promptly if circumstances change, for example if a general fall in markets leads to far more attractive investment opportunities and the most sensible funding is not sale of existing investments, or the use of MFF's borrowing capacity. At the moment debt markets are favourable. Your Board also considers the possible benefits of greater scale. If new capital is sought in the future, your Board is likely to again adopt the principles which guided the bonus issue of options, and attempt to ensure that all shareholders have equal opportunity to participate or to realise some market value for their entitlements.

On-market Share Buy-back

MFF did not acquire any further shares pursuant to the on-market buy-back during 2013/2014 but the on-market buyback authorisation remains operative.

Annual General Meeting

My fellow Directors and I look forward to meeting those of you who can attend the Annual General Meeting on 15 October 2014. We welcome your input and feedback on MFF. The Notice of Annual General Meeting will be despatched to shareholders in the coming weeks.

MAGELLAN FLAGSHIP FUND LIMITED

CHAIRMAN'S LETTER

for the year ended 30 June 2014

During the year MFF changed from a company fully managed by Magellan Asset Management (a subsidiary of ASX listed Magellan Financial Group Limited "MFG") to a company with its own Managing Director (Chris Mackay, who continues as Portfolio Manager) with MFG providing most administrative and other services and enabling its research to be available to the Portfolio Manager under a Service Agreement. Chris set a key personal objective in relation to the changes to work tirelessly to maintain and enhance MFG's strength. This priority was wholeheartedly supported by your Board who agree that MFG's continuing excellence is valuable for MFF, as it is our dominant service provider. On behalf of the Board and personally I want to record my congratulations to Hamish Douglass and the MFG team on their continuing performance and professionalism.

There is ample time prior to the end of calendar 2016 for MFF and MFG to consider longer term arrangements. In the meantime we are delighted with Chris' focus and the quality of MFF's portfolio.

Yours faithfully,



Richard F E Warburton AO

Chairman

6 August 2014

MAGELLAN FLAGSHIP FUND LIMITED

PORTFOLIO MANAGER'S REPORT

for the year ended 30 June 2014

Dear Shareholder,

I am particularly happy with the composition of the portfolio, with the caveats that market prices generally have risen, and we have few materially under priced holdings. Our portfolio is very high quality as it is concentrated in companies where there are well above average probabilities of their businesses continuing to perform very well in their market places. In current market conditions, our investment approach is likely to have "duration advantages" as we are not overly concerned when materially higher earnings might emerge to produce attractive returns to us in comparison with prices, whereas many market participants need more near term satisfaction. During the year, there was further improvement in the business predictability of the portfolio from an already high base.

The portfolio's market prices appear satisfactory, with favourable medium term business prospects being the key attraction rather than low prices. We were spoiled in recent years with very high quality companies on sale at knockdown prices. My caution about valuation risks is heightened compared with 12 months ago, although some important "event risks" dissipated at least temporarily during the year. Broad market risks, business risks, political interference, bureaucracy, global competition, demand and margin compression continue. Demand for stocks is not yet rampant, possibly because investors as a whole have the financial crisis fresh in memories and also have a range of concerns about individual companies and some loss aversion for sector groupings.

This year's pre tax after costs investment returns for MFF were approximately 15.5%, which exceeded my expectations of a year ago. Even discounting "hindsight bias", my expectations were too cautious, and this caution was reflected in holding low yielding USD cash, and some sales during the year which were costly compared with simply letting them run as they came back into investor favour (Apple and Microsoft most obviously).

MFF's primary investment focus is on businesses with high levels of business predictability for the medium term. At this stage of the market upswing, risks to capital are rising and require caution about some elevated market prices and estimates relating to business changes, technology, competition and growth assumptions. There is no change in our need to be vigilant, involved and focussed on our companies, data, prices and risks including new and developing risks.

During 2013/14 MFF moderately increased its holdings in Wells Fargo and Visa. These are our two largest positions and MFF Directors have authorised acquisitions in these two businesses up to a limit of 12% at cost compared with a limit of 10% at cost for other holdings. The business results of both have remained excellent and notwithstanding price appreciation, we do not feel compelled to sell either. Visa does not take lending risk, as it and MasterCard (another holding which we increased during the year) are global transaction processors.

Wells Fargo and our other financials (which we increased during the year) are competitively advantaged, credit and other service providing financial institutions. Although their attributes extend well beyond their net interest margins, the credit providing institutions will benefit when interest rates "normalise". Their 2013/14 results were penalised by margin compression from lower interest rates primarily due to Central Bank policy which inevitably will reverse, but with uncertain magnitude and timing.

MFF significantly increased its holdings in Home Depot and Lowes, the two market leaders in home improvement retailing. Holdings were also increased in HCA Holdings, the largest hospital network in the US, and Wal-Mart. We also added Lloyds Banking Group which is the UK's leading retail banking group. Clearly we like market leading businesses providing vital services.

During the year, large reductions or eliminations (in addition to Apple and Microsoft, as mentioned above), included Tesco, Yum! Brands and McDonalds.

MAGELLAN FLAGSHIP FUND LIMITED

PORTFOLIO MANAGER'S REPORT

for the year ended 30 June 2014

Holdings with market values above A\$1m (shown as percentages of total investment assets) as at 30 June 2014 are shown in the table below:

Holding	\$million	%	Holding	\$million	%
Wells Fargo	69.6	12.8	Sainsbury J	17.8	3.3
Visa	56.9	10.6	Danone	7.4	1.4
Lowe's	49.3	8.8	Qualcomm	7.0	1.3
Home Depot	47.2	8.7	Adidas	6.7	1.3
Bank of America	44.3	8.4	Unilever	5.0	0.9
MasterCard	39.8	7.5	Singapore Technologies		
HCA Holdings	36.8	6.8	Engineering	3.1	0.6
Lloyds Banking Group	32.3	6.3	SIA Engineering	2.8	0.5
US Bancorp	30.3	5.6	eBay	2.7	0.5
Wal-Mart Stores	29.2	5.4	Diageo	2.6	0.5
Bank of New York Mellon	25.4	4.5	SATS	1.5	0.3
State Street	19.8	3.7			

Net borrowings as at 30 June 2014 were approximately 5.9 % of investment assets. We have been buying investments with current and foreseeable earnings yields materially above our funding costs.

You will see from the financial results that dividend income was approximately \$1m lower this year than in the previous year. This is notwithstanding that the MFF portfolio has a higher proportion of regular dividend paying companies, paying moderately higher regular dividends than in the previous year. In the 2013 financial year MFF received the benefit of more special dividends, including from HCA, one of the larger holdings. Other income and expense items were similar to last year, with the major differences being the lower level of market gains than for the 2013 financial year, along with the unfavourable foreign exchange movements.

We continue to be positive about MFF's investee companies buying back their own shares when they are trading below intrinsic value. Active capital management, including value focussed buybacks, add to earnings per share growth rates and to shareholder value.

Although our investments comprise many "very high probability" businesses, we lack the dirt cheap mouth-watering opportunities which have been available in previous years. We have some businesses which have reasonable probabilities of sustaining well above economy average growth rates, and some that are somewhat out of favour with investors, for example because of concerns about regulatory risks and financial system stability. We continue to review many businesses around the world to compare with our holdings.

Buying "Quality" when it is out of favour inevitably results in some "value traps", but eventually earnings and market valuation follow, unless our assessment is wrong. Overall recent returns on the portfolio have materially exceeded returns on cash, on a risk adjusted basis and on our perceived opportunity cost basis (opportunity costs have much higher hurdle rates). In the cases of Apple and Microsoft, they were both Quality and out of favour, and now investors as a whole are ascribing much higher expectations for growth.

The usual equation for Quality/Value investors is that even if prices for the highest "Quality" investments run ahead of their value, it is only a matter of time before future returns catch up. This relationship is more challenged in a low growth world with global overcapacity changing competitive dynamics and artificially low interest rates distorting prices of most asset classes.

Markets will inevitably again give us opportunities to buy freely at very attractive prices compared with perceived values. In the meantime we have remained largely invested with moderate utilisation of our borrowing capacity and some additional perceived risk management benefit from the short AUD position. Sales are needed in a closed end portfolio such as MFF's to have capacity when compelling opportunities arrive.

MAGELLAN FLAGSHIP FUND LIMITED

PORTFOLIO MANAGER'S REPORT

for the year ended 30 June 2014

Currencies and Interest Rates

Our expectation remains that the AUD will trade materially lower for at least part of the next decade. In our view, the "safe haven" currency argument is not sustained by the data.

There are reasonable prospects that there will be a crossover between the US and Australia in some economic variables including unemployment rates, balances of payments (as percentages of GDP), state and Federal budget deficits (as percentages of GDP) and GDP growth rates. If the US continues its recovery and Australia's terms of trade do not recover to the recent cyclical highs, these crossovers become closer and the interest rate differential narrower, taking away one of the causes of AUD strength.

Although we are not fans of some US policies, we continue to have the USD as the primary cash holding. High quality equities (for example those with sustainably high returns on capital) at attractive valuations, are more likely to hold value over decades, and cash is a much less attractive long term asset. The USD cash holding as part of the "short AUD" position, detracted from overall results for MFF compared with the equivalent amount being invested in the portfolio.

There are risks relating to inevitable upward spikes in interest rates whether or not as part of a Crisis (peripheral Europe recently, or Asia in 1997) or more broadly (e.g. 1994 or 1979), as well as debt market dislocations such as withdrawal of private sector liquidity. We believe that the AUD is not a genuine safe haven and is vulnerable to such crises, which are inevitable. Although arguments in favour of sustained extraordinarily low interest rates may continue to hold up over the next few months and years, such situations have always reversed historically.

MFF will continue with its unhedged/short AUD position in the current market conditions. We will promptly advise the ASX of any material changes.

Other

Investors can track the portfolio and the underlying price movements, as we report MFF's net tangible asset backing to the ASX on a weekly basis and also advise changes to the portfolio and cash/borrowing levels regularly.

I thank the MFG team that is looking after MFF as a client, particularly after the changes from 1 October 2013 to replace the original management agreement. MFG now provides almost all of the key services for MFF and I have access to the investment research for the benefit of MFF. It is not simply that our input helps MFG's excellent investment processes, it is in MFF's interests for MFG to maintain its outstanding performance and continue to strengthen.

MFG's operational excellence assists MFF directly, its distribution team communicates effectively with financial planners and other interested shareholders, and MFG is widening its excellent research coverage.

MAGELLAN FLAGSHIP FUND LIMITED

PORTFOLIO MANAGER'S REPORT

for the year ended 30 June 2014

I also thank your Non-executive Directors, who continue to provide excellent guidance, judgement and counsel. They understand the benefits of focus and limited distractions and have also been very patient and supportive with the changes over recent years, including working very well with MFG.

We look forward to seeing you at the Annual General Meeting in October.

Yours faithfully,



Chris Mackay
Portfolio Manager

6 August 2014

Important note

Magellan Flagship Fund Limited ABN 59 108 437 592 (**MFF**) has prepared the information in this Portfolio Manager's Report (Report). This Report has been prepared for the purpose of providing general information only, without taking account of any particular investor's objectives, financial situation or needs. It is not an offer or invitation for subscription or purchase, or a recommendation of any financial product and is not intended to be relied upon by investors in making an investment decision. Past performance is not a reliable indicator of future performance. To the extent any general financial product advice is provided in this Report, it is provided by MFF as a corporate authorised representative of Magellan Asset Management Limited ABN 31 120 593 946 AFSL 304 301. An investor, before acting on anything that he or she construes as advice, should consider the appropriateness of such construction and advice having regard to their objectives, financial situation or needs.

MAGELLAN FLAGSHIP FUND LIMITED

DIRECTORS' REPORT

for the year ended 30 June 2014

The Directors of Magellan Flagship Fund Limited (MFF or the "Company") submit their report in respect of the year ended 30 June 2014.

1. Operations and Activities

1.1 Company Overview

The Company is a listed public company incorporated in Australia. Its principal place of business is Level 7, 1 Castlereagh Street, Sydney, New South Wales, 2000.

The Company is listed on the Australian Stock Exchange (ASX code: MFF).

1.2 Principal Activity

The principal activity of the Company remains unchanged which is the investment into a minimum of twenty exchange listed international and Australian companies with attractive business characteristics.

1.3 Dividends

During the year, dividends amounting to \$7,053,000 were paid representing 2.0 cents per ordinary share, unfranked (June 2013: \$6,904,000 representing 2.0 cents per ordinary share, partially franked).

On 6 August 2014, the Directors declared an unfranked final dividend of 1.0 cent per ordinary share (June 2013: unfranked final dividend of 1.0 cent per ordinary share), which is expected to be paid on 14 November 2014. The amount of the proposed dividend, which is not recognised as a liability as at 30 June 2014, based on the number of shares on issue at 30 June 2014 is \$3,553,000. The Dividend Reinvestment Plan (DRP) will operate in conjunction with this dividend and no discount will be applied for the DRP.

On 30 June 2014, the Company's total available imputation credits (based on a tax rate of 30%) were \$147,000.

The Directors have maintained the Company's current dividend policy, which is for regular six monthly dividends at 1 cent per ordinary share. The Directors consider that the current dividend policy is appropriate. The Directors note that some shareholders prefer regular dividend payments. The Directors also note that there continue to be liquid markets in MFF ordinary shares and MFF 2017 options for shareholders who might need additional cash in excess of the dividends. The MFF share price has traded in recent times above per share net asset values.

1.4 Review of Results and Operations

- **Financial results for the year**

The Company recorded a pre-tax profit of \$68,014,000 (June 2013: \$114,865,000) and a net profit for the year after income tax of \$49,343,000 (June 2013: \$80,819,000). A final dividend of 1 cent per ordinary share brought the Company's full year dividend to 2 cents per ordinary share.

The Company's net assets increased by \$52,127,000 in the year (June 2013: \$75,251,000) which was primarily due to the performance of the Company's investment portfolio. This has resulted in a higher pre-tax net tangible assets (NTA) of \$1.427 per ordinary share (before net tax liabilities of \$0.119) as at 30 June 2014 compared with \$1.263 per ordinary share as at 30 June 2013. The Company also reported a higher post-tax NTA of \$1.308 per ordinary share as at 30 June 2014 compared with \$1.191 per ordinary share as at 30 June 2013. If all of the MFF 2017 Options had been exercised at 30 June 2014, the Pre-tax and Post-tax NTA values would have been reduced by 8.7 and 6.0 cents per share to \$1.340 and \$1.248 per ordinary share respectively as at that date.

As markets continue to be subject to fluctuations, the investment performance and results of the past year to 30 June 2014 should not be considered to be representative of results and returns in future financial periods.

- **Operations – Portfolio and Activities**

MFF's focus on high quality companies was unchanged, as was the approach to risk management. The financial results, investment returns, portfolio composition and changes during the year are summarised elsewhere and detailed in the financial statements.

MAGELLAN FLAGSHIP FUND LIMITED

DIRECTORS' REPORT

for the year ended 30 June 2014

1.4 Review of Results and Operations (continued)

- **Operations – Portfolio and Activities (continued)**

In the twelve months to 30 June 2014, MFF moved from being externally managed by Magellan Asset Management Limited ((MAM), a wholly owned subsidiary of ASX listed Magellan Financial Group (MFG)). Mr Mackay was appointed as Managing Director and Portfolio Manager for MFF, which has provided continuity in MFF's portfolio management, and from 1 October 2013, MAM ceased to be the investment manager of MFF. MAM continues to provide investment research and administrative services to MFF on commercial terms materially equivalent to the previous Investment Management Agreement. Full details are provided in section 1.6

- **Strategy and Future Outlook**

The Company is invested in equities, with a focus upon the equities of non-Australian domiciled companies and this is expected to continue. As markets continue to be subject to fluctuations, it is not meaningful or prudent to provide a detailed outlook statement or statement of expected results of operations.

It is also not meaningful or prudent to forecast the level of franking credits that may arise from income tax that might become payable from net realised gains from the Company's investment portfolio particularly given there are non-controllable variables involved such as future currency and equity movements, as well as foreign tax withholding for most overseas jurisdictions. As at 30 June 2014, MFF's tax provisions comprised a deferred income tax liability of \$42,340,000 and current income tax liability of \$95,000 in respect of the current financial year.

The Company provides regular updates in the weekly and monthly NTA announcements, which can be found in the ASX announcements and in the investor centre section of the MFF website, www.magellangroup.com.au/mff.

Releases to shareholders and the ASX have included discussions in relation to MFF's investment processes and some investee companies from time to time. The Company sets out its largest portfolio holdings at 30 June 2014 in the Portfolio Manager's Report (this information was also released to the ASX on 2 July 2014 as part of the June 2014 monthly NTA release).

1.5 Likely Developments and Expected Results of Operations

The Company will continue to pursue its principal investment objective which is to increase the per share net asset value of the Company, over time, in a manner consistent with prudent risk management. Additional comments on expected results of certain operations of the Company are included in this report under the review of operations at section 1.4. Refer also to the Chairman's Letter and the Portfolio Manager's Report for further information.

The methods of operating the Company are not expected to change in the foreseeable future.

1.6 Significant Changes in State of Affairs

During the year, the Company varied its arrangements with Magellan Asset Management Limited (MAM) effective 1 October 2013, with the commercial terms remaining materially equivalent to those previously announced to ASX on 28 June 2013. The key changes were:

- MAM ceased as the Company's Investment Manager on 30 September 2013 however continued to provide the Company with investment research and administrative services. Mr Mackay resigned as Chairman of Magellan Financial Group Limited in order to be appointed Managing Director and Portfolio Manager of the Company with effect from 1 October 2013;
- MAM receives services fees calculated at 1.25% per annum (plus GST, payable quarterly in arrears) of the market value of the portfolio less total indebtedness of the Company divided by the weighted average number of the Company's shares on issue during the quarter and multiplied by the lesser of (i) the number of shares on issue at 30 June 2013 or (ii) the weighted average number of shares on issue during the relevant quarter. The services fees are received in respect of the provision of investment research and administrative services and are reduced by an amount equivalent to Mr Mackay's remuneration (capped at \$250,000 per quarter), associated payroll related costs, travel costs and incidental expenses (capped at \$120,000 per annum). Fees incurred prior to 1 October 2013 are classified as management fees in the Statement of Profit or Loss and Other Comprehensive Income;

MAGELLAN FLAGSHIP FUND LIMITED

DIRECTORS' REPORT

for the year ended 30 June 2014

1.6 Significant Changes in State of Affairs (continued)

Fees incurred from 1 October 2013 are classified as research and service fees in the Statement of Profit or Loss and Other Comprehensive Income. There were no changes to the performance fees as detailed in Section 3.4(a) and as announced to the ASX on 28 June 2013; and

- the Company waived its right to terminate the arrangements with MAM without cause by giving 90 days notice in the event that Mr Chris Mackay (then employed by MAM) ceased to be the Company's Portfolio Manager, Mr Hamish Douglass (Chief Executive Officer of MAM) was unable to act as the Company's portfolio manager, and MAM was unable to identify a person to act as the Company's portfolio manager who was acceptable to the Company (acting reasonably).

In the opinion of the Directors, there were no other significant changes in the state of affairs of the Company that occurred during the year.

1.7 Events Subsequent to the End of the Financial Year

In the latest release to the ASX on 2 August 2014, the Company reported a Pre-Tax NTA per ordinary share of \$1.437 (excluding net tax liabilities of \$0.109) as at 1 August 2014.

	01 August 2014	30 June 2014
Pre-tax NTA	\$1.437	\$1.427
Net tax liabilities	(\$0.109)	(\$0.119)
Post-tax NTA	\$1.329	\$1.308

The above NTA values have not been adjusted for the expected dilution from the exercise of the MFF 2017 Options. If all of the MFF 2017 Options had been exercised at 30 June 2014, the Pre-tax and Post-tax NTA values would have been reduced by 8.7 and 6.0 cents per share to \$1.340 and \$1.248 respectively as at that date.

Other than the above, and the proposed final dividend detailed at section 1.3, the Directors are not aware of any other matter or circumstance not otherwise dealt with in this report that has significantly or may significantly affect the operations of the Company, the results of those operations or the state of affairs of the Company in future financial years.

1.8 Environmental Regulation

The Company is not subject to any particular or significant environmental regulation under either Commonwealth, State or Territory legislation.

1.9 Unissued Shares under Option

On 17 October 2012 the Company issued 114,516,157 listed MFF 2017 Options to shareholders on a 1 listed option for every 3 ordinary shares held on the record date of 10 October 2012 for nil consideration. As at the date of this report, there were 105,901,295 MFF 2017 Options on issue, with 8,614,862 MFF 2017 Options having been exercised. Refer to note 8(c)(ii) for further details on the Options and section 3.8 in the Remuneration Report for the Options issued to the Directors of the Company.

No listed option holder has any right, by virtue of the option, to participate in any share issue or interest issue of the Company.

MAGELLAN FLAGSHIP FUND LIMITED

DIRECTORS' REPORT

for the year ended 30 June 2014

2. Directors and Secretaries

2.1 Directors

The following persons were Directors of the Company during the year and up to the date of this report:

<u>Name</u>	<u>Directorship</u>	<u>Appointed</u>
Richard Warburton AO	Chairman & Independent Non-executive Director	19 October 2006
John Ballard	Independent Non-executive Director	19 October 2006
Andy Hogendijk	Independent Non-executive Director	19 October 2006
Chris Mackay	Executive Director ^(A)	29 September 2006

(A) On 1 October 2013, Mr Chris Mackay was appointed Managing Director and Portfolio Manager of the Company. Following this change, Mr Mackay ceased being a non-independent Non-executive director and was an Executive Director from 1 October 2013.

2.2 Secretaries

The following persons were Company Secretaries of the Company during the year and up to the date of this report:

<u>Name</u>	<u>Appointed</u>	<u>Resigned</u>
Geoffrey Stirton	20 March 2014	-
Nerida Campbell	20 November 2009	20 March 2014
Leo Quintana	29 February 2008	20 March 2014

There are no other officers of the Company.

2.3 Information on Directors and Secretaries

The following information is current as at the date of this Report.

Richard Warburton AO

Independent Non-executive Director, Chairman of the Board and member of the Audit and Risk Committee

Richard Warburton is one of Australia's most prominent company directors. Prior to becoming a professional director, he was the Chairman and Chief Executive Officer of DuPont Australia and New Zealand where he was responsible for DuPont's petro-chemical business operations in Australia and New Zealand. He is currently a director of Scentre Group (following the merger of Westfield Group and Westfield Retail Trust on 30 June 2014, the latter of which he was a Director and Chairman, appointed in December 2010) and is currently Chairman of Citigroup Pty Limited.

Richard was previously Director and Chairman of Tandou Limited, Chairman of David Jones Limited, Aurion Gold Limited, Caltex Australia Limited, and The Board of Taxation, and a Director of Tabcorp Holdings Limited, Southcorp Limited, Nufarm Limited and the Reserve Bank of Australia. He is a Fellow (and former National President) of the Australian Institute of Company Directors.

John Ballard

Independent Non-executive Director and member of the Audit and Risk Committee

John Ballard has extensive senior executive experience across a wide range of industries. He was previously Chairman of Elders Limited (appointed July 2010, resigned June 2013), Managing Director and Chief Executive Officer of Southcorp Limited, Managing Director Asia Pacific at United Biscuits Limited and Managing Director Snack Foods for Coca-Cola Amatil Limited, a Director of Woolworths Limited and Email Limited, Chairman of Wattyl Limited, a Director of CSR Limited and subsequently Rinker Limited, a former Director of Fonterra Co-operative Group Limited (appointed May 2006, resigned April 2012) and a Trustee of the Sydney Opera House Trust.

John is currently a director of International Ferro Metals Limited, Chairman of the Advisory Boards at Pacific Equity Partners and a Director of the Sydney Neuro Oncology Group. John is a Fellow of the Australian Institute of Company Directors.

MAGELLAN FLAGSHIP FUND LIMITED

DIRECTORS' REPORT

for the year ended 30 June 2014

2.3 Information on Directors and Secretaries (continued)

Andy Hogendijk

Independent Non-executive Director and Chairman of the Audit and Risk Committee

Andy Hogendijk has extensive senior management and finance experience having previously been Chief Financial Officer of Suncorp Metway Limited (1997 – 2000), Commonwealth Bank of Australia Limited (1991 – 1997) and John Fairfax Group (1989 – 1991). Andy has also held several senior positions with Shell Company Australia and Australian Paper Manufacturers.

Andy is formerly a Director of AWE Limited (appointed October 2007, resigned November 2013) and was previously the Chairman of Gloucester Coal Limited, a Director of Aditya Birla Minerals Limited, Hills Motorway Management Limited and Magnesium International Limited. Andy is a Fellow of both the Australian Society of Certified Practising Accountants and the Australian Institute of Company Directors.

Chris Mackay

Managing Director/Portfolio Manager

Chris Mackay was appointed Managing Director and Portfolio Manager of the Company with effect from 1 October 2013. He is a Director of Seven Group Holdings Limited (appointed June 2010) and was a Director of Consolidated Media Holdings (formerly Publishing and Broadcasting) from 2006 until its takeover by News Corporation in November 2012.

Chris has considerable experience in business management, business assessment, capital allocation, risk management and investment. He became an investment banker in 1988, after being a corporate and banking lawyer, and has broad experience in the financial and corporate sectors over many years.

Chris retired as Chairman of the investment bank UBS Australasia, in March 2006, having previously been its Chief Executive Officer. He is a member of the Federal Treasurer's Financial Sector Advisory Council, and is a former member of the Business Council of Australia and director of the International Banks & Securities Association.

Geoffrey Stirton

Company Secretary

Geoffrey Stirton was appointed the Company Secretary of the Company on 20 March 2014. Geoffrey was previously Group Company Secretary at The Trust Company and has also held Group Company Secretary roles at Investa Property Group and MLC Limited. He has over 20 years experience in financial services in various company secretarial, finance and management roles. Geoffrey holds a Bachelor of Commerce degree from the University of NSW, is a Chartered Accountant, a Fellow of the Governance Institute of Australia and a Fellow of the Australian Institute of Company Directors.

MAGELLAN FLAGSHIP FUND LIMITED

DIRECTORS' REPORT

for the year ended 30 June 2014

2.4 Directors' Meetings

The number of Board meetings, including meetings of Board Committees, held during the year ended 30 June 2014 and the number of those meetings attended by each Director is set out below:

Name	Board		Audit & Risk Committee	
	Held while a Director	Attended	Held while a Member	Attended
Richard Warburton AO ^(a)	4	4	1	1
John Ballard	4	4	5	5
Andy Hogendijk	4	4	5	5
Chris Mackay ^(b)	4	4	4	4

^(a) Mr Warburton was appointed a member of the Audit & Risk Committee on 14 May 2014. Mr Warburton otherwise attended all other meetings of the Audit and Risk Committee as a guest.

^(b) Mr Mackay resigned as a member of the Audit & Risk Committee on 14 May 2014. Mr Mackay otherwise attended all other meetings of the Audit and Risk Committee as a guest.

2.5 Directors' Interests

On 1 October 2013, Mr Mackay entered into a consultancy agreement with Magellan Asset Management Limited (MAM) after being appointed Special Advisor to both the Board and CEO of MAM's parent entity ASX listed Magellan Financial Group Limited (MFG). Mr Mackay is a substantial shareholder of MFG. Under this agreement Mr Mackay is paid consultancy fees of \$250,000 per annum. Refer to section 3.7 of the Remuneration Report for further details. Apart from the above, no other Director has or has had any interest in a contract entered into up to the date of this Directors' Report with the Company or any related party other than as disclosed in this report.

MAGELLAN FLAGSHIP FUND LIMITED

DIRECTORS' REPORT

for the year ended 30 June 2014

3. 2014 Remuneration Report (Audited)

This Remuneration Report outlines the remuneration arrangements of the Company for the year ended 30 June 2014. It details the remuneration arrangements for key management personnel (KMP) who are defined as those persons and corporate entities having authority and responsibility for planning, directing and controlling activities of the Company, directly or indirectly.

In the 2014 financial year, the KMPs for the Company included the Non-executive Directors and its sole employee, the Managing Director and Portfolio Manager, and Magellan Asset Management Limited (MAM) for the dates as listed in the table below.

On 1 October 2013, the Company moved from being externally managed by MAM, a wholly owned subsidiary of ASX listed Magellan Financial Group Limited (MFG) and appointed Mr Mackay as Managing Director and Portfolio Manager for the Company, which has provided continuity in the Company's portfolio management. As a result, Mr Mackay is an Executive Director from 1 October 2013. MAM ceased to be a KMP from 1 October 2013 as from that date it provided the Company with investment research and administration services which are not considered directing or controlling activities.

The Board does not grant options to Key Management Personnel under its remuneration policy. The Remuneration Report has been prepared and audited against the disclosure requirements of the Corporations Act 2001.

Name	Position	Term as KMP
Independent Non-Executive Directors		
Richard Warburton AO	Chairman	Full Year
John Ballard	Director	Full Year
Andy Hogendijk	Director	Full Year
Non-Independent Non-Executive Director		
C Mackay ^(A)	Director	1 Jul 2013 - 30 Sept 2013
Executive Director		
C Mackay ^(C)	Managing Director/Portfolio Manager	1 Oct 2013 - 30 Jun 2014
Investment Manager		
Magellan Asset Management Limited	Investment Manager	1 Jul 2013 - 30 Sept 2013

3.1 Remuneration of Non-executive Directors

The Independent Non-executive Directors are remunerated by the Company. It is the policy of the Board to remunerate at market rates commensurate with the responsibilities borne by the Independent Non-executive Directors. The remuneration of the Independent Non-executive Directors is not linked to the performance or earnings of the Company.

Directors' fees

The Independent Non-executive Directors' base remuneration is reviewed annually. Base fees paid to each Director have remained unchanged from the time of their appointment. The amount of base remuneration is not dependant on the satisfaction of a performance condition, or on the performance of the Company, the Company's share price, or dividends paid by the Company. The fees payable to Richard Warburton have increased by \$12,500 per annum effective from 14 May 2014 as a result of his appointment to the Audit and Risk Committee.

Retirement benefits

The Company does not provide retirement benefits (other than superannuation) to the Independent Non-executive Directors.

Other benefits (including termination) and incentives

The Company does not provide other benefits and incentives to the Independent Non-executive Directors.

MAGELLAN FLAGSHIP FUND LIMITED

DIRECTORS' REPORT

for the year ended 30 June 2014

3. 2014 Remuneration Report (Audited) (continued)

3.1 Remuneration of Non-executive Directors (continued)

On 6 August 2014 the Board approved an increase to Directors' Fees. Effective 1 August 2014 the Chairman will receive \$110,000 per annum, Directors \$70,000 per annum, and in addition the Audit and Risk Committee Chairman will receive \$25,000 per annum, and an Audit and Risk Committee Member \$12,500 per annum. The Chairman is not entitled to other committee fees. Total annual Directors' fees remain within the limit set in the Company's Constitution of \$500,000. The Chairman is a member of the Audit and Risk Committee and does not receive an additional fee for this role. There has been no increase in Non-executive Directors' remuneration since incorporation in 2006.

3.2 Remuneration of Non-Independent Non-executive Directors

On 1 October 2013, the Company moved from being externally managed by Magellan Asset Management Limited (MAM), a wholly owned subsidiary of ASX listed Magellan Financial Group Limited (MFG). The Non-Independent Non-executive Directors were employees of, and remunerated by, MAM up to and including 30 September 2013. For this period, the Non-Independent Non-executive Directors' remuneration was determined by the Board of MFG and in respect to the year ended 30 June 2014 comprised fixed base compensation and a discretionary payment.

The amount of fixed base compensation and the discretionary payment was not dependant on the satisfaction of a performance condition, the performance of either MAM or the Company, the Company's share price, dividends paid by the Company, or management and performance fees paid to MAM.

Retirement benefits

The Company and MAM do not provide retirement benefits (other than superannuation) to the Non-Independent Non-executive Directors.

Other benefits (including termination) and incentives

The Company does not pay other benefits and incentives to the Non-Independent Non-executive Directors. MAM did not pay incentives to the Non-Independent Non-executive Directors. In the year ended 30 June 2014 a payment of \$125,000 was made to Mr Mackay upon his resignation as Chairman of MFG and an employee of MAM on 30 September 2013, acknowledging his compliance, up to that time, with the investment restrictions in his employment agreement with MAM, as a discretionary payment determined by the MFG Board.

3.3 Remuneration of Executive Director

On 1 October 2013, the Company moved from being externally managed by MAM and appointed Mr Mackay as Managing Director and Portfolio Manager for the Company. The Executive Director is remunerated by the Company. It is the policy of the Board to remunerate at market rates commensurate with the responsibilities borne. The remuneration is not linked to the performance or earnings of the Company. Refer to Section 3.7 for further details on the employment agreement of Mr Mackay.

3.4 Remuneration of Magellan Asset Management Limited

(a) Investment Manager

For the period 1 July 2013 to 30 September 2013 when the Company appointed MAM as its Investment Manager, MAM was a corporate entity that had specified authority and responsibility in regard to the management of the Company's investment portfolio. During this period, MAM was remunerated by the Company in accordance with the Investment Management Agreement (IMA) between the Company and MAM, and are entitled to:

- a base management fee calculated as 1.25% per annum of the market value of the portfolio less total indebtedness of the Company (excluding GST, payable quarterly in arrears) capped to the actual number of the Company's ordinary shares on issue; and
- a performance fee if the Company's total shareholder return exceeded 10% per annum, annually compounded, with respect to the following four measurement periods:

MAGELLAN FLAGSHIP FUND LIMITED

DIRECTORS' REPORT

for the year ended 30 June 2014

3. 2014 Remuneration Report (Audited) (continued)

3.4 Remuneration of Magellan Asset Management Limited (continued)

(a) Investment Manager (continued)

- 1 July 2013 to 30 June 2014
- 1 July 2013 to 30 June 2015
- 1 July 2013 to 30 June 2016
- 1 July 2013 to 31 December 2016

The performance fee that may be payable in respect to each of the four periods was \$2,000,000 and each was non-cumulative. Performance fees would cease to be payable to MAM after 31 December 2016 and the total maximum total performance fees payable over the period 1 July 2013 to 31 December 2016 was capped at \$8,000,000.

Under the IMA, the Company had the right to terminate the IMA without cause upon 90 days notice and MAM had the right to terminate the IMA upon 6 months notice, with such notice not expiring prior to 12 December 2016. Until that time, termination rights without cause were limited to an event where Mr Mackay (then employed by MAM) ceased to be the Company's Portfolio Manager, Hamish Douglass (Chief Executive Officer of MAM) was unable to act as the Company's portfolio manager, and MAM was not able to identify a person to act as the Company's portfolio manager that was acceptable to the Company (acting reasonably). The Company received services from MAM under an Administrative Services Agreement for no additional charge while the IMA was in effect.

(b) Investment Research and Administrative Services Provider

With the Company's move to being internally managed, MAM ceased to be the Investment Manager of the Company effective 1 October 2013. MAM continued to provide investment research and administrative services to the Company on commercial terms materially equivalent to the previous IMA, which is detailed above in section 3.4(a) of this Remuneration Report, under a Services Agreement (SA) and Administrative Services Agreement (ASA). As a result, during the period 1 October 2013 to 30 June 2014, MAM was remunerated by the Company in accordance with the agreements between the Company and MAM and is entitled to:

- service fees calculated at 1.25% per annum (plus GST, payable quarterly in arrears) of the market value of the portfolio less total indebtedness of the Company divided by the weighted average number of the Company's shares on issue during the quarter and multiplied by the lesser of (i) the number of shares on issue at 30 June 2013 or (ii) the weighted average number of shares on issue during the relevant quarter. The research and service fees are reduced by an amount equivalent to Mr Mackay's remuneration and associated payroll related costs, travel costs, and incidental expenses; and
- a performance fee, as detailed above in section 3.4(a) of this Remuneration Report. There were no changes to the performance fees as detailed in Section 3.4(a) above and announced to the ASX on 28 June 2013.

Under the SA, the Company has the right to terminate the SA upon 90 days notice and MAM has the right to terminate the SA upon 6 months notice, with such notice not expiring prior to 12 December 2016. After 12 December 2016, the Company has the right to terminate the SA upon 90 days notice and MAM has the right to terminate upon 6 months notice.

The fees incurred prior to 1 October 2013 are classified as management fees in the Statement of Profit or Loss and Other Comprehensive Income. The fees incurred from 1 October 2013 are classified as research and service fees in the Statement of Profit or Loss and Other Comprehensive Income.

No performance fee was payable to MAM in respect of the year ended 30 June 2014 as the Company's total shareholder return did not exceed 10% per annum, annually compounded, for the period 1 July 2013 to 30 June 2014.

MAGELLAN FLAGSHIP FUND LIMITED

DIRECTORS' REPORT

for the year ended 30 June 2014

3. 2014 Remuneration Report (Audited) (continued)

3.5 Details of Remuneration

The Independent Non-executive Directors and Executive Director were remunerated by the Company. The Non-Independent Non-executive Directors were remunerated by MAM. The total amount paid or payable to the Directors by the Company and MAM during the year is detailed below:

		Short Term Benefits		Post-employment	Long-term	Other	Total
		Salary	Cash Bonus ^(D)	Benefits	Benefits	Benefits	
		\$	\$	\$	\$	\$	\$
Independent Non-Executive Directors							
Richard Warburton AO	2014	79,164	-	7,323	-	-	86,487
	2013	77,982	-	7,018	-	-	85,000
John Ballard	2014	57,208	-	5,292	-	-	62,500
	2013	57,340	-	5,160	-	-	62,500
Andy Hogendijk	2014	68,650	-	6,350	-	-	75,000
	2013	68,807	-	6,193	-	-	75,000
Executive Directors							
C Mackay ^(A)	2014	736,669	-	13,331	-	-	750,000
	2013	-	-	-	-	-	-
Total KMP remunerated by the Company	2014	941,691	-	32,296	-	-	973,987
	2013	204,129	-	18,371	-	-	222,500
Non-Independent Non-Executive Directors							
C Mackay ^{(B)(D)}	2014	482,225	-	17,775	-	125,000	625,000
	2013	583,530	100,000	16,470	51,884	-	751,884
H Douglass ^{(C)(D)}	2014	-	-	-	-	-	-
	2013	232,220	438,973	9,972	20,647	-	701,812
Personnel remunerated by MAM	2014	482,225	-	17,775	-	125,000	625,000
	2013	815,750	538,973	26,442	72,531	-	1,453,696

(A) Mr Mackay was appointed Managing Director and Portfolio Manager of the Company on 1 October 2013 and was an Executive Director of the Company from that date. Mr Mackay's remuneration is shown as a pro-rata for the period 1 October 2013 to 30 June 2014. Refer to remuneration details described in section 3.7 of the Remuneration Report.

(B) Mr Mackay's remuneration is shown as a pro-rata for the period 1 July 2013 to 30 September 2013 when he was the Chairman of MFG and employed by MAM as the Company's Portfolio Manager, and held the position of Non-Independent Non-executive Director of the Company.

(C) Mr Douglass is the Chief Executive Officer of MAM. Mr Douglass' remuneration is shown as a pro-rata for the period 1 July 2012 to 6 February 2013, the period he was a Director of the Company.

(D) Mr Mackay was the Chairman of MFG and an employee of MAM up to 30 September 2013. Mr Mackay's 2013 cash bonus is the deferred component of the 30 June 2012 bonus that was paid to him over the course of the year ended 30 June 2013. Under the terms of his remuneration, Mr Mackay was not entitled to receive a short term or long term incentive in respect of the years ended 30 June 2013 and 30 June 2014. Mr Douglass' cash bonus included a pro rata of the deferred component of his 30 June 2012 bonus and the cash component of his bonus in respect to the year ended 30 June 2013.

(E) Includes long service leave entitlements accrued during the year ended 30 June 2013. Upon Mr Mackay's resignation as MFG Chairman and from MAM on 30 September 2013, Mr Mackay was no longer eligible for the long service leave. As a result, the long service leave entitlement that had accrued to Mr Mackay at 30 September 2013 was forfeited.

(F) Mr Mackay resigned as Chairman of MFG and an employee of MAM on 30 September 2013. A payment was made to Mr Mackay upon his resignation as Chairman of MFG and an employee of MAM on 30 September 2013, acknowledging his compliance, up to that time, with the investment restrictions in his employment agreement with MAM, as a discretionary payment determined by the MFG Board.

MAGELLAN FLAGSHIP FUND LIMITED

DIRECTORS' REPORT

for the year ended 30 June 2014

3. 2014 Remuneration Report (Audited) (continued)

3.5 Details of Remuneration (continued)

A portion of the remuneration paid by MAM to the Non-Independent Non-executive Directors was in relation to managing the affairs of the Company up to 30 September 2013. MAM made no determination as to what proportion of this remuneration paid related to managing the affairs of the Company.

For the period 1 July 2013 to 30 September 2013 when MAM was the Investment Manager of the Company and KMP, the Company paid base fees of \$1,466,408 (June 2013: \$4,656,473). For the period 1 October 2013 to 30 June 2014, the Company paid MAM research and service fees of \$3,914,063 (June 2013: nil). No performance fees were paid to MAM during the period 1 July 2013 to 30 June 2014 (June 2013: nil).

The total amount paid or payable by the Company to the KMP (Independent Non-executive Directors, Non-Independent Non-executive Director, Executive Director, and MAM in the capacity of Investment Manager) for the year ended 30 June 2014 was \$2,440,395 (June 2013: \$4,878,973).

3.6 Service Agreements

Remuneration and other terms of employment for the Independent Non-executive Directors are formalised in service agreements with the Company.

Richard Warburton AO, Chairman, Independent Non-executive Director and member of the Audit and Risk Committee

- Commenced on 19 October 2006
- No term of agreement has been set unless the Director is not re-elected by shareholders of the Company
- Base salary, inclusive of superannuation, for the year ended 30 June 2014 of \$86,487

John Ballard, Independent Non-executive Director and member of the Audit and Risk Committee

- Commenced on 19 October 2006
- No term of agreement has been set unless the Director is not re-elected by shareholders of the Company
- Base salary, inclusive of superannuation, for the period ended 30 June 2014 of \$62,500

Andy Hogendijk, Independent Non-executive Director and Chairman of the Audit and Risk Committee

- Commenced on 19 October 2006
- No term of agreement has been set unless the Director is not re-elected by shareholders of the Company
- Base salary, inclusive of superannuation, for the period ended 30 June 2014 of \$75,000

3.7 Employment Agreements

Remuneration and other terms of employment for the Non-Independent Non-executive Directors and Executive Director are formalised in the respective employment agreement with the Company or MAM.

Chris Mackay, Managing Director/Portfolio Manager

Commenced as Director on 29 September 2006 and held the office of Non-Independent Non-executive Director until 30 September 2013. Mr Mackay was appointed Managing Director/Portfolio Manager of the Company from 1 October 2013.

During the year, Mr Mackay was employed under a contract with MAM which was the Company's Investment Manager until 30 September 2013. The contract had effect from 7 June 2012 and continued until terminated. On 1 October 2013, Mr Mackay resigned as Chairman of MFG and from MAM and as a result the employment contract was terminated. Under the terms of the contract with MAM, which applied for the period 1 July 2013 to 30 September 2013, Mr Mackay:

Non-Independent Non-executive Director (1 July 2013 – 30 September 2013)

- received a fixed compensation structured as a total employment cost package of \$1,250,000 per annum (inclusive of superannuation) effective from 1 July 2013, which may be received as a combination of cash, non-cash benefits and superannuation contributions

MAGELLAN FLAGSHIP FUND LIMITED

DIRECTORS' REPORT

for the year ended 30 June 2014

3. 2014 Remuneration Report (Audited) (continued)

3.7 Employment Agreements (continued)

- was not entitled to receive short term or long term incentive payments
- had undertaken to MAM that for the period up to and including 1 July 2017 neither he nor his associates would, within Australia and New Zealand, invest in any outside business which in the reasonable opinion of MAM was primarily engaged in the business of funds management, other than an investment in MFG, the Company, MAM and related entities, and any managed investment scheme in which MAM acted as trustee or responsible entity. The restrictions did not apply in respect of any investment in:

(a) shares in a company; or

(b) interests in a managed investment scheme; or

(c) other interests in an entity, which represented less than 10% of the issued shares in that company, interests in that managed investment scheme or other interests in that other entity respectively.

In consideration for complying with the above investment restriction, Mr Mackay was entitled to receive an amount of \$500,000 paid on or before 15 July 2017. If prior to 1 July 2017, employment ceased by reason of termination of the contract by MAM; or due to the death, total and permanent disability, ill health or genuine redundancy of Mr Mackay, and MAM reasonably considered that the investment restrictions had been complied with, the amount would be paid on a pro rated basis.

- may terminate the contract at any time by giving not less than 3 months written notice to MAM. MAM may terminate the contract by providing 3 months written notice or providing payment in lieu of that notice.
- may have his contract terminated by MAM at any time without notice if serious misconduct has occurred. Where the contract is terminated for cause, MAM must pay any accrued but unpaid amounts to which Mr Mackay is entitled after setting off for misfeasance for any loss suffered by MAM from the acts which caused the termination.
- was restrained from soliciting employees and clients of MAM for a period of 3 months after termination of employment.

The investment restrictions ceased when Mr Mackay's employment contract terminated on 30 September 2013. A payment of \$125,000 was made to Mr Mackay upon his resignation as Chairman of MFG and an employee of MAM on 30 September 2013, acknowledging his compliance, up to that time, with the investment restrictions in his employment agreement with MAM, as a discretionary payment determined by the MFG Board.

Executive Director (1 October 2013 – 30 June 2014)

On 1 October 2013, Mr Mackay was appointed Managing Director and Portfolio Manager of the Company and entered into an employment contract with the Company with effect from that date. Under the terms of the Contract, which would continue indefinitely until terminated, Mr Mackay:

- receives fixed compensation structured as a total employment cost package of \$1,000,000 per annum (inclusive of superannuation) effective from 1 October 2013, which may be received as a combination of cash, non-cash benefits and superannuation contributions and is subject to annual review;
- is not entitled to receive short term incentive payments;
- is restrained from soliciting clients, employees or agents of the Company or related party for a period of 6 months after termination of employment;
- may have his contract terminated by the Company at any time without notice for cause; and
- may terminate the contract at any time by providing the Company with not less than 6 months written notice. The Company may terminate the contract by providing 6 months written notice or providing payment in lieu of that notice.

MAGELLAN FLAGSHIP FUND LIMITED

DIRECTORS' REPORT

for the year ended 30 June 2014

3. 2014 Remuneration Report (Audited) (continued)

3.7 Employment Agreements (continued)

Chris Mackay, Managing Director/Portfolio Manager (continued)

Mr Mackay is a substantial shareholder of MFG, the parent entity of MAM. Mr Mackay has entered into a consultancy agreement with MAM and has been appointed Special Advisor to both the MFG Board and CEO. Under this agreement, which was effective from 1 October 2013, Mr Mackay is entitled to consultancy fees of \$250,000 per annum, payable quarterly in advance. The agreement is to continue indefinitely until terminated by either Mr Mackay or MAM.

Hamish Douglass, Non-Independent Non-executive Director

- Commenced as Director on 29 September 2006 and resigned on 6 February 2013
- No term of agreement has been set unless the Director is not re-elected by shareholders of the Company
- No base salary or other compensation was received from the Company
- During the period Mr Douglass was a director of the Company, he was employed under a contract with MAM, which had effect from 7 June 2012 and which would continue indefinitely until terminated.

Under the terms of the contract, for the period Mr Douglass was a director of the Company and which applied for the comparative year to 30 June 2013, Mr Douglass:

- received fixed compensation structured as a total employment cost package of \$400,000 per annum, inclusive of superannuation, which may be received as a combination of cash, non-cash benefits and superannuation contributions.
- received variable compensation comprising an annual short term incentive amount of 200% of his fixed compensation. As MFG Group's diluted EPS for the year ended 30 June 2013 exceeded twenty (20) cents per share, the MFG Board approved an additional discretionary short term incentive of \$400,000. Mr Douglass' annual short term incentive amount was based on the following three key criteria and relative weight distributions:
 - MFG Group performance and profitability (50% weighting)
 - Investment Performance of the Global Equity Strategy (40% weighting)
 - Other Criteria as determined by the MFG Board in its absolute discretion (10% weighting)

Specific performance metrics for the above were set by the MFG Board.

- had undertaken to MAM that for the period up to and including 1 July 2017, neither he nor his associates would, within Australia and New Zealand, invest in a business which in the reasonable opinion of MAM was primarily engaged in the business of funds management, other than an investment in MFG, the Company, MAM and related entities, and any managed investment scheme in which MAM acts as trustee or responsible entity. These restrictions would cease to apply prior to 1 July 2017, if a third party acquires control of MAM or MFG, or if the employment contract is terminated for any reason. The restrictions do not apply in respect of any investment in:
 - (a) shares in a company; or
 - (b) interests in a managed investment scheme; or
 - (c) other interests in an entity, which represent less than 10% of the issued shares in that company, interests in that managed investment scheme or other interests in that other entity respectively.

In consideration for complying with the above investment restriction Mr Douglass was entitled to receive an amount of \$500,000 paid on or before 15 July 2017.

MAGELLAN FLAGSHIP FUND LIMITED

DIRECTORS' REPORT

for the year ended 30 June 2014

3. 2014 Remuneration Report (Audited) (continued)

3.7 Employment Agreements (continued)

Hamish Douglass, Non-Independent Non-executive Director (continued)

- may terminate the contract at any time by giving not less than 3 months written notice to MAM and MAM may terminate the contract by providing 12 months written notice or providing payment in lieu of that notice.
- may have his contract terminated by MAM at any time without notice if serious misconduct has occurred.
- was restrained from soliciting employees and clients of MAM for a period of 3 months after termination of employment.

3.8 Options and Shareholdings

The number of ordinary shares and MFF 2017 Options held in the Company at 30 June 2014 by the KMPs is below:

	Balance 1 July 2012	Additions/ (disposals)	Exercised Options	Balance 1 July 2013	Additions/ (disposals)	Exercised Options	Balance 30 June 2014
Current Directors							
Richard Warburton AO							
- Ordinary shares	650,000	10,966	-	660,966	-	-	660,966
- MFF 2017 Options	-	220,299	-	220,299	-	-	220,299
John Ballard							
- Ordinary shares	1,100,000	20,905	-	1,120,905	-	-	1,120,905
- MFF 2017 Options	-	373,592	-	373,592	-	-	373,592
Andy Hogendijk							
- Ordinary shares	225,000	17,216	-	242,216	3,386	-	245,602
- MFF 2017 Options	-	79,213	-	79,213	-	-	79,213
Chris Mackay							
- Ordinary shares	19,213,299	6,538,744	-	25,792,043	436,782	7,134,306	33,363,131
- MFF 2017 Options	-	8,388,236	-	8,388,236	-	(7,134,306)	1,253,930
Former Directors							
Hamish Douglass^(A)							
- Ordinary shares	750,000	-	-	750,000	-	-	-
- MFF 2017 Options	-	249,999	-	249,999	-	-	-

(A) Mr Douglass resigned as director on 6 February 2013 and the transactions and balances above relate to the period 1 July 2012 to 6 February 2013.

(B) None of the Ordinary shares or MFF 2017 Options vested during the year ended 30 June 2014 or during the prior year ended 30 June 2013.

MAGELLAN FLAGSHIP FUND LIMITED

DIRECTORS' REPORT

for the year ended 30 June 2014

4. Other

4.1 Indemnification and Insurance of Directors and Officers

The Company insures the Directors and Officers of the Company in office to the extent permitted by law for losses, liabilities, costs and charges in defending any legal proceedings arising out of their conduct while acting in the capacity of Directors and Officers of the Company, other than conduct involving a wilful breach of duty in relation to the Company.

During the year, the Company paid insurance premiums to insure the Directors and Officers of the Company. The terms of the contract prohibit the disclosure of the premiums paid.

4.2 Auditor

Ernst & Young continues in office in accordance with section 327 of the *Corporation Act 2001*.

4.3 Non-audit Services

During the year, Ernst & Young, the Company's auditor, has performed other services in addition to its statutory duties. Details of the amounts paid or payable to the auditor are set out in note 10 to the financial report.

The Directors, in accordance with advice received from the Audit Committee, are satisfied that the provision of those non-audit services during the year by the auditor is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The Directors are satisfied, considering the nature and quantum of the non-audit services that the provision of non-audit services by the Auditor, as set out below, did not compromise the Auditor independence requirements of the *Corporations Act 2001* for the following reasons:

- all non-audit services have been reviewed by the Audit Committee to ensure that they do not impact the impartiality and objectivity of the auditor
- none of the services undermine the general principles relating to auditor independence as set out in APES 110 Code of Ethics for Professional Accountants.

4.4 Auditor's Independence Declaration

A copy of the Auditor's Independence Declaration as required under section 307C of the *Corporations Act 2001* is set out on page 26.

4.5 Rounding of Amounts

The Company is of a kind referred to in the Australian Securities & Investments Commission's Class Order 98/0100 (as amended) and consequently amounts in the Directors' Report have been rounded off to the nearest thousand dollars in accordance with that Class Order, unless otherwise indicated.

This report is made in accordance with a resolution of the Directors.



Richard Warburton AO

Chairman



Chris Mackay

Managing Director and Portfolio Manager

Sydney, 6 August 2014

MAGELLAN FLAGSHIP FUND LIMITED

AUDITOR'S INDEPENDENCE DECLARATION



Ernst & Young
680 George Street
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Auditor's Independence Declaration to the Directors of Magellan Flagship Fund Limited

In relation to our audit of the financial report of Magellan Flagship Fund Limited for the financial year ended 30 June 2014, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the *Corporations Act 2001* or any applicable code of professional conduct.

Ernst & Young

Graeme McKenzie
Partner
6 August 2014

MAGELLAN FLAGSHIP FUND LIMITED

CORPORATE GOVERNANCE STATEMENT

Magellan Flagship Fund Limited (the 'Company') is a listed investment company whose shares are traded on the Australian Securities Exchange ('ASX'). For the period 1 July 2013 to 30 September 2013, the Company had appointed Magellan Asset Management Limited (MAM) as its Investment Manager. With the Company's move to being internally managed, and appointment of Mr Chris Mackay as Managing Director and Portfolio Manager on 1 October 2013, MAM ceased to be the Investment Manager, continuing to provide investment research and administrative services to the Company.

The Company's Directors and management recognise the importance of good corporate governance. The Company's corporate governance framework, policies and practices are designed to ensure the effective management and operation of the Company, and will remain under regular review.

This Corporate Governance Statement reports against the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations ('ASX Recommendations'). To the extent they are relevant to the Company, the ASX Recommendations have been adopted by the Company. Where, after due consideration, the Company's corporate governance practices departs from an ASX Recommendation, this Corporate Governance Statement will set out the reasons for the departure.

1. LAY SOLID FOUNDATIONS FOR MANAGEMENT AND OVERSIGHT

Role and responsibilities of the Board

The Board is responsible for the overall operation and stewardship of the Company and is responsible for its overall success and long-term growth and corporate governance. The Board will act in the best interests of the Company to ensure the business of the Company is properly managed. The Company's corporate governance policies revolve around its Board Charter, the purpose of which is to:

- promote high standards of corporate governance;
- clarify the role and responsibilities of the Board; and
- enable the Board to provide strategic guidance for the Company and effective operational oversight.

The Board Charter will apply subject to applicable legal and regulatory requirements, including duties and obligations imposed on the Board by statute and general law. The Board may review and amend the Board Charter at any time. The Board Charter is available on the Company's website.

The principal responsibilities of the Board include:

- assessing the Company's overall performance;
- reporting to shareholders;
- appointing and removing the Managing Director and Portfolio Manager and carrying out succession planning for the Managing Director and Portfolio Manager as applicable;
- reviewing the performance of the Managing Director and Portfolio Manager, his/her remuneration and contractual arrangements;
- exercising all rights conferred on it and performing all obligations imposed on it under agreements with service providers;
- setting the designated authorities for the Managing Director and Portfolio Manager in respect to portfolio construction and investment management decisions;
- reviewing and having input into overall target portfolio composition;
- providing strategic guidance to the Managing Director and Portfolio Manager on investments;
- monitoring the services provided by service providers and agents appointed by the Company;
- reviewing at regular intervals the relevant aspects of agreements entered into with service providers and agents;
- oversight and ensuring compliance with best practice corporate governance requirements; and
- ensuring the risk management systems, including internal controls, operating systems and compliance processes, are operating efficiently and effectively.

Subject to any legal requirement and the Company's Constitution, the Board may delegate any of the above powers to individual Directors, committees of the Board or management. Any such delegation shall be in compliance with the law and the Company's Constitution. The Board has authorised MAM to act as agent in certain circumstances but has expressly reserved certain matters which require a decision of the Board.

MAGELLAN FLAGSHIP FUND LIMITED

CORPORATE GOVERNANCE STATEMENT

2. STRUCTURE THE BOARD TO ADD VALUE

Board Composition

The Company's Board must comprise Directors:

- with an appropriate range of skills, experience and expertise;
- who can understand and competently deal with current and emerging business issues; and
- who can effectively monitor and review the performance of the Managing Director and Portfolio Manager, MAM and other service providers and exercise independent judgment.

The following persons were Directors of the Company during the year:

- Richard Warburton AO (Chairman, Independent Non-executive Director)
- John Ballard (Independent Non-executive Director)
- Andy Hogendijk (Independent Non-executive Director)
- Chris Mackay (Non-executive Director to 30 September 2013, appointed Managing Director and Portfolio Manager on 1 October 2013).

Details of each Director's background, date of appointment and attendance at Board meetings are set out in the Directors' Report. The Board is confident that each of the Directors will bring skills and qualifications to the Company which will enable them to effectively discharge their individual and collective responsibilities as Directors of the Company.

The Company's Constitution provides that there must be a minimum of three and a maximum of ten Directors. Having regard to the size of the Company and the nature of its business, the Board has determined that a four member Board of Directors is the appropriate composition for the Board and will enable it to continue to effectively discharge its responsibilities to the Company. However, the composition of the Board is reviewed periodically and its independence, and that of the individual Directors, is assessed as part of those reviews.

Independent Directors

The Board has a majority of Independent Non-executive Directors. An Independent Non-executive Director is a Non-executive Director who is independent of MAM and its parent entity Magellan Financial Group Limited and free of any business or other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the exercise of their unfettered and independent judgment.

Access to information

Directors have access to any information they consider necessary to fulfil their responsibilities and to exercise independent judgment when making decisions. Directors may obtain independent professional advice at the Company's expense, subject to making a request to, and obtaining the prior authorisation of, the chairman of the Board. Where the chairman of the Board wishes to obtain independent professional advice, he or she is required to make a request to, and obtain the prior authorisation of, the chairman of the Audit and Risk Committee of the Board.

Retirement of Directors

A Director must retire from office no later than three years following the Director's last election or appointment and may seek re-election at the Company's annual general meeting.

Nominations and appointment of new Directors

ASX Recommendation 2.4 provides that the Board should establish a Nominations Committee. Given the size and the nature of the Company, the Board has determined that a Nomination Committee is not warranted. The Board considers the issues that would otherwise be considered by a Nominations Committee.

Review of Board performance

Under the Company's Board Charter, the Board will conduct a review of its collective performance and the performance of its Directors every two years. This review will consider the Board's role; the processes of the Board and its Committees; the Board's performance; and each Director's performance before the Director stands for re-election.

MAGELLAN FLAGSHIP FUND LIMITED

CORPORATE GOVERNANCE STATEMENT

3. PROMOTE ETHICAL AND RESPONSIBLE DECISION MAKING

Corporate Code of Conduct

The Company has a Corporate Code of Conduct (the “Code”) that applies to Directors of the Company. The purpose of this Code is to:

- articulate the high standards of honest, ethical and law-abiding behaviour that the Company expects of its Directors;
- encourage the observance of those standards so as to protect and promote the interests of shareholders and other stakeholders;
- guide the Company’s Directors as to the practices thought necessary to maintain confidence in the Company’s integrity; and
- set out the responsibilities and accountabilities of Directors to report and investigate reports of unethical practices.

A copy of the Corporate Code of Conduct is available on the Company’s website.

Trading Policy

The Company has a Trading Policy that sets out the circumstances in which the Company’s Directors and employees may trade in the Company’s securities.

The Policy places restrictions and notification requirements, including the imposition of blackout periods, trading windows and the need to obtain pre-trade approval.

A copy of the Company’s Trading Policy has been lodged with the Australian Securities Exchange (ASX) is available on the Company’s website.

Diversity

MFF has not established a Diversity Policy or set measurable objectives for gender diversity in accordance with ASX Recommendations 3.2 and 3.3. Given the Company has one employee, the Board has determined that a Diversity Policy and the setting of measurable objectives for achieving gender diversity are not warranted. The composition of the Board is reviewed periodically.

4. SAFEGUARD INTEGRITY IN FINANCIAL REPORTING

Audit and Risk Committee

Committee composition

The Company has established an Audit and Risk Committee (‘Committee’). The following persons were members of the Committee during the year:

- Andy Hogendijk (Chairman, Independent Non-executive Director)
- John Ballard (Independent Non-executive Director)
- Richard Warburton AO (Independent Non-executive Director) – appointed 14 May 2014
- Chris Mackay (Executive Director) – resigned 14 May 2014

Details of each Committee member’s background and attendance at Audit and Risk Committee meetings are set out in the Directors’ Report.

The Chairman of the Committee is an Independent Non-executive Director and is not the Chairman of the Board. The Committee consisted of two independent Non-executive Directors and one Executive Director for the period from 1 October 2013 to 14 May 2014. From 14 May 2014 the Committee comprised of three independent Non-executive Directors with the Executive Director attending by invitation, subject to exclusion by the Committee Chairman as may be required from time to time where a conflict of interest exists.

MAGELLAN FLAGSHIP FUND LIMITED

CORPORATE GOVERNANCE STATEMENT

4. SAFEGUARD INTEGRITY IN FINANCIAL REPORTING (continued)

Objectives and responsibilities of the Committee

The objective of the Committee is to assist the Board to discharge its responsibilities in relation to:

- effective management of financial and operational risks;
- compliance with applicable laws and regulations;
- accurate management and financial reporting;
- maintenance of an effective and efficient audit; and
- high standards of business ethics and corporate governance.

These objectives form the foundation of the Committee's Charter. A copy of the Committee's Charter is available on the Company's website.

The Committee will endeavour to:

- maintain and improve the quality, credibility and objectivity of the financial accountability process;
- promote a culture of compliance within the Company;
- ensure effective communication between the Board, MAM and other service providers and agents;
- ensure effective audit functions and communications between the Board and the Company's auditor;
- ensure that compliance strategies are effective; and
- ensure that Directors are provided with financial and non-financial information that is of high quality and relevant to the judgments to be made by them.

The Committee will meet a minimum of four times each year. The Chairman of the Committee will report to the Board in respect of each Committee meeting.

Independent external audit

The Company's independent external auditor is Ernst & Young. The Committee is responsible for recommending to the Board the appointment and removal of the external auditor. The independence and effectiveness of the external auditor is reviewed regularly. The Committee is also responsible for ensuring that the external audit engagement partners are rotated in accordance with relevant statutory requirements, and otherwise after a maximum of five years' service.

The external auditors attend the Committee's meetings when the Company's half year and full year Financial Statements are being considered. The external auditors also attend other meetings where relevant items are on the Committee's agenda.

The Company's external auditors attend the Company's Annual General Meeting and are available to answer questions from shareholders in relation to the conduct of the audit, the Audit Report, the accounting policies adopted by the Company in preparing the Financial Statements and the independence of the auditors.

5. MAKE TIMELY AND BALANCED DISCLOSURE

The Company is committed to complying with its continuous disclosure obligations under the Corporations Act 2001 and the ASX Listing Rules and releasing relevant information in a timely and direct manner and to promoting investor confidence in the Company and its securities.

Continuous Disclosure Policy

The Board has adopted a Continuous Disclosure Policy that is designed to ensure:

- the Company as a minimum complies with its continuous disclosure obligations under the Corporations Act 2001 and the ASX Listing Rules;
- the Company provides shareholders and the market with timely, direct and equal access to information issued by it; and
- that information which is not generally available and which may have a material effect on the price or value of the Company's securities be identified and appropriately considered by the Directors for disclosure to the market.

The Continuous Disclosure Policy, which is available on the Company's website, also sets out the procedures in relation to releasing announcements to the market and discussions with analysts, the media or shareholders.

The Company's market announcements will also be available on its website after they are released to the ASX.

MAGELLAN FLAGSHIP FUND LIMITED

CORPORATE GOVERNANCE STATEMENT

6. RESPECT THE RIGHTS OF SHAREHOLDERS

Communication to Shareholders

The Board is committed to ensuring that shareholders are fully informed of material matters that affect the Company's position and prospects. It seeks to accomplish this through:

- the release of the Company's Half Year Results in February each year;
- the release of the Company's Full Year Results in August each year;
- the release of the Chairman's Letter to Shareholders each year;
- the release of Company's Annual Report in September each year;
- the release of the Chairman's and Managing Director and Portfolio Manager's addresses to the Annual General Meeting;
- the posting of the Company's weekly and monthly NTA on the Company's website as soon as it is disclosed to the market; and
- the posting of significant information on the Company's website promptly after it is disclosed to the market.

Shareholder Meetings

The Company holds its Annual General Meeting in October and a copy of the notice of Annual General Meeting is posted on the Company's website and mailed to shareholders. The Board encourages shareholders to attend the Annual General Meeting or to appoint a proxy to vote on their behalf if they are unable to attend. The formal addresses by the Chairman and Managing Director and Portfolio Manager at the Annual General Meeting are disclosed to the market.

The Company's external auditor will be invited to attend any Annual General Meeting and will be available to answer questions about the conduct of the audit and the preparation and contents of the Auditor's Report.

7. RECOGNISE AND MANAGE RISK

Risk management responsibility

The Board, through the Audit and Risk Committee, is responsible for ensuring:

- the oversight and management of material business risks to the Company;
- the review of reports provided by MAM and other services providers and agents appointed by the Company;
- that effective systems are in place to identify, assess, monitor and manage the risks of the Company and to identify material changes to the Company's risk profile; and
- the monitoring of compliance with laws and regulations applicable to the Company.

Risks assessed include:

- implementing strategies (strategic risk);
- outsourced services and operations or external events (operational and investment risk);
- legal and regulatory compliance (legal risk);
- changes in community expectation of corporate behaviour (reputation risk)
- being unable to fund operations or convert assets into cash (liquidity risk); and
- contingency plans in the event of incapacity of the Managing Director / Portfolio Manager (personnel risk)

The Company has implemented risk management and compliance frameworks. These frameworks ensure that:

- an effective control environment is maintained;
- accountability and delegations of authority are clearly identified;
- risk profiles are in place and regularly reviewed and updated;
- timely and accurate reporting is provided to the Board and its respective Committees; and
- compliance with the law, contractual obligations and internal policies (including the Corporate Code of Conduct) is communicated and demonstrated.

The Company has a Risk Management Process, which defines the process used to identify risks, the execution of appropriate responses, the monitoring of risks and the controls applied to mitigate risks associated with the Agreements and with its other arrangements with MAM, other service providers, and agents.

MAGELLAN FLAGSHIP FUND LIMITED

CORPORATE GOVERNANCE STATEMENT

7. RECOGNISE AND MANAGE RISK (continued)

Assurance

In respect of the year ending 30 June 2014 the Managing Director and Portfolio Manager for the Company has made the following certifications to the Board:

- a) the Company's Financial Statements and notes applicable thereto represent a true and fair view of its financial position and performance and comply with the requirements of the Accounting Standards, Corporations Act and Corporations Regulations; and
- b) the risk management and internal compliance and control systems are sound, appropriate, operating efficiently and effectively managing the Company's material business risks.

8. REMUNERATE FAIRLY AND RESPONSIBLY

Remuneration Committee

ASX Recommendation 8.1 provides that the Board should establish a Remuneration Committee. Given the size and the nature of the Company and the fact the Company has only one employee, the Board has determined that a Remuneration Committee is not warranted, nor does it have a Remuneration Policy to disclose.

Remuneration for the Independent Non-executive Directors is set at market rates commensurate with the responsibilities borne by the Independent Non-executive Directors. Remuneration for the Managing Director and Portfolio Manager is determined by the Board. Further information is provided in the Remuneration Report contained within the Directors' Report.

MAGELLAN FLAGSHIP FUND LIMITED

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

for the year ended 30 June 2014

	Note	30 June 2014 \$'000	30 June 2013 \$'000
Investment income			
Dividend income		8,236	9,191
Interest income		79	177
Net change in fair value of investments		75,236	106,032
Net gains / (losses) on foreign currency cash and borrowings		(4,661)	9,338
Net gains / (losses) on foreign exchange		116	(112)
Other income		-	12
Total net investment income		79,006	124,638
Expenses			
Management fees	12(b)(i)(iii)	1,466	4,656
Research and service fees	12(b)(ii)	3,914	-
Finance costs – interest expense		3,992	4,290
Executive Director's salary		750	-
Non Executive Directors' fees		224	222
Transaction costs		83	121
Registry fees		194	194
Fund administration and operational costs		65	63
ASX listing, clearing and settlement fees		84	92
Auditor's remuneration		70	55
Legal and professional fees		19	26
Employment related taxes		49	11
Other expenses		83	43
Total operating expenses		10,992	9,773
Profit before income tax expense		68,014	114,865
Income tax expense	3(a)	(18,671)	(34,046)
Net profit after income tax expense		49,343	80,819
Other comprehensive income		-	-
Total comprehensive income for the year		49,343	80,819
Basic earnings per share (cents per share)	9	14.08	23.41
Diluted earnings per share (cents per share)	9	12.94	23.29

The above Statement of Profit or Loss and Other Comprehensive Income should be read in conjunction with the accompanying notes

MAGELLAN FLAGSHIP FUND LIMITED

STATEMENT OF FINANCIAL POSITION

as at 30 June 2014

	Note	30 June 2014 \$'000	30 June 2013 \$'000
Current Assets			
Cash and cash equivalents	4(a)	144	3,358
Investments	6	538,813	433,653
Receivables	5	1,155	1,719
Prepayments		13	11
Total current assets		540,125	438,741
Non-current assets			
Total non-current assets		-	-
Total assets		540,125	438,741
Current Liabilities			
Payables	7	1,440	1,485
Current tax liability		95	-
Borrowings	4(b)	31,684	-
Total current liabilities		33,219	1,485
Non-current liabilities			
Deferred tax liability	3(d)	42,340	24,817
Total non-current liabilities		42,340	24,817
Total liabilities		75,559	26,302
Net assets		464,566	412,439
Equity			
Contributed equity	8	365,270	355,433
Retained profits		99,296	57,006
Total Equity		464,566	412,439

The above Statement of Financial Position should be read in conjunction with the accompanying notes

MAGELLAN FLAGSHIP FUND LIMITED

STATEMENT OF CHANGES IN EQUITY

for the year ended 30 June 2014

	Note	30 June 2014 \$'000	30 June 2013 \$'000
Contributed equity			
Balance at beginning of year		355,433	354,097
Transactions with owners in their capacity as owners:			
Issue of securities:			
- on Dividend Reinvestment Plan	8(a)	1,182	1,033
- on exercise of MFF 2017 options	8(a)	8,658	378
Transaction costs:			
- on issue of MFF 2017 options	8(b)	(3)	(107)
- on issue of MFF 2017 options – tax effect		-	32
Balance at end of year		365,270	355,433
Retained profits / (loss)			
Balance at beginning of year		57,006	(16,909)
Total comprehensive income for the year		49,343	80,819
Dividends paid	2	(7,053)	(6,904)
Balance at end of year		99,296	57,006
Total equity		464,566	412,439

The above Statement of Changes in Equity should be read in conjunction with the accompanying notes

MAGELLAN FLAGSHIP FUND LIMITED

STATEMENT OF CASH FLOWS

for the year ended 30 June 2014

	Note	30 June 2014 \$'000	30 June 2013 \$'000
Cash flows from operating activities			
Dividends received		7,567	6,710
Interest received		79	177
Other income received		-	12
Payments for purchase of investments		(211,002)	(337,448)
Proceeds from sale of investments		181,273	172,259
Net foreign exchange (losses)/gains		116	(112)
Management fees paid	12(b)(i)(iii)	(2,838)	(4,316)
Research and service fee paid	12(b)(ii)	(2,620)	-
Other expenses paid		(1,613)	(831)
Net cash (outflow)/inflow from operating activities	4(c)	(29,038)	(163,549)
Cash flows from financing activities			
Net proceeds/(repayment) of borrowings		27,022	9,338
Interest paid		(3,992)	(4,290)
Proceeds from exercise of MFF 2017 options	8(a)	8,658	378
Payment of issue costs on MFF 2017 options	8(b)	(3)	(107)
Dividends paid (net of DRP)	2	(5,861)	(5,820)
Net cash (outflow)/inflow from financing activities		25,824	(501)
Net increase/(decrease) in cash and cash equivalents		(3,214)	(164,050)
Cash and cash equivalents at the beginning of year		3,358	167,408
Cash and cash equivalents at the end of year	4(a)	144	3,358

The above Statement of Cash Flows should be read in conjunction with the accompanying notes

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

1. Summary of Significant Accounting Policies

This financial report is for Magellan Flagship Fund Limited (MFF or the “Company”) for the year ended 30 June 2014. The principal accounting policies adopted in the preparation of the financial report are set out below. These policies have been consistently applied to the year presented, unless otherwise stated.

a) Basis of Preparation

This financial report for the year ended 30 June 2014 is a general purpose financial report and has been prepared in accordance with the Corporations Act 2001, Australian Accounting Standards and Interpretations issued by the Australian Accounting Standards Board and other mandatory professional reporting requirements. It is presented in Australian dollars (\$) and was approved by the Board of Directors on 6 August 2014. The Directors have the power to amend and reissue the financial report.

Compliance with IFRS

This financial report complies with Australian Accounting Standards and International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board.

Historical cost convention

This financial report has been prepared on a going concern basis and under the historical cost convention except for assets and liabilities which are measured at fair value.

The Company is a for-profit entity limited by shares, incorporated and domiciled in Australia, whose securities are publicly traded on the Australian Securities Exchange (ASX code: MFF and MFFO).

New accounting standards

The accounting policies adopted are consistent with those of the previous financial year except for the adoption of the following new standards and amendments which became mandatory for the first time from 1 July 2013. The adoption of these standards and amendments did not result in any adjustments to the amounts recognised in the financial statements and only affected the disclosures in the notes as described below:

- **AASB 13 Fair Value Measurement and AASB 2011-8 Amendments to Australian Accounting Standards arising from AASB 13**
AASB 13 provided guidance for determining the fair value of assets and liabilities. It did not change when the Company is required to use fair value but, rather, provides guidance on how to determine fair value when fair value is required or permitted. It also expands the disclosure requirements for all assets or liabilities carried at fair value. As a result of the guidance in AASB 13, the Company reviewed its policies for measuring fair values and the application of AASB 13 has not resulted in any change in the fair value measurements of the Company however some additional disclosures has been included in note 11(d).
- **AASB 2013-9 Amendments to Australian Accounting Standards – Conceptual Framework, Materiality and Financial Instruments**
AASB 9 was revised in December 2013 to include new hedge accounting requirements including changes to hedge effectiveness testing, treatment of hedging costs, risk components that can be hedged and disclosures. As the Company does not apply hedge accounting, the revision to AASB 9 has not resulted in any impact on the Company’s financial statements or disclosures.
- **AASB 2012-2 Amendments to Australian Accounting Standards – Disclosures – Offsetting Financial Assets and Financial Liabilities** (effective 1 July 2013) **and AASB 2012-3 Amendments to Australian Accounting Standards – Offsetting Financial Assets and Financial Liabilities** (effective 1 July 2014)
AASB 2012-2 and AASB 2012-3 amends AASB 7 Financial Instruments: Disclosures and AASB 132 Financial Instruments: Presentation requiring disclosure about rights of offset and related arrangements where financial assets and financial liabilities can be offset under contractual agreements. There is not expected to be a material impact to the financial statements. The disclosures arising from the application of AASB 2012-2 are included in note 4.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

1. Summary of Significant Accounting Policies (continued)

a) Basis of Preparation (continued)

There are no other pronouncements or accounting standards, not yet effective that at this time, that are expected to have a material impact to the financial statements in future periods.

(b) Segment reporting

An operating segment is a group of assets and operations engaged in providing products and services that are subject to risks and returns that are different to those of other segments.

The Managing Director and Portfolio Manager makes the investment decisions for the Company and the Company's operating segments are determined based on the reports reviewed by the Portfolio Manager to make investment decisions. The Portfolio Manager manages the Company's investments on a portfolio basis and considers the Company operates in a single operating segment.

(c) Foreign Currency Translation

The functional and presentation currency of the Company as determined in accordance with AASB 121: *The Effects of Changes in Foreign Exchange Rates* is the Australian dollar. Transactions denominated in foreign currencies are translated into Australian currency at the foreign currency exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated to Australian Dollars at the foreign currency closing exchange rate ruling at the balance date.

Foreign currency exchange differences arising on translation, and realised gains and losses on disposals or settlements of monetary assets and liabilities, are recognised in the Statement of Profit or Loss and Other Comprehensive Income. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to Australian dollars at the foreign currency closing exchange rates ruling at the dates that the values were determined. Foreign currency exchange differences relating to monetary items, including cash and cash equivalents, are presented separately in the Statement of Profit or Loss and Other Comprehensive Income.

(d) Investment Income

Dividend income

Dividend income is recognised on the applicable ex-dividend date gross of withholding tax. Foreign dividends received are recognised net of withholding tax in the Statement of Cashflows.

Net changes in fair value of investments

Realised and unrealised gains and losses on investments measured at fair value through profit or loss are recognised in the Statement of Profit or Loss and Other Comprehensive Income.

Interest income

Interest income is recognised on an accruals basis using the effective interest rate method.

If revenue is not received at balance date, it is included in the statement of financial position as a receivable and carried at amortised cost.

(e) Expenses

All expenses are recognised in the Statement of Profit or Loss and Other Comprehensive Income on an accruals basis.

Directors' fees (including superannuation) and related employment taxes are included as an expense in the Statement of Profit or Loss and Other Comprehensive Income as incurred. Information regarding the Directors' remuneration is provided in the Remuneration Report on page 12 of the Directors' Report.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

1. Summary of Significant Accounting Policies (continued)

(e) Expenses (continued)

Management and investment research and administrative services fees

Management and investment management and administrative services fees are set out in note 12.

Finance Costs

The basis on which finance costs incurred on borrowings are recognised is included in note 1(n).

Performance fees

Performance fees are set out in note 12(b). During each measurement period, the Company will assess the likelihood of whether the respective performance fees will be payable. A performance fee in respect of a period is recognised in the Statement of Financial Position if the Company's total shareholder return exceeds 10% per annum at the end of the relevant measurement period, which is the date where certainty exists that the criteria has been met and the liability has been crystallised.

(f) Income Tax

The income tax expense/benefit for the year is the tax payable/receivable on the current year's taxable income based on the current income tax rate adjusted by changes in deferred tax assets and liabilities attributable to temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements, and to unused tax losses.

Deferred tax assets and liabilities are recognised for all deductible temporary differences and unused tax losses carried forward to the extent that it is probable that future taxable amounts will be available against which the deductible temporary differences and the carry-forward of unused tax credits and unused tax losses can be utilised.

The carrying amount of deferred income tax assets is reviewed at each reporting date and recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Unrecognised deferred income tax assets are reassessed at each reporting date and are recognised only to the extent that it is become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at balance date.

Current and deferred tax balances attributable to amounts recognised directly in equity are also recognised directly in equity. Deferred tax assets and deferred tax liabilities are offset as there is a legally enforceable right to set off current tax assets and liabilities.

(g) Goods and Services Tax (GST)

Revenue, expenses and assets (with the exception of receivables) are recognised net of the amount of GST, except when GST incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the GST is recognised as part of the cost of that purchase or as an expense.

Receivables and payables are stated inclusive of GST. The net amount of GST recoverable from, or payable to, the taxation authority is included in the statement of financial position as receivable or payable.

Cashflows are included in the statement of cash flows on a gross basis. The GST component of cash flows arising from financing activities which are recoverable from, or payable to the taxation authority, are presented as operating cash flows.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

1. Summary of Significant Accounting Policies (continued)

(h) Financial assets and liabilities

The Company classifies and measures its financial assets and financial liabilities in accordance with AASB 9 *Financial Instruments* which the Company early adopted from 1 July 2010. Under AASB 9, all financial assets and financial liabilities are measured at fair value.

Derecognition of financial instruments

Financial assets and financial liabilities are derecognised when the Company no longer controls the contractual rights that comprise the financial instrument which is normally the case when the instrument is sold.

(i) Cash and cash equivalents

Cash includes cash at bank and demand deposits. Cash equivalents are short-term highly liquid investments that are readily convertible to known amounts of cash, are subject to an insignificant risk of changes in value, and are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes.

(j) Receivables

Receivables are measured at fair value and include dividends, distributions and amounts due on investments sold but not settled at balance date. Receivables relating to the sale of investments are usually settled between two and five days after trade date.

Collectability of receivables is reviewed on an ongoing basis, and non-recoverable amounts are written off by reducing the amount of the receivable in the Statement of Financial Position.

(k) Investments

The Company's investments comprise shares in listed entities and are recognised at fair value through profit or loss in accordance with AASB 9 *Financial Instruments*. Transaction costs directly attributable to the acquisition of investments are expensed in the Statement of Profit or Loss and Other Comprehensive Income as incurred. Changes in the fair value of investments are recognised in the Statement of Profit or Loss and Other Comprehensive Income. When investments are disposed, the net gain and loss on sale is recognised in the Statement of Profit or Loss and Other Comprehensive Income on the date of sale.

Payments and receipts relating to the purchase and sale of investment securities are classified as cash flows from operating activities as movements in the fair value of these securities represent the Company's main income generating activity.

(l) Payables

Payables are measured at fair value. Payables comprise trade creditors and accrued expenses owing by the Company at balance date which are unpaid. Payables relating to the purchase of investments are usually settled between two and five days after trade date. Trade creditors are unsecured and usually paid within 30 days of recognition.

A dividend payable to shareholders of the Company is recognised if it has been approved by the Directors on or before balance date but has not been paid.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

1. Summary of Significant Accounting Policies (continued)

(m) Employee Expenses and Entitlements

Wages, Salaries, Annual Leave and Long Service Leave

Liabilities for wages and salaries (including non-monetary benefits) and annual leave are recognised in payables within accrued employee entitlements and are measured at the amounts to be expected to be paid when the liabilities are settled. The employee entitlement liability expected to be settled within 12 months from balance date is recognised in current liabilities. Liabilities for non-accumulating sick leave are recognised when the leave is taken and measured at the rates paid or payable. Employee benefit on-costs are included in accrued employee entitlements in the Statement of Financial Position and employee costs in the Statement of Profit or Loss and Other Comprehensive Income when the employee entitlements to which they relate are recognised in liabilities.

Long Service Leave

Liabilities for long service leave are recognised when employees reach a qualifying period of continuous service and are measured at the amount expected to be settled within 12 months from balance date. Any amount which is expected to be payable after 12 months from balance date is classified as a non-current liability and measured as the present value of expected future payments. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service and discounted using market yields at balance date on national government bonds with terms to maturity that match, as closely as possible, the estimated future cash outflows.

(n) Borrowings

Borrowings are recognised at fair value where any transaction fees and costs directly related to the borrowings are recognised in the Statement of Profit or Loss and Other Comprehensive Income over the expected life of the borrowings. Borrowings are classified as current liabilities where the liability has been drawn under a financing facility which expires within one year. Finance costs include interest expense related to the borrowings which are expensed in the Statement of Profit or Loss and Other Comprehensive Income as incurred.

(o) Contributed Equity

The Company's ordinary shares and MFF 2017 Options are classified as equity and recognised at the value of consideration received by the Company. Incremental costs directly attributable to the issue of new shares and options are recognised in equity as a deduction, net of tax. Where the Company purchases its own issued shares under a buy-back, the consideration paid, including any directly attributable transaction costs, is deducted from contributed equity.

(p) Earnings Per Share

Basic earnings per share is calculated as net profit / (loss) after income tax expense for the year divided by the weighted number of ordinary shares on issue. Diluted earnings per share is calculated by adjusting the basic earnings per share to take into account the effect of any costs associated with dilutive potential ordinary shares and the weighted average number of additional ordinary units that would have been outstanding assuming the conversion of all dilutive potential ordinary shares, namely the MFF 2017 Options when the Company's average share price exceeds the exercise price over the period the MFF 2017 Options are on issue. Refer to note 9 for further details.

(q) Rounding of amounts

The Company is of a kind referred to in the Australian Securities & Investments Commission's Class Order 98/0100 (as amended) and amounts in the financial statements have been rounded off to the nearest thousand dollars in accordance with that Class Order, or in certain cases, the nearest dollar.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

1. Summary of Significant Accounting Policies (continued)

(r) Critical accounting estimates and judgements

The preparation of the financial statements requires the Directors to make judgements, estimates and assumptions that affect the amounts reported in the financial statements. The Directors base their judgements and estimates on historical experience and various other factors they believe to be reasonable under the circumstances, but which are inherently uncertain and unpredictable, the result of which forms the basis of the carrying values of assets and liabilities. As such, actual results could differ from those estimates.

Where listed equities have no active market the Directors determine fair value with reference to external observable information and conditions existing at balance date (refer to further detail in note 6(a)(i)). Fair values may however move materially with movements in market prices.

As most investments are valued with reference to listed quoted prices and the Company's cash and borrowing facility are provided by strongly rated financial institutions (refer to note 4 and 11(c)), the Company's financial assets are not subject to significant judgment or complexity nor are the Company's liabilities.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

2. Dividends

Dividends paid and payable by the Company during the year are:	30 June 2014 \$'000	30 June 2013 \$'000
For the year ended 30 June 2014:		
Unfranked interim dividend (1.0 cent per ordinary share)		
– paid 16 May 2014	3,548	-
Unfranked final dividend for June 2013 (1.0 cent per ordinary share)		
– paid 15 November 2013	3,505	-
For the year ended 30 June 2013:		
Unfranked interim dividend (1.0 cent per ordinary share)		
– paid 16 May 2013	-	3,456
Partially franked final dividend for June 2012 (1.0 cent per ordinary share)		
– paid 16 November 2012	-	3,448
Total dividends declared and paid during the year	7,053	6,904

Of the \$7,053,000 dividends paid during the year ended 30 June 2014, \$5,869,000 (\$5,861,000 net of withholding taxes) was paid in cash to ordinary shareholders that did not elect to participate in the Company's Dividend Reinvestment Plan (DRP) and \$1,182,000 of dividends were paid via the issue of 822,713 ordinary shares under the terms of the DRP (refer to note 8(a)).

(a) Dividend declared

In addition to the above dividends declared and paid during the year, on 6 August 2014 the Directors declared an unfranked dividend of 1.0 cent per ordinary share in respect of the year ended 30 June 2014. The amount of the proposed dividend, based on the number of shares on issue at 30 June 2014, is \$3,533,000. The DRP will operate in conjunction with this dividend. No discount will be applied to the DRP.

(b) Dividend reinvestment plan (DRP)

The Company's DRP was available to eligible shareholders during the year ended 30 June 2014.

Under the terms of the DRP, eligible shareholders are able to elect to reinvest their dividends in additional MFF shares, free of any brokerage or other transaction costs. Shares are issued and/or transferred to DRP participants at a predetermined price, less any discount that the directors may elect to apply from time to time. No discount has been applied to shares issued under the DRP during the year ended 30 June 2014. The DRP issue price is equal to the average of the daily volume weighted average market price of all Company shares sold in the ordinary course of trading on the Australian Securities Exchange during the 5 trading day period commencing from the day the Company's shares go ex-dividend or other dates as determined by the Board.

During the year ended 30 June 2014, the following ordinary shares were issued under the terms of the DRP:

- on 16 May 2014: 408,485 ordinary shares were issued at a reinvestment price of \$1.4804; and
- on 15 November 2013: 414,228 ordinary shares were issued at a reinvestment price of \$1.3954.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

3. Income Tax

	30 June 2014 \$'000	30 June 2013 \$'000
(a) The income tax (expense) attributable to the year differs from the prima facie amount payable on the operating profit. The difference is reconciled as follows:		
Profit before income tax expense	68,014	114,865
Prima facie income tax (expense) on net profit at 30%	(20,404)	(34,460)
Tax effect of franked dividends received	21	13
Over / (under) provision of prior year tax	-	401
Recouped prior year tax losses	1,712	-
	(18,671)	(34,046)
(b) The major components of income tax (expense) are:		
Current income tax (expense) / benefit	(9,333)	-
Deferred income tax (expense)		
– origination and reversal of temporary differences	(11,080)	(34,463)
– imputation credits on dividends received	30	16
Over / (under) provision of prior year tax	-	401
Recouped prior year tax losses	1,712	-
	(18,671)	(34,046)
(c) Income tax (expense) charged directly to equity:		
Costs associated with the issue of shares	-	(32)
	-	(32)
(d) Deferred tax (liability) / assets relate to the following:		
Tax losses carried forward	-	5,908
Costs associated with the issue	21	29
Unrealised gain on investments ^(A)	(42,085)	(30,333)
Other temporary differences	(276)	(421)
Total net deferred tax liability	(42,340)	(24,817)
^(A) Gains and losses on investments are on revenue account		
(e) Imputation credits:		
Total imputation credits available in subsequent financial years based a tax rate of 30% (2012 – 30%)	47	17

The above amount represents the balance of the imputation credits at 30 June 2014 adjusted for income tax paid/payable, franked dividend receivables and declared franked dividends.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

4. Cash and Cash Equivalents, and Net Interest Bearing Borrowings

	30 June 2014 \$'000	30 June 2013 \$'000
(a) Cash and cash equivalents		
Cash at bank - denominated in Australian Dollars	144	305
Set-off cash and borrowings and net cash amount presented in Statement of Financial Position:		
Borrowings - denominated in Australian Dollars	-	(95,645)
Cash - denominated in US Dollars	-	83,340
Borrowings - denominated in Euros	-	(17,526)
Borrowings - denominated in British Pounds	-	(6,684)
Borrowings - denominated in Swiss Francs	-	(197)
Cash - denominated in Hong Kong Dollars	-	32,426
Cash - denominated in Singapore Dollars	-	7,339
Total cash and cash equivalents	<u>144</u>	<u>3,358</u>
(b) Borrowings		
Set-off cash and borrowings and net borrowings amount presented in Statement of Financial Position:		
Borrowings - denominated in Australian Dollars	(98,242)	-
Cash - denominated in US Dollars	66,534	-
Borrowings - denominated in Euros	(826)	-
Cash - denominated in British Pounds	7	-
Cash - denominated in Singapore Dollars	843	-
Total borrowings	<u>(31,684)</u>	<u>0</u>

The Company holds cash at bank, which is at call and subject to floating interest rates, with an Australian bank. The foreign currency cash balances, which are held with Merrill Lynch International (MLI), a wholly owned subsidiary of Bank of America, are demand deposits and also subject to floating interest rates.

(a) Set-off arrangement

The foreign currency cash balances held with MLI are set-off against the borrowings drawn under the multi-currency financing facility provided by Merrill Lynch International (Australia) Limited (MLIA), which is discussed in detail at note 4(b). The Company and MLI intend to net settle. As a result, at 30 June 2014, the Company's borrowings with MLI totalling \$99,068,000 have been presented net of the \$67,384,000 total cash deposits held with MLI, as the requirements under Australian Accounting Standards to offset have been met. At 30 June 2013, the total cash deposits held with MLI of \$123,105,000 exceeded borrowings provided by MLI of \$120,052,000 and as a result the net cash position of \$3,053,000 was included within cash and cash equivalents in the Statement of Financial Position.

(b) Multi-currency financing facility

The Company has a multi-currency facility with Merrill Lynch International (Australia) Limited (MLIA) which was established in October 2007. MLIA has the ultimate discretion as to the amount to lend under the facility, having regard to the high quality and liquidity of the Company's investments. Amounts drawn as borrowings are repayable on demand. The facility, which is included in the International Prime Brokerage Agreements (IPBA), provides MLI with a fixed charge over the Company's right, title and interest in the assets held in custody with MLI, as security for the performance of its obligations under the IPBA.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

4. Cash and Cash Equivalents and Net Interest Bearing Borrowings (continued)

(c) Reconciliation of net profit after income tax to net cash from operating activities

	30 June 2014 \$'000	30 June 2013 \$'000
Net profit after income tax	49,343	80,819
Net (gains) / losses on foreign currency cash and borrowings	4,661	(9,338)
Foreign currency revaluation of outstanding settlements	126	-
Interest expense	3,992	4,290
(Increase) in investments at market value	(105,160)	(294,316)
Decrease / (Increase) in interest and dividends receivable	496	(1,407)
(Increase) in foreign tax recoverable	(1,096)	(955)
(Increase) in GST receivables	(15)	(22)
(Increase) in prepayments	(2)	(2)
Decrease in unsettled trades receivable	-	22,978
(Decrease) / Increase in management fee payable	(1,372)	340
Increase in research and service fee payable	1,294	
Increase in trade payables and accrued expenses	24	18
Increase in deferred, current and withholding tax	18,671	34,046
Net cash (outflow) / inflow from operating activities	(29,038)	(163,549)

Non-cash financing and investing activities

Dividends satisfied by the issue of shares under the DRP are shown in note 2.

5. Receivables

	30 June 2014 \$'000	30 June 2013 \$'000
Dividends receivable	960	1,456
Foreign tax recoverable	44	1
GST receivable	144	129
Outstanding settlements	7	133
	1,155	1,719
Denomination of current receivables by currency:		
Australian Dollars	144	129
US Dollars	260	192
Euro	44	1
British Pounds	707	1,397
	1,155	1,719

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

6. Investments

Company Name	Domicile of Principal Exchange Listing	30 June 2014 \$'000	30 June 2013 \$'000
Wells Fargo	United States	69,538	50,095
Visa	United States	56,893	44,727
Lowe's	United States	49,291	17,594
Home Depot	United States	47,156	2,323
Bank of America	United States	44,271	30,685
MasterCard	United States	39,750	20,362
HCA Holdings	United States	36,824	24,495
Lloyds Banking Group	United Kingdom	32,258	-
US Bancorp	United States	30,309	21,029
Wal-Mart Stores	United States	29,138	21,275
Bank of New York Mellon	United States	25,361	17,197
State Street	United States	19,770	14,704
Sainsbury's	United Kingdom	17,823	11,363
Danone	France	7,420	-
Qualcomm	United States	6,981	-
Adidas	Germany	6,741	-
Unilever	United Kingdom	4,987	-
Singapore Technologies Engineering	Singapore	3,124	2,308
SIA Engineering	Singapore	2,746	1,611
eBay	United States	2,678	-
Diageo	United Kingdom	2,547	-
SATS	Singapore	1,478	-
Treasury Group	Australia	730	1,614
McDonalds	United States	666	21,361
Tesco	United Kingdom	333	33,238
Apple	United States	-	37,122
Microsoft	United States	-	32,641
Yum! Brands	United States	-	27,698
Other companies		-	211
Total investments		538,813	433,653

Foreign exchange rates

The Australian dollar exchange rates against the following currencies (London 4.00pm rates) are:

	30 June 2014	30 June 2013
US Dollar	0.94385	0.9154
Euro	0.68937	0.7042
British Pound	0.55201	0.6035
Swiss Franc	0.83701	0.8661
Hong Kong Dollar	7.31517	7.0998
Singapore Dollar	1.17665	1.1609

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

7. Payables

	30 June 2014 \$'000	30 June 2013 \$'000
Accrued expenses	1294	1,372
Trade payables	82	59
Other payables	64	54
	1,440	1,485
Denomination of current payables by currency:		
Australian Dollars	1,440	1,485

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

8. Contributed equity

	30 June 2014 Number	30 June 2013 Number	30 June 2014 \$'000	30 June 2013 \$'000
(a) Ordinary Shares				
Opening balance	346,221,267	344,844,354	355,508	354,097
Shares issued under DRP - 16 Nov 12	-	535,225	-	498
Shares issued under DRP - 16 May 13	-	481,576	-	535
Shares issued under DRP - 15 Nov 13	414,228	-	578	-
Shares issued under DRP - 16 May 14	408,485	-	604	-
Shares issued from exercise of options	8,246,049	360,112	8,658	378
Total ordinary shares	355,290,029	346,221,267	365,348	355,508
(b) Listed Options				
Opening balance	114,156,045	-	(75)	-
Options issued	-	114,516,157	-	-
Shares issued from exercise of options	(8,246,049)	(360,112)	-	-
Transaction costs	-	-	(3)	(75)
Total listed options	105,909,996	114,156,045	(78)	(75)
Total contributed equity			365,270	355,433

(c) Terms and conditions

(i) Ordinary shares

Fully paid ordinary shares entitle the holder to receive dividends as declared and the proceeds on winding up the Company in proportion to the number of and amounts paid up on shares held. Ordinary shares entitle their holder to one vote, either in person, or by proxy, at a meeting of the Company.

(ii) Options

Each eligible shareholder of the Company received one MFF 2017 Option for every 3 ordinary shares held at 10 October 2012 for nil consideration. A total of 114,516,157 Options were issued by the Company on 17 October 2012. The MFF 2017 Options are listed on the ASX (ASX code: MFFO).

MFF 2017 Options entitle the holder to the right to acquire one ordinary share in the Company at a price of \$1.05 and are exercisable at any time on or prior to 31 October 2017, at which time they will lapse. The MFF 2017 Options are not entitled to dividends, and ordinary shares issued on exercise of the options rank equally with all other ordinary shares from the date of exercise and entitle the holder to receive dividends on or prior to the applicable record date.

(iii) Share buy-back

The Company completed an on-market share buy-back of 20,000,000 shares at a total cost of approximately \$11,200,000 on 30 July 2009. On 6 August 2014, the Company announced the extension to the on-market share buy-back period to 9 September 2015. To date, the Company has bought back and cancelled 33,200,000 shares at a total cost of approximately \$19,500,000. No shares were acquired under the buy-back during the year ended 30 June 2014.

(iv) Dividend reinvestment plan (DRP)

Refer to note 2(b) for details on the DRP.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

9. Earnings per Share

	30 June 2014	30 June 2013
Basic earnings per share (cents)	14.08	23.41
Diluted earnings per share (cents)	12.94	23.49
Weighted average number of ordinary shares		
Weighted average number of ordinary shares on issue used in calculating basic earnings per share	350,565,102	345,249,172
add: equivalent number of unexercised options for the purposes of calculating diluted earnings per share	30,741,035	1,786,715
Weighted average number of ordinary shares on issue used in calculating diluted earnings per share	381,306,137	347,035,887
Earnings reconciliation		
Net profit after income tax expense used in the calculation of basic and diluted earnings per share (\$'000)	49,343	80,819

The MFF 2017 Options granted on 17 October 2012 and which remain unexercised at 30 June 2014 are considered to be potential ordinary shares and have been included in the determination of diluted earnings per share to the extent they are dilutive. Details of the MFF 2017 Options are set out in note 8(c)(ii).

10. Auditor's Remuneration

	30 June 2014 \$	30 June 2013 \$
Audit services		
Statutory audit and review of the financial reports	60,000	47,000
Non-audit services		
Taxation services	9,500	8,000
Total auditor's remuneration	69,500	55,000

Amounts received or due and receivable by the auditor of the Company, Ernst & Young:

11. Capital and Financial Risk Management

(a) Financial risk management

The Company's investing activities expose it to various types of risk: price risk, currency risk, credit risk and liquidity risk.

The Company has investment restrictions designed to reduce risk, including the requirement that:

- individual investments comprising the investment portfolio will not exceed 10% (or higher amount authorised by the board, with 12% limits in respect of two holdings currently) of the investment portfolio value of the Company at the time of the investment;

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

11. Capital and Financial Risk Management (continued)

(a) Financial risk management (continued)

- total borrowings must not exceed 20% of the Company's investments at market value;
- the use of derivatives is very limited and permitted only where the Portfolio Manager considers that a derivative is preferable to purchasing ordinary share capital, in accordance with the investment objectives and philosophy. In addition, short selling is very limited and permitted only in relation to implementing hedges of underlying investments or merger arbitrage relating to a portfolio investment. The Company did not use derivatives or undertake short selling during the year ended 30 June 2014.

(b) Capital management

The Company's objective in managing capital and investment is to maximise compound after-tax returns for shareholders by identifying and investing in an investment portfolio of listed international and Australian companies, predominantly those which are assessed to have attractive business characteristics, at a discount to their assessed intrinsic values, while minimising the risk of permanent capital loss

The Company recognises that its capital position and market price will fluctuate in accordance with market conditions and, in order to adjust the capital structure, it may vary the amount of dividends paid, issue new shares or options from time to time, or buy back its own shares.

The Company's capital consists of shareholder equity and net borrowings. The Company issued 114,516,157 MFF 2017 Options to ordinary shareholders on 17 October 2012 and the Company continues to have an active on-market share buy-back programme. Refer to note 8(c)(iii) for further details.

A breakdown of the Company's equity and changes in equity during the current year is provided in note 8. There were no changes in the Company's approach to capital management during the current year and the Company is not subject to any externally imposed capital requirements.

(c) Credit Risk

Credit risk represents the financial loss that would be recognised if counterparties failed to perform as contracted. Market prices generally incorporate credit assessments into valuations and the risk of loss is implicitly provided for in the carrying value of financial assets and liabilities when valued at fair value. The maximum exposure to credit risk at balance date is therefore carrying amount of financial assets recognised in the Statement of Financial Position.

The Company's key credit risk exposure is to Merrill Lynch International (MLI) and Merrill Lynch International (Australia) Limited (MLIA). The services provided by MLI under the International Prime Brokerage Agreement dated May 2011 (IPBA) include clearing and settlement of transactions, securities lending and acting as custodian for the Company's assets. Under an addendum to the IPBA, MLIA may also provide financing services to the Company. The IPBA with MLI is in a form that is typical of prime brokerage arrangements and each of the Company's investment securities held by MLI may be used by MLI for its own purposes, whereupon such investment securities will become the property of MLI and the Company will have a right against MLI for the return of equivalent securities. These securities are set out in note 6. Effective from 25 June 2014 the Company agreed to waive the AUD \$200,000,000 limit it had previously applied to the total amount of the securities that MLI could use for its own purposes.

The Company has granted MLI a fixed charge over the Company's right, title and interest in the assets held in custody with MLI, as security for the performance of its obligations under the IPBA.

On 28 November 2013, the Company's arrangement with Prime Asset Custody Transfer Limited (PACT), to which the Company could transfer its unencumbered securities from MLI, was terminated.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

11. Capital and Financial Risk Management (continued)

(c) Credit Risk (continued)

In the event of MLI becoming insolvent, the Company would rank as an unsecured creditor and the Company may not be able to recover such equivalent securities in full. Cash which MLI holds or receives on behalf of the Company (refer to note 4) is not segregated from MLI's own cash and therefore may be used by MLI in the course of its business.

The credit quality of Bank of America / Merrill Lynch's senior debt is rated, as at 30 June 2014, by Standard & Poor's as being A- , and by Moody's as being Baa2 (A- and Baa2 respectively at 30 June 2013). MLI and MLIA are wholly owned subsidiaries of Bank of America which disclosed net assets attributable to common stockholders as at 30 June 2014 of approximately US\$222 billion. Bank of America does not guarantee the obligations in respect of MFF.

The Company also minimises credit risk by investing and transacting with counterparties that are reputable and have acceptable credit ratings determined by a recognised rating agency, and regularly monitoring receivables on an ongoing basis.

Ageing analysis of receivables

At 30 June 2014, all of the Company's receivables are due within 0 to 30 days (June 2013: 0 to 30 days). No amounts are impaired or past due at 30 June 2014 or 30 June 2013.

(d) Fair Value Measurement

The Company classifies the fair value measurements of financial assets and financial liabilities using the three level fair value hierarchy set out below, to reflect the source of valuation inputs used when determining the fair value:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities. The Company invests in securities and rights in listed entities. The fair value of these investments is based on the closing bid price for the security as quoted on the relevant exchange;

Level 2: valuation techniques using market observable inputs, either directly or indirectly. The fair value of asset and liabilities with short-term maturities are valued at the amount at which the asset or liability could be exchanged in a current transaction between willing parties. The fair value of variable-rate receivables/borrowings are based on parameters such as interest rates and individual creditworthiness of the investee company; and

Level 3: valuation techniques using non-market observable market data with the fair value for investments based on a Director's valuation.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

11. Capital and Financial Risk Management (continued)

(d) Fair Value Measurement (continued)

The table below presents the fair value measurement hierarchy of the Company's financial assets and liabilities:

	Note	30 June 2014 \$'000	30 June 2013 \$'000
Assets measured at fair value			
Level 1: Investments - valued using quoted price		538,813	433,653
Level 2: Receivables and Prepayments ^(A)		1,168	1,730
Level 3: Investments - directors' valuation as no quoted price	(i)	-	-
Total financial assets		539,981	435,383
Liabilities measured at fair value			
Level 2: Payables ^(A)		1,440	1,485
Level 2: Borrowings - valued using bank valuation ^(A)		31,684	-
Total financial liabilities		33,124	1,485

(A) Given the short-term maturities of these instruments, refer to note 1(j) and 1(l) for details on valuation basis.

There have been no transfers between any of the three levels in the hierarchy during the year and the Company's policy is to recognise transfers into and out of fair value hierarchy levels as at the end of the year.

The reconciliation of the fair value movements within level 3 is shown below:

	30 June 2014 \$'000	30 June 2013 \$'000
Opening balance - 1 July	-	-
Transfer into level 3 from level 1	-	5,976
Unrealised loss recognised in net changes in fair value of investments	-	(5,976)
Closing balance - 30 June	-	-

(i) Level 3 Investment

The level 3 investment comprises the Company's shares in China Metals Recycling (Holdings) Limited (CMR), for which there is no active market as the shares have been halted from trading since 28 February 2013. On 26 July 2013, CMR was subject to a liquidation petition by the Hong Kong Securities and Futures Commission (SFC). According to the SFC website, a court hearing to challenge the appointment of the liquidators by the former Chairman of CMR was scheduled for March 2014 with further hearings later in 2014 and 2015.

This investment is categorised as a Level 3 in the fair value hierarchy. The Directors' have adopted a valuation of zero as at 30 June 2014, which has been determined using a discounted cashflow method. This is the same as the value adopted as at 30 June 2013. As a consequence there has been no movement in the balance held in level 3 during the year, nor financial impact in the Statement of Profit or Loss and Other Comprehensive Income for year ended 30 June 2014.

The fair value of all other financial assets and liabilities approximate their carrying values in the Statement of Financial Position.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

11. Capital and Financial Risk Management (continued)

(e) Liquidity and Refinancing Risk

Liquidity risk refers to the risk that the Company will not have sufficient funds to settle liabilities or obligations on the due date or will be forced to sell financial assets at a value which is less than they are worth.

A key component of liquidity risk is refinancing risk, which may arise in the unlikely event that MLIA demanded repayment of the borrowings at short notice under the terms of the multi-currency facility (refer to note 8 for further details on borrowings). The Directors are confident that the net borrowings could be repaid via settlement proceeds from the sale of part of the Company's highly liquid investment portfolio, even in the unlikely event that the Company was unable to achieve satisfactory terms for refinancing elsewhere

Therefore as net borrowings repayable on demand at 30 June 2014 were \$31,684,000 (June 2013: nil) and amounts payable within 28 days relating to other payables were \$1,440,000 (June 2013: \$1,485,000), the Company has sufficient funds to meet its liabilities as the market value of the Company's investments at 30 June 2014 is \$538,813,000 (2013: \$433,653,000) and the value of these investments well exceeds the liabilities of the Company.

Maturities of financial liabilities

At 30 June 2014, the Company's financial liabilities comprise payables which mature in 1 year or less (June 2013: 1 year or less).

(f) Price Risk

Price risk is the risk that the value of the Company's investment portfolio will fluctuate as a result of changes in market prices of individual investments and / or the market as a whole. The Company's investments are carried at market value with changes recognised in the Statement of Profit or Loss and Other Comprehensive Income. Price risk is managed by ensuring that all activities are transacted in accordance with the Company's investment policy and within approved limits.

Over the past 10 years, the annual movement in the major global share indices (MSCI and S&P 500) has varied between +35.11% and -23.42% (in AUD) and +30.69% and -29.50% (in USD). This range of yearly performances of markets may not be a reliable guide to future performances, and the Company's investment portfolio does not attempt to mirror the global indices, but this very wide range of historic movements in the indices provides an indication of the magnitude of equity price movements that might reasonably be expected within the portfolio over the next twelve months. The impact of equity price movements, expressed in percentage terms, on the net profit reported by the Company, is linear. Each 5% incremental increase in the market prices of the Company's portfolio compared to 30 June 2014 would increase the total equity and net profit by \$18,858,000 (June 2013: \$15,178,000) and each 5% incremental decrease would have an equal and opposite impact.

(g) Currency Risk

The Company has exposure to foreign currency denominated cash and borrowings (refer to note 4) and also other assets and liabilities denominated in foreign currencies as it invests in listed international and Australian companies. Therefore the Company is exposed to movements in the exchange rate of the Australian dollar relative to foreign currencies.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

11. Capital and Financial Risk Management (continued)

(g) Currency Risk (continued)

At balance date, had the Australian dollar strengthened by 10% against the foreign currencies in which the Company holds foreign currency denominated monetary assets and liabilities (cash and borrowings), with all other variables held constant, the impact of monetary assets and liabilities on the Company's equity and net profit would have been:

30 June 2014			30 June 2013		
Australian dollar strengthens by:		Net increase / (decrease) in net profit	Australian dollar strengthens against:		Net increase / (decrease) in net profit
		A\$'000			A\$'000
US Dollars	10%	(4,657)	US Dollars	10%	(5,834)
Euros	10%	58	Euros	10%	1,227
British Pounds	10%	-	British Pounds	10%	468
Swiss Francs	10%	-	Swiss Francs	10%	14
Hong Kong Dollars	10%	-	Hong Kong Dollars	10%	(2,270)
Singapore Dollars	10%	(59)	Singapore Dollars	10%	(514)
		(4,658)			(6,909)

A 10% decline in the Australian dollar against these foreign currencies would have an equal and opposite impact on the Company's equity and net profit. Currency movements may not be correlated.

Had the Australian dollar strengthened by 10% against the foreign currencies in which the Company holds total foreign currency denominated monetary and non-monetary assets and liabilities with all other variables held constant, total equity and net profit would have decreased by \$42,394,000 (2013: \$37,254,000). A 10% decline in the Australian dollar would have had an equal and opposite impact.

The Company's total net exposure to fluctuations in foreign currency exchange rates at the Statement of Financial Position date is:

	30 June 2014	30 June 2013
<i>All amounts stated in AUD equivalents</i>	\$'000	\$'000
Assets and liabilities at fair value ^(A)		
US Dollars	525,421	466,838
Euros	13,379	(17,525)
British Pounds	58,653	39,396
Singapore Dollars	8,192	11,257
Swiss Francs	0	(197)
Hong Kong Dollars	0	32,426
	605,645	532,195

(A) Foreign currency cash balances held with MLI are netted against foreign currency borrowings provided by MLIA (refer note 4).

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

11. Capital and Financial Risk Management (continued)

(g) Currency Risk (continued)

Assets and liabilities in the Statement of Financial Position exposed to foreign currencies:

	30 June 2014 \$'000	30 June 2013 \$'000
<i>All amounts stated in AUD equivalents</i>		
Assets - exposed to foreign currencies	539,087	532,195
Assets - not exposed to foreign currencies	1,038	(93,454)
Assets - as per Statement of Financial Position	540,125	438,741
Liabilities - exposed to foreign currencies ^(A)	66,558	-
Liabilities - not exposed to foreign currencies	(142,117)	(26,302)
Liabilities - as per Statement of Financial Position	(75,559)	(26,302)
Net assets - exposed to foreign currencies	605,645	532,195
Net assets - not exposed to foreign currencies	(141,079)	(119,756)
Net assets - as per Statement of Financial Position	464,566	412,439

(A) Foreign currency cash and borrowings subject to set-off refer note 4(b)

(h) Interest Rate Risk

Interest rate risk is the risk that the fair value of a financial instrument will fluctuate due to changes in market interest rates. The Company's exposure to interest rate risk relates primarily to cash balances and net interest bearing borrowings as follows:

	Interest rate Cash & cash equivalents / (Borrowings)	30 June 2014 \$'000	Interest rate Cash & cash equivalents / (Borrowings)	30 June 2013 \$'000
	%		%	
Australian Dollars	2.4	144	2.70	305
US Dollars	0.02	66,534	0.16	83,340
Hong Kong Dollars	n/a	-	0.21	32,426
Singapore Dollars	0.04	843	0.17	7,339
British Pounds	0.38	7		-
		67,384		123,105
Australian Dollars	(3.41)	(98,242)	(4.08)	(95,645)
Swiss Francs	n/a	-	(1.25)	(197)
Euros	(0.82)	(826)	(1.35)	(17,526)
British Pounds	n/a	-	(1.74)	(6,684)
		(99,068)		(120,052)
		(31,684)		3,053
		(31,540)		3,358

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

11. Capital and Financial Risk Management (continued)

(h) Interest Rate Risk (continued)

Sensitivity analysis

The sensitivity of the Company's net profit and equity of a reasonably possible upwards or downwards movement in interest rate risk, assuming all other variables remain constant is set out below:

	Interest Rate Risk			
	Impact on profit increase / (decrease)		Impact on equity increase / (decrease)	
	+10bps	- 10bps	+10bps	- 10bps
	\$'000	\$'000	\$'000	\$'000
30 June 2014				
Cash and cash equivalents	674	(674)	674	(674)
Borrowings	(989)	989	(989)	989
	(315)	315	(315)	315
30 June 2013				
Cash and cash equivalents	123	(123)	123	(123)
Borrowings	(120)	120	(120)	120
	3	(3)	3	(3)

Interest rate movements may not be correlated.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

12. Related Parties

On 1 October 2013, the Company moved from being externally managed by Magellan Asset Management Limited (MAM), a wholly owned subsidiary of ASX listed Magellan Financial Group (MFG) and appointed Mr Mackay as Managing Director and Portfolio Manager for the Company, which has provided continuity in the Company's portfolio management.

(a) Key Management Personnel

The Key Management Personnel (KMP) of the Company comprise the Independent Non-executive Directors, the Executive Director, the Non-Independent Non-executive Directors of the Company and MAM for the period 1 July 2013 to 30 September 2013 when MAM was the Investment Manager of the Company.

(b) Magellan Asset Management Limited

(i) For the period 1 July 2013 to 30 September 2013

For the period 1 July 2013 to 30 September 2013 when the Company appointed Magellan Asset Management Limited (MAM) as Investment Manager, MAM was a corporate entity that had specified authority and responsibility in regard to the management of the Company's investment portfolio. During this period, MAM was remunerated by the Company in accordance with the Investment Management Agreement (IMA) between the Company and MAM, and was entitled to:

- a base management fee calculated as 1.25% per annum (plus GST, payable quarterly in arrears) capped to the actual number of the Company's ordinary shares on issue.
- a performance fee if the Company's total shareholder return exceeded 10% per annum, annually compounded, with respect to the following four measurement periods:
 - 1 July 2013 to 30 June 2014
 - 1 July 2013 to 30 June 2015
 - 1 July 2013 to 30 June 2016
 - 1 July 2013 to 31 December 2016

The performance fee that may be payable in respect to each of the four periods was \$2,000,000 and each was non-cumulative. Performance fees would cease to be payable to MAM after 31 December 2016 and the total maximum total performance fees payable over the period 1 July 2013 to 31 December 2016 was capped at \$8,000,000.

The IMA was terminated effective 1 October 2013, and MAM was no longer a KMP from 1 October 2013. MAM continued to provide the Company with investment research and administration services.

(ii) For the period 1 October 2013 to 30 June 2014

With the Company's move to being internally managed, MAM ceased to be the Investment Manager of the Company effective 1 October 2013. MAM continued to provide investment research and administrative services to the Company on commercial terms materially equivalent to the previous IMA, which is detailed above in note 12(b)(i). As a result, during the period 1 October 2013 to 30 June 2014, MAM was remunerated by the Company in accordance with a Services Agreement (SA) between the Company and MAM and is entitled to:

- service fees calculated at 1.25% per annum (excluding GST, payable quarterly in arrears) of the market value of the portfolio less total indebtedness of the Company divided by the weighted average number of the Company's shares on issue during the quarter and multiplied by the lesser of (i) the number of shares on issue at 30 June 2013 or (ii) the weighted average number of shares on issue during the relevant quarter. The research and service fees are reduced by an amount equivalent to Mr Mackay's remuneration, associated payroll related costs, travel costs and incidental expenses.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

12. Related Parties (continued)

(ii) For the period 1 October 2013 to 30 June 2014 (continued)

- performance fees, as detailed above in note 12(b)(i). There were no changes to the performance fees as detailed in note 12(b)(i) and announced to the ASX on 28 June 2013.

The fees incurred from 1 October 2013 are classified as research and service fees in the Statement of Profit or Loss and Other Comprehensive Income. The fees incurred prior to 1 October 2013 are classified as management fees in the Statement Profit or Loss and Other Profit or Loss and Other Comprehensive Income.

No performance fee was payable in respect of the year ended 30 June 2014 as the Company's total shareholder return did not exceed 10% per annum, compounded annually, for the period 1 July 2013 to 30 June 2014.

(iii) For the period 1 July 2012 to 30 June 2013

MAM was entitled to management and performance fees for the year ended 30 June 2013 as set out below:

- a base fee calculated as 1.25% per annum (excluding GST, payable quarterly in arrears) of the market value of the portfolio less total indebtedness of the Company. MAM determined that net deferred tax assets/liabilities would be excluded from the calculation of the base fee, thereby reducing the amount of the base fee.
- a performance fee of 10% of the outperformance of the investment portfolio relative to the MSCI World Index, subject to performance also meeting absolute return and high water mark hurdles. Performance fee entitlements are calculated on an annual basis, commencing on 1 July of each calendar year.

No performance fee was payable to MAM in respect of the year ended 30 June 2013.

The management and performance fees set out at 12(b)(i) were effective 1 July 2013 as a result of a variation to the Investment Management Agreement announced to the ASX on 28 June 2013.

(c) Remuneration of Key Management Personnel

The following remuneration was paid or payable by the Company to the Independent Non-executive Directors and Executive of the Company, and MAM, for the period it was the Investment Manager, during the year:

	2014	2013
	\$	\$
Short term benefits	941,691	204,129
Post-employment benefits	32,296	18,371
Management fee	1,466,408	4,656,473
Total paid by the Company	2,440,395	4,878,973
Short term benefits	482,225	1,354,723
Post-employment benefits	17,775	26,442
Long-term benefits	-	72,531
Other benefits	125,000	-
Total paid by MAM	625,000	1,453,696

Further details of remuneration paid to the Directors is disclosed in the Remuneration Report in the Directors' Report.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

13. Segment Information

The Company operates in one business segment being equity investment, and in one geographic segment, Australia, however the Company continues to have foreign exposures as it invests in companies which operate internationally.

14. Contingent Assets, Liabilities and Commitments

Under the Services Agreement effective 1 October 2013, Magellan Asset Management Limited is entitled to a performance fee if the Company's total shareholders return exceeds 10% per annum, annually compounded, with respect to the three remaining measurement periods set out in note 12(b). The performance fees that may be payable in respect to each period is \$2,000,000 and each is non-cumulative. As markets continue to be subject to fluctuation, there remains uncertainty as to whether the total shareholder returns will be achieved.

The maximum total performance fees payable over the remaining periods is capped at \$6,000,000.

The Company has no material commitments or contingent assets as at 30 June 2014 (June 2013: nil).

15. Events Subsequent to Reporting Date

On 6 August 2014, the Directors declared an unfranked final dividend of 1.0 cent per ordinary share in respect of the year ended 30 June 2014 (refer to note 2(a) for further details).

In the latest release to the ASX on 2 August 2014, the Company reported a Pre-tax NTA per share of \$1.437 (excluding net deferred tax liabilities of \$0.109) as at 2 August 2014.

MAGELLAN FLAGSHIP FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2014

16. Net Tangible Assets (NTA) Value Per Share

	1 August 2014	30 June 2014
Pre-tax NTA	\$1.437	\$1.427
Net tax liabilities	(\$1.109)	(\$0.119)
Post-tax NTA	\$1.329	\$1.308

The above NTA values have not been adjusted for the expected dilution from the exercise of the MFF 2017 Options. If all of the MFF 2017 Options had been exercised at 30 June 2014, the Pre-tax and Post-tax NTA values would have been reduced by 8.7 and 6.0 cents per share to approximately 134.0 and 124.8 cents per share respectively as at that date.

Other than the above, the Directors are not aware of any matter or circumstance not otherwise dealt with in this financial report that has significantly or may significantly affect the Company's operations, the results of those operations or the Company's state of affairs in future years.

The following table reconciles the NTA ^(A) presented in the Statement of Financial Position as at 30 June 2014 to the NTA per share reported to the ASX on 2 July 2014.s

	30 June 2014	30 June 2014	30 June 2013	30 June 2013
	Pre-tax	Post-tax	Pre-tax	Post-tax
Audited NTA Value – cents per share ^(B)	1.427	1.308	1.262	1.191
ASX Reported NTA Value – cents per share ^{(B)(C)} <i>per the ASX announcement dated 2 July 2014</i>	1.427	1.308	1.263	1.190

^(A) Net tangible assets (NTA) refers to the net assets of the Company including the net current and deferred tax liabilities/assets. This is also referred to as the 'Post-tax NTA' per share in the Company's ASX NTA announcements. Where the Company reports 'Pre-tax' NTA per share, this refers to the net assets of the Company excluding the net current and deferred tax assets/liabilities presented in the Statement in Financial Position.

^(B) The NTA values have not been adjusted for the expected dilution from the exercise of the MFF 2017 Options. If all of the MFF 2017 Options had been exercised at 30 June 2014, the Pre-tax and Post-tax NTA values would have been reduced by 8.7 and 6.0 cents per share to approximately \$1.340 and \$1.248 per ordinary share respectively as at that date.

^(C) Since the Post-tax NTA value of 119.0 cents per share was issued on 2 July 2013, an additional \$387,000 deferred tax asset was recorded in relation to tax losses. This was reflected in the Company's audited financial statements for the financial year ended 30 June 2013 and resulted in an increase of 0.1 cent per share to the Post-tax NTA value.

MAGELLAN FLAGSHIP FUND LIMITED

DIRECTORS' DECLARATION

In the Directors' opinion:

- (a) the financial statements and notes set out on pages 33 to 61 are in accordance with the *Corporations Act 2001*, including:
 - (i) giving a true and fair view of the financial position of Magellan Flagship Fund Limited as at 30 June 2014 and of its performance, as represented by the results of its operations and its cashflows, for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards, International Financial Reporting Standards (IFRS) as disclosed in Note 1(a), the *Corporations Regulations 2001* and other mandatory professional reporting requirements;
- (b) there are reasonable grounds to believe that Magellan Flagship Fund Limited will be able to pay its debts as and when they become due and payable.

This declaration has been made after receiving the declarations required to be made to the Directors in accordance with section 295A of the *Corporations Act 2001* for the year ended 30 June 2014.

Signed in accordance with a resolution of the Directors.



Richard FE Warburton AO
Chairman



Chris Mackay
Managing Director and Portfolio Manager

Sydney
6 August 2014

MAGELLAN FLAGSHIP FUND LIMITED

INDEPENDENT AUDITOR'S REPORT



Ernst & Young
680 George Street
Sydney NSW 2000 Australia
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Independent auditor's report to the members of Magellan Flagship Fund Limited

Report on the financial report

We have audited the accompanying financial report of Magellan Flagship Fund Limited, which comprises the statement of financial position as at 30 June 2014, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration.

Directors' responsibility for the financial report

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the Corporations Act 2001 and for such internal controls as the directors determine are necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In Note 1(a), the directors also state, in accordance with Accounting Standard AASB 101 Presentation of Financial Statements, that the financial statements comply with International Financial Reporting Standards.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance about whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation of the financial report that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Independence

In conducting our audit we have complied with the independence requirements of the *Corporations Act 2001*. We have given to the directors of the company a written Auditor's Independence Declaration, a copy of which is included in the directors' report.

MAGELLAN FLAGSHIP FUND LIMITED

INDEPENDENT AUDITOR'S REPORT



Opinion

In our opinion:

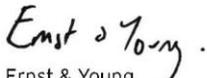
- a. the financial report of Magellan Flagship Fund Limited is in accordance with the *Corporations Act 2001*, including:
 - i giving a true and fair view of the company's financial position as at 30 June 2014 and of its performance for the year ended on that date; and
 - ii complying with Australian Accounting Standards and the *Corporations Regulations 2001*; and
- b. the financial report also complies with *International Financial Reporting Standards* as disclosed in Note 1(a).

Report on the remuneration report

We have audited the Remuneration Report included in pages 17 to 24 of the directors' report for the year ended 30 June 2014. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Opinion

In our opinion, the Remuneration Report of Magellan Flagship Fund Limited for the year ended 30 June 2014 complies with section 300A of the *Corporations Act 2001*.


Ernst & Young



Graeme McKenzie
Partner
6 August 2014

MAGELLAN FLAGSHIP FUND LIMITED

SHAREHOLDER INFORMATION

as at 4 August 2014

Distribution of Shareholders

The distribution of shareholders of the Company as at 4 August 2014 is presented below:

Distribution Schedule of Holdings	Holders	Number of Percentage	
		Ordinary Shares	of Shares in Issue
1-1,000	972	440,500	0.12
1,001-5,000	1,608	4,588,206	1.29
5,001-10,000	1,566	11,970,575	3.37
10,001-100,000	4,610	140,345,850	39.50
100,001 and over	455	197,953,599	55.71
Total	9,211	355,298,730	100.00
Number of holders with less than a marketable parcel	549	121,770	0.03

Twenty Largest Shareholders

The names of the twenty largest shareholders of the Company as at 4 August 2014 are listed below:

Holder Name	Number of Ordinary Shares	Percentage of Shares in Issue
UBS Wealth Management Australia Nominees Pty Ltd	17,549,428	4.94
Christopher John Mackay	15,602,345	4.39
Naumov Pty Ltd	9,355,022	2.63
Magellan Equities Pty Limited	7,723,492	2.17
Mutual Trust Pty Ltd	7,552,141	2.13
Citicorp Nominees Pty Limited	5,108,390	1.44
Forsyth Barr Custodians Ltd	4,636,136	1.31
Cavalane Holdings Pty Ltd	4,367,432	1.23
HSBC Custody Nominees (Australia) Limited	4,187,531	1.18
Midas Touch Investments Pty Ltd	3,961,535	1.12
Emmanuel Capital Pty Ltd	3,000,000	0.84
Citicorp Nominees Pty Limited	2,953,460	0.83
Navigator Australia Ltd	2,260,944	0.64
Netwealth Investments Limited	2,064,267	0.58
Wulura Investments Pty Ltd	2,000,000	0.56
Nota Bene Investments Pty Ltd	1,975,975	0.56
Netwealth Investments Limited	1,888,508	0.53
Rogand Superannuation Pty Ltd	1,626,202	0.46
Cremorne Co Pty Ltd	1,415,118	0.40
National Nominees Limited	1,262,958	0.36
Total shares held by the twenty largest shareholders	100,490,884	28.28
Total shares in issue	355,298,730	

MAGELLAN FLAGSHIP FUND LIMITED

SHAREHOLDER INFORMATION

as at 4 August 2014

Substantial Shareholders

The names of the substantial shareholders appearing on the Company's Register of Substantial Shareholders as at 4 August 2014 are listed below:

Shareholder	Number of Ordinary Shares
Christopher Mackay and Associates	33,363,131

Ordinary Share Capital

All issued ordinary shares carry one vote per share and carry the rights to dividends.

Stock Exchange Listing

The Company's ASX code is "MFF" for its ordinary shares and "MFFO" for its options.

MAGELLAN FLAGSHIP FUND LIMITED

CORPORATE INFORMATION

Directors

Richard Warburton AO
John Ballard
Andy Hogendijk
Chris Mackay

Company Secretaries

Geoffrey Stirton

Registered Office

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Sydney NSW 2000
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Fax: +61 2 8114 1800
Email: info@magellangroup.com.au

Auditor and Taxation Adviser

Ernst & Young
680 George Street
Sydney NSW 2000

Share Registrar

Boardroom Pty Limited
Level 7, 207 Kent Street
Sydney NSW 2000
Telephone: +61 2 9290 9600
Fax: +61 2 9279 0664
Email: enquiries@boardroomlimited.com.au

Securities Exchange Listing

Australian Securities Exchange (ASX)
ASX code (ordinary shares): MFF
ASX code (options): MFFO

Website

<http://www.magellangroup.com.au/mff>

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