Stock Story - Transurban Group

The investment process that is applied to the Elite Opportunities Fund consists of four key principles:

- a bottom-up investment style - investment decisions are based on in-depth, proprietary research and analysis;
- being selectively contrarian – we aim to invest in companies where the current share price does not fully reflect our view of the potential value of that company's business;
- extensive company visits – we gain a first-hand understanding of businesses and the industries in which they operate by meeting with management on a one-on-one basis;
- The ability to trade shorter term opportunities when they arise.

The following stock story on the Transurban Group provides a good illustration of how we apply this process to investment decisions.

Company Overview

Transurban Group owns and operates toll roads in Australia and North America. The company was formed in 1996 as a single purpose business with one asset – Melbourne's CityLink. Since then, it has grown to be a well diversified portfolio of mature, high quality toll road assets. The company has a stake in seven toll roads and has recently signed an agreement to purchase the Lane Cove Tunnel in Sydney.

Transurban's main toll road assets are CityLink in Melbourne and the Hills M2, Westlink M7, Eastern Distributor and M5 Motorway in Sydney. The company also has an interest in two tollways in Virginia, USA.

What made Transurban an attractive investment?

Transurban is a fairly straightforward business as the company primarily builds and operates toll roads. Projects are usually entered into as joint ventures with governments and the concessions granted to Transurban by these governments have tended to be quite generous.

Transurban's cost base is stable and well publicised. Once a toll road has been completed, the on-going costs are low (mainly maintenance) and they tend not to increase rapidly. Costs can rise if the company chooses to expand a road or add more lanes to a tollway but Transurban is in the process of completing some major expansion projects hence we expect costs to be fairly predictable looking forward.

Transurban's main source of revenue is the toll paid by road users. This revenue stream has low volatility as traffic flows on toll roads are not very sensitive to the economic cycle. This can be illustrated by the fact that Transurban only experienced a small fall in traffic volumes during the 2008 global financial crisis.

Transurban's revenues are expected to continue to grow steadily for several reasons:

- On-going population growth should generate higher traffic volumes;
- the recent CityLink upgrade is starting to deliver higher traffic flows and enhancements to the M2 & M5 in Sydney should be completed in 2012;
- the tolls that Transurban charges road users are usually indexed to inflation. This suggests toll growth of around 3% per annum given the current inflation rate.

This indexation of tolls is a key difference between Transurban and other toll road companies. It significantly increases the attractiveness of the company as a long term investment as it suggests revenue growth should comfortably exceed cost growth, leading to wider margins overtime.

Since 2007, Transurban has also had a policy of paying all of its free cash flow to shareholders in the form of dividends. This means the company is offering an attractive dividend stream that should rise in value overtime.

Our favoured method of valuing Transurban is to use a discounted cash flow analysis (DCF) as it enables us to explicitly incorporate our long term assumptions for traffic volumes and toll growth. Using our DCF model and discounting with the company's weighted average cost of capital, our valuation of the company suggested a target price of just over $6.

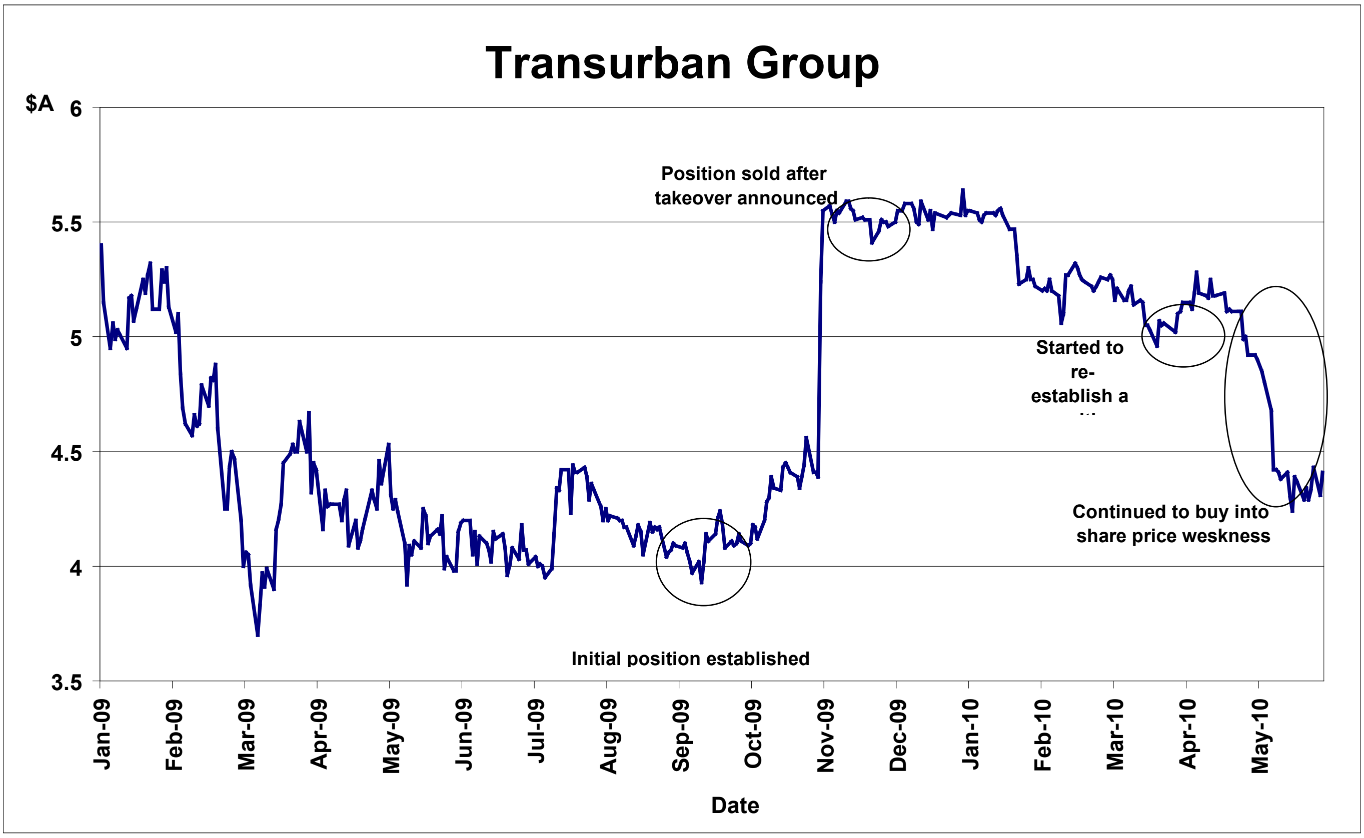
By contrast, the market's valuation of Transurban tends to be lower (around $5) as many participants use a dividend discount model (DDM) to value the company. This method only incorporates discounted future dividends and does not enable projected traffic and toll growth to be explicitly modelled. We believe this approach does not fully capture Transurban's long term potential.

The short term trade

In September 2009, the Elite Opportunities Fund started to build a long term position in Transurban when the stock was trading around $4. Our research suggested a valuation closer to $6 was appropriate, so the company appeared to have significant upside potential.

Soon after this position was established, a consortium of Canadian pension funds (comprising Transurban's three largest share holders), announced its intention to take over the business. Transurban's share price immediately jumped to around $5.50.

At this stage, the takeover bid was not finalised but Transurban's share price was approaching our target price. Although we were still positive on the company over the longer term, we took the opportunity to trade out of the position and lock in a profit for the fund.



Re-establishing a long term position

In early 2010, Transurban's share price drifted back towards $5, so we started to re-establish a long term position based on our analysis of the underlying value of the business. Having met with Transurban management four times since our initial investment in September 2009, we were convinced that our analysis was accurate and the outlook for the company was sound.

Two events then occurred that pushed the share price lower:

- In May 2010, Transurban won a tender to purchase the Lane Cove Tunnel in Sydney. The company announced a capital raising worth $542.3 million to fund this acquisition. The offer price for the capital raising was $4.60 per share.
- On 11 & 12 May, the Transurban board received two formal takeover bids from the Canadian consortium. Both these bids were rejected as the Transurban board did not believe the deals were sufficient to compensate share holders for the long term value inherent in the company. One member of the Canadian consortium was dissatisfied with this decision and subsequently liquidated its large Transurban holding, pushing the share price lower.

In contrarian fashion, we bought more Transurban shares during this period of weakness as we viewed these two events as merely short term drivers of the share price. At around $4.40, the company was very attractive relative to our $6 target price.

Looking forward

The outlook for Transurban remains positive and we believe our target price of $6 is achievable. The company has a low, stable, predictable cost base. Its revenue growth exceeds cost growth and is indexed to inflation. The company is offering investors a very attractive dividend stream and there remains the possibility that an improved takeover bid will emerge at sometime in the future.

Transurban is an example of our process in action. The decision to invest was based on in-depth proprietary research and extensive meetings with management. The position was established during a period of share price weakness when we did not believe the share price fully reflected our view of the potential value of the business. The stock is a core holding in the Elite Opportunities Fund but we have been able to trade the position to enhance returns.

Below are short commentaries on each Aviva Investors fund, outlining their gross performance and the main contributors to performance.#

Australian Equities Fund - The fund returned -9.8% for the June quarter, outperforming the benchmark S&P/ASX 200 Accumulation Index return of -11.1% by 1.3%. The main contributors to performance for the portfolio over the quarter were overweight positions in Westfield Group and CSR. Being overweight Brambles and Sonic Healthcare detracted from performance.

Australian Resources Fund - The fund delivered a return of -11.1% for the quarter, in line with the benchmark S&P/ASX 300 Resources Accumulation Index of -11.1%. Positively contributing to performance during the quarter were overweight positions in Riversdale Mining and Avoca Resources. Main detractors from performance were overweight positions in Bauxite resources and Aditya Birla Minerals.

Dividend Builder - The fund delivered a return of -8.1% for the quarter, outperforming the benchmark S&P/ASX 200 Industrials Accumulation Index of -11.2% by 3.1%. Overweight positions in Foster's Group and CSR positively contributed to performance. Being overweight in Westpac Banking Corporation and not owning Amcor detracted from performance.

Elite Opportunities Fund - The fund returned -11.0% for the quarter, outperforming the benchmark S&P/ASX 200 Accumulation Index return of -11.1% by 0.1%. The main contributors to performance for the portfolio were overweight positions in Telstra Corporation and Newcrest Mining. Main detractors from performance over the quarter was an overweight positions in Brambles and not owning Lihir Gold.

High Growth Shares Fund - The fund returned -10.4% for the quarter, outperforming the benchmark S&P/ASX 200 Accumulation Index of -11.1% by 0.7%. Contributing to performance during the June quarter were overweight positions in Lihir Gold and Newcrest Mining. Main detractors from performance were overweight positions in Downer EDI and Sonic Healthcare.

Long/Short Equity Fund - The fund delivered a return of -7.6% for the quarter, outperforming the combined benchmark S&P/ASX 200 Accumulation Index (75%) and UBS Bank Bill Index (25%) of -8.2% by 0.6%. Positively contributing to performance during the quarter was an underweight position in Westpac Banking Corporation and an overweight position in Lihir Gold. Detracting from performance were overweight positions in Downer EDI and BlueScope Steel.

Small Companies Fund - The fund delivered a return of -14.4% for the quarter, underperforming the benchmark S&P/ASX Small Ordinaries Accumulation Index of -11.6% by 2.8%. The main contributors to performance for the portfolio were overweight positions in McMillan Shakespeare and Mineral Resources. Detracting from performance were overweight positions in Virgin Blue Holdings and Ausenco.

Sustainable Investment Fund - The fund returned -12.9% for the quarter, underperforming the benchmark S&P/ASX 200 Accumulation Index of -11.1% by 1.8%. The main contributors to performance for the portfolio during the June quarter, were overweight positions in Amcor and Westfield Group. Stocks detracting from performance were overweight positions in Brambles and an underweight position in Telstra Corporation.

Australian Shares Fund* - The fund delivered a return of -10.0% for the quarter, outperforming the benchmark S&P/ASX 200 Accumulation Index of -11.1% by 1.1%. The main contributors to performance for the portfolio over the quarter were overweight positions in Westfield Group and CSR. Being overweight Brambles and Sonic healthcare detracted from performance.

Listed Property Fund - The fund delivered a return of -0.9% for the quarter, outperforming the benchmark S&P/ASX 200 A-REIT Accumulation Index of -1.3% by 0.4%. Positively contributing to performance during the quarter were underweight positions in Mirvac Group and ING Industrial Fund. Stocks detracting from performance were overweight positions in Transurban Group and Lend Lease Group.

Premier Fixed Income Fund - The fund underperformed its benchmark by 0.4% over the quarter. This underperformance was mainly due to an overweight position in global high yield bonds that were negatively impacted by European sovereign debt concerns in May. The fund benefitted from its small overweight position to global bonds towards the end of the quarter. An underweight position in Australian bonds negatively impacted performance.

All returns are gross of fees. Please refer to page 4 of the Quarterly Review for a summary of returns which are net of fees.

* Closed to new investments

[1] Benchmark is 75% UBS Australia Composite Bond Index and 25% Barclays Capital Global Aggregate Bond Index (hedged into A$)

[2] Benchmark is UBS Australia Composite 0-5 Year Index

Aviva Investors Investment Returns

Performance to 30 June 2010

		3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	Since Inception % p.a.
Australian Equities						
Australian Equities Fund Inception date: 03/07/1995	Gross Return	-9.8	14.4	-4.4	6.9	10.8
	Benchmark Return	-11.1	13.1	-7.9	4.5	9.5
	Excess Return	1.3	1.3	3.5	2.4	1.3
	Net Return	-10.0	13.4	-5.2	6.0	9.9
Australian Resources Fund Inception date: 03/03/2008	Gross Return	-11.1	11.7	-	-	-4.3
	Benchmark Return	-11.1	9.8	-	-	-7.0
	Excess Return	0.0	1.9	-	-	2.7
	Net Return	-11.3	10.3	-	-	-5.5
Dividend Builder Inception date: 06/09/2005	Gross Return	-8.1	15.8	-7.4	-	2.8
	Benchmark Return	-11.2	14.6	-10.2	-	1.2
	Excess Return	3.1	1.2	2.8	-	1.6
	Net Return	-8.3	15.1	-8.0	-	2.2
Elite Opportunities Fund Inception date: 18/11/2002	Gross Return	-11.0	17.4	-2.0	8.4	13.6
	Benchmark Return	-11.1	13.1	-7.9	4.5	9.4
	Excess Return	0.1	4.3	5.9	3.9	4.2
	Net Return	-11.1	16.3	-2.7	7.6	12.6
High Growth Shares Fund Inception date: 07/12/1999	Gross Return	-10.4	15.3	-1.1	8.3	13.7
	Benchmark Return	-11.1	13.1	-7.9	4.5	7.4
	Excess Return	0.7	2.2	6.8	3.8	6.3
	Net Return	-10.7	13.9	-2.4	7.0	11.8
Long/Short Equity Fund Inception date:	Gross Return	-7.6	13.3	2.2	10.6	13.7
	Benchmark Return	-8.2	11.1	-4.7	6.7	9.8
	Excess Return	0.6	2.2	6.9	3.9	3.9
	Net Return	-7.8	12.2	0.7	9.4	12.5
Small Companies Fund Inception date: 19/11/1999	Gross Return	-14.4	16.0	-6.9	9.7	11.6
	Benchmark Return	-11.6	11.2	-14.2	2.7	4.8
	Excess Return	-2.8	4.8	7.3	7.0	6.8
	Net Return	-14.6	14.9	-7.8	8.6	10.5
Sustainable Investment Fund Inception date: 16/02/2006	Gross Return	-12.9	13.7	-3.6	-	3.1
	Benchmark Return	-11.1	13.1	-8.0	-	1.8
	Excess Return	-1.8	0.6	4.4	-	1.3
	Net Return	-13.1	12.7	-4.5	-	2.2
Australian Shares Fund* Inception date: 25/01/2000	Gross Return	-10.0	15.1	-4.1	6.9	9.1
	Benchmark Return	-11.1	13.1	-7.9	4.5	7.6
	Excess Return	1.1	2.0	3.8	2.4	1.5
	Net Return	-10.2	14.1	-4.9	6.0	8.1
Listed Property						
Listed Property Fund Inception date: 28/02/1994	Gross Return	-0.9	18.4	-18.7	-3.8	7.2
	Benchmark Return	-1.3	20.4	-23.8	-8.0	5.5
	Excess Return	0.4	-2.0	5.1	4.2	1.7
	Net Return	-1.1	17.6	-19.3	-4.5	6.4
Fixed Income						
Premier Fixed Income Fund Inception date: 31/05/2000	Gross Return	3.1	10.3	7.9	6.4	7.0
	Benchmark Return	3.5	8.8	8.4	6.4	6.9
	Excess Return	-0.4	1.5	-0.5	0.0	0.1
	Net Return	2.9	9.8	7.5	6.0	6.6

* Closed to new investments