

TRANSCRIPT – NABTRADE INTERVIEW WITH MAGELLAN CHIEF INVESTMENT OFFICER HAMISH DOUGLASS

INTERVIEW DETAILS

- **Video title** - 4 quality international stock ideas
- **Interviewee** – Hamish Douglass (HD), Chief Investment Officer, Magellan Financial Group
- **Interviewer** – Vishal Teckchandani (VT), Customer Insights Manager, nabtrade
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- **Link to the video interview on nabtrade** –
https://www.nabtrade.com.au/investor/insights/latest-news/news/2018/12/four_quality_magellan

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EDITED TRANSCRIPT

VT - Welcome, my name is Vishal Teckchandani. Today I'm speaking to Hamish Douglass, the Chief Investment Officer of Magellan Financial Group and we're going to discuss some stock ideas as we turn to the New Year. Hamish it's such a pleasure to be with you, how are you?

HD - I'm very well, how are you Vishal?

VT - I'm great thanks Hamish. So 2019's just around the corner; many investors might be looking to rebalance their portfolios and redeploy some cash potentially. Why don't we start off with the technology sector and some ideas there. We've had a roaring start to 2018 for the FAANG stocks and other tech stocks, they have fallen off a bit in the latter half of the year, what do you make of valuations in the tech sector and what are some of the names you like?

HD - Well first of all the tech sector is a very, very broad term. So I probably don't have a view on the entire tech sector. There's many things in that sector as defined that we wouldn't invest in.

But we do invest in certain technology related companies that we actually have done a lot of research on and we have a lot of conviction in their investment cases. And you're right some of these share prices have gone up a lot in the last 12 months, and actually a lot in the last three years. Some of them have come back materially and some of them have come back very, very modestly in the last little while.

So we're in the areas in the technology sector where we feel we have the expertise and businesses that we think are super high quality and ones where we're very confident about where their businesses are headed maybe in the next three, five, seven years into the future.

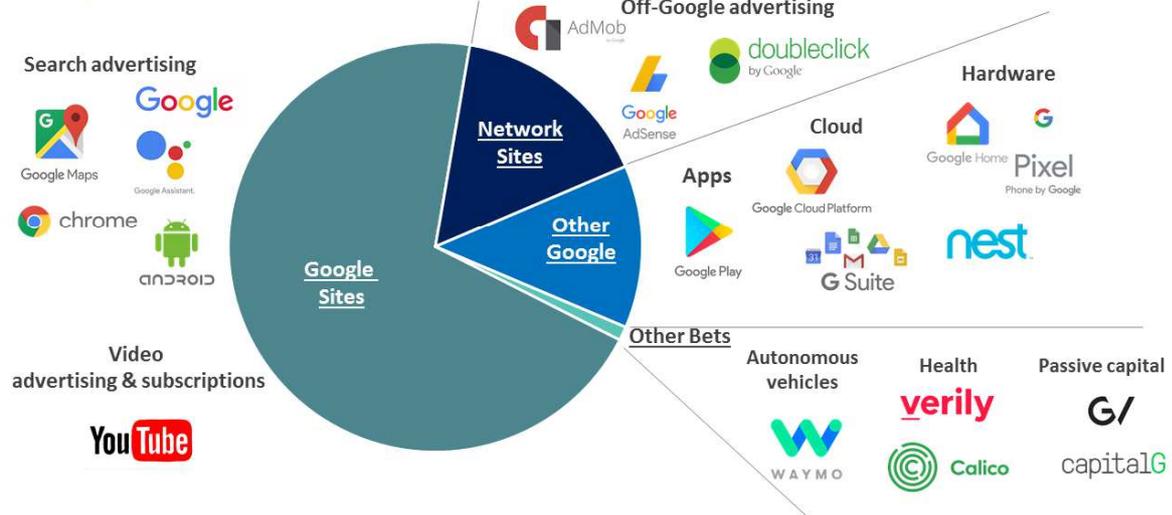
I'd start in the two biggest advertising technology platform companies in the world. Alphabet's our largest investment at the moment. Alphabet of course owns Google; if you peel away the onion a little bit in terms of the emerging businesses they have and their cash I think you could quickly identify that Alphabet's trading at a very modest price/earnings (PE) multiple - maybe in that 15 to 16 times sort of underlying adjusted earnings and there's still enormous opportunities for Alphabet.

First of all in their core advertising business, their search businesses as we know it, they're doing a whole lot of things in relation to local based advertising. So what they're trying to do is connect the user which they know an enormous amount of information about with the information on geolocation where they are with the environment they're in at any point in time which is local businesses.

So with Google Maps and things like Google Lens, which they're now developing, and the information they have and geolocating, they'll be able to serve up very relevant information to a user as they're moving around on maps or when they're doing search - the results will be hyper-local and it's sort of the holy grail for advertising.

Alphabet

What generates current and future value?



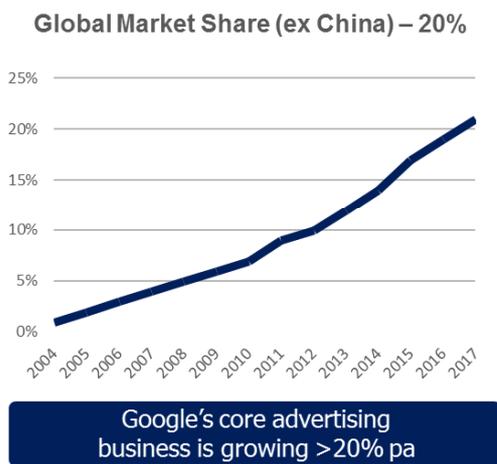
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But of course they've got a massive opportunity via their YouTube business for getting a large share, we would argue, of the advertising revenue that's sitting with television and paid television at the moment. So we still see an enormous advertising opportunity.

Google's advertising business



Sources: MagnaGlobal and Company Data.



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And they have a number of emerging businesses. One is their cloud infrastructure hosting business called Google Cloud Platform. It's still very early days but an enormous addressable market - they're really competing against Amazon and Microsoft in that business and you've got an emerging technology which is their driverless car technology and I think that's really going to be a story for the next 10 to 15 years.

We'd expect Google to develop Waymo as the business is known - one of the dominant autonomous driving platforms in the world and they're going to start with an autonomous taxi fleet. That's going to be the first thing, it's actually rolling out in Phoenix, Arizona in the United States at the moment.

VT - Why don't we talk about some risks within the payments space because that I think is a theme your investors are very familiar with and I've certainly become very familiar with - 'the move towards a cashless society' - people using contactless payments, PayPal etcetera.

This year we've had the real emergence of Blockchain, of cryptocurrencies and there's been hype around that these technologies are going to replace existing payments infrastructure. So I'd love you to talk about the validity of that theme still - is that a risk to payments companies?

HD - Well first of all let's talk about the theme itself. The move to the cashless society - there's still an enormous amount of commerce in the world that is undertaken by cash and cheque and there's an inevitable transfer out of [those payment methods].

If we're looking at consumption expenditure, what is known as personal consumption expenditure, it grows at 5-6% per year and then you've got this transition out of cash and cheque into more digital forms of payment: credit card payments, tap-and-go payments, you've got Apple Pay.

When is the last time in e-commerce that you've ever done cash on delivery? It just doesn't occur, so this whole trend to internet shopping it's all been paid for in a digital form, there's no physical cash or cheques being written to do this and what's happening is, because of the transition adding to just the fundamental growth in personal consumption expenditure, the ecosystem is growing at 10-12% per annum at the moment and we still have a very, very long runway of converting that cash and cheque into these cashless forms of payments.

And nearly every underlying form of payment, the vast majority outside of China gets powered by two large payments networks: Visa and Mastercard. So if you want to pay on Amazon via Amazon Pay you load your Visa or your Mastercard or maybe your American Express card.

PayPal: 50% of their transactions go through Visa and Mastercard. If you want to use Apple Pay, you can use a Visa, Mastercard or an American Express card and the same in Google Pay and Samsung Pay. So they are the rails that connect all the merchants and all the banking systems together with this underlying secular growth that's [got] another 10 or 15 years [to run].

You're asking the question of threats to the system and there are regulatory threats. Are we worried about cryptocurrency per se? Do we think the world is going to start transacting in Bitcoin? We're not losing a lot of sleep on that.

I don't think Bitcoin is a store of value. It is so volatile that I don't think it's going to take over and it's a major threat to financial stability. I don't think the regulator is going to allow that form of currency to be the main form of currency at the end of the day.

But are there forms of changes to the system that could in the long-term threaten part of these payment networks? The answer to that question is yes there are. I don't want to go into the full detail; all I'll say is we don't think they're immediate.

VT - Let's take a different tilt. A consumer defensive play you've nominated is Starbucks. Australians are perhaps not the biggest fan of their coffee but why do you like it as a stock?

HD - Yes why do we like it as a stock - fundamentally it's called China at the end of the day. Starbucks really has three very big businesses.

Key three businesses



Source: Company data as at 30 June 2018

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It's got a very, very large core business in the United States; 65% of its earnings comes from the United States. It is the dominant takeout coffee business in the United States, it's a habitual product, it's addictive [and] has a very, very loyal client based in the United States and they're still rolling out 300-400 stores a year; more and more drive throughs are coming.

It's also got a very large business where they sell coffee to supermarkets in a packaged form and via pods, like a Nespresso pod, but different to Nespresso pods, but also to what is known as food service. They're putting their coffee into stadiums and hotels and businesses.

This is predominantly a US business, a very, very good business, but they've just entered into a global alliance with Nestle. So they're effectively selling the right to sell those brands down those channels on a global basis and Nestle's just paid them US\$7 billion.

They (Nestle) are the largest coffee company in the world and the largest food company in the world. They of course own Nescafe but they also own Nespresso and they're going to enable Starbucks pods and everything to be put through their whole global system.

And Starbucks will provide the coffee, get a margin on that and a royalty on sales. And of course Nestle is going to collect a royalty on those sales or a margin on those sales as well, so a very interesting alliance.

And then there's China. They've got I think around 3,400 in China today. They're rolling out 600 stores a year in China. There is one cup of coffee drunk per person, per year in China. There are over 300 cups per person, per year in the United States. So they've got an enormous opportunity to keep rolling out stores at least for a decade or more in China.

They get ridiculous returns on their capital by rolling out new stores in China - they get 85% pre-tax return on the cash they invest in the first year that they invest at. So it's a very attractive place to put capital. Even though it's a relatively small part of Starbucks, maybe around 12% of Starbucks today is China, over the next decade we think it's going to drive around 50% of Starbucks' profit growth.

VT - Now I couldn't finish off the interview without asking: 2018, it's been a volatile year for markets. What's been your biggest investment lesson this year that perhaps you'll apply as a New Year's financial resolution?

HD - That's a really interesting question. First of all I'd say is the lesson is that we've had volatility but we haven't had a market correction. People are talking about a market correction - this is not a market correction. So you need to make sure you distinguish between that.

We're actually very happy about how the year's played out. We actually like volatility, it opens up more opportunities and more things are being opened up. So when I think out a year ahead we're expecting more volatility and we're going to have further interest rate rises in the United States.

Who knows what happens between China and the United States, it looks like there's a truce, but that could easily blow up. So we would expect there to be more volatility and if I was going to have a resolution it would be if we get that volatility: make sure you are bold and you take advantage of it.

We've got 18% cash, so it's the famous Warren Buffett saying 'be fearful when others are greedy and be greedy when others are fearful' that would be my motto going into 2019, so if the world starts to wobble or markets really start to come off in 2019 I think it'd be the time to get greedy.

VT - You're looking very hungry for stock opportunities next year Hamish. Love it.

HD - We hope so.

VT - Thank you so much for your time and sharing these invaluable insights with our investors. Really appreciate it. I hope you (our viewers) enjoyed this video, now please remember what we talked about today isn't investment advice. If you're thinking about investing in any of the opportunities that Hamish pointed out or looking at Magellan's strategies, it's really important that you do your search and please consider seeking financial advice.

My name is Vishal Teckchandani, have a happy holiday, and see you next time. **END OF INTERVIEW**