



Pengana Emerging Companies Fund

September 2005 Quarterly Review

The Pengana Emerging Companies Fund posted a net return of 13.2% over the September quarter, which whilst almost completely in line with the benchmark performance was 2.4% above the small industrials index (this being a better reflection of our investment universe as the fund does not invest in resource stocks). Since inception in November 2004, the fund has returned 27.7% outperforming the smallcap benchmark by 5.9%.

The fund now has over \$35m invested, and was recently rated "Strong Buy" by **InvestorWeb**, adding to positive similar recommendations by **Lonsec, Morningstar, and Zenith**. The fund is approved for **BT and Macquarie Wrap platforms**, and various margin lending providers.

Total return performance for periods ending 30 September 2005

	3 months	6 months	Since inception*
Pengana Emerging Companies Fund	13.2%	12.8%	27.7%
S&P/ASX Small Ordinaries Acc Index	12.9%	15.9%	21.8%
Outperformance of benchmark	0.3%	-3.1%	5.9%
Pengana Emerging Companies Fund	13.2%	12.8%	27.7%
S&P/ASX Small Industrials Acc Index**	10.8%	13.2%	17.8%
Outperformance of benchmark	2.4%	-0.4%	9.9%

* Since Nov 1, 2004

** The fund does not invest in resource stocks

Total return performance figures are derived from Manager's records and are shown after all fees and assume reinvestment of income.

Market backdrop

The September quarter saw the All Ords reaching record highs, up 9% over the period, smallcaps rallied 13%, with small cap resource stocks rising 20%. Following a series of profit warnings in April/May, the August result's season proved better than expected, especially in sectors exposed to business spending. Another key driver in equity markets was increased liquidity, as fund managers sought to reinvest funds following the removal of Newscorp from the index, and cash takeovers for WMC, Southcorp etc.

Review of quarterly performance

Key successes for the fund during the period were Cabcharge, Candle, Espreon, Healthscope, Primary Healthcare, Smorgon Steel, Viridis and Wellcom.

Cabcharge rallied 35% following a strong result, and acquisition of the Westbus network in Sydney on highly favourable terms. **Candle's** result exceeded it's recently upgraded forecast reflecting strong demand for temporary IT staffing. **Espreon** is a new addition to the portfolio which recently acquired Billback, which is a rapidly growing software business with global applications. **Healthscope** rallied 34% following a strong result, and the acquisition of 14 hospitals from Ramsay Healthcare in August. **Primary Healthcare's** result continued the company's predictable growth record, while **Smorgon Steel** rallied on confirmation of the strong environment for steel volume, plus changes in the business profile which leave it far less exposed to volatile scrap metal prices. **Viridis** and **Wellcom** were both strongly performing floats which the fund subscribed to.

Pengana Capital Limited ABN 30 103 800 568 Australian Financial Services Licence no. 226566

Level 29, 20 Bond Street, **Sydney**, 2000
Phone 02 8524 9900 Fax 02 8524 9901
Level 31 360 Collins Street **Melbourne** VIC 3000
Phone 03 8602 0300 Fax 03 9600 0911

Portfolio activity

During the period, we reduced exposure to some stocks which had reached our valuation objectives such as **Adsteam Marine**, **Commander**, and **SAI Global**. We also sold out of **Transurban** after it was elevated into the ASX50 Leaders Index and therefore no longer qualified for the portfolio.

We established smaller positions in a range of stocks which we had been closely monitoring for some time, including **Bradken**, **Espreon**, **Gropep**, **Reject Shop**, **Vision Group**, and **Webster**, and subscribed for shares in the IPO's of **Viridis**, and **Wellcom**.

The weighted average PER of our portfolio for the FY06 year is estimated at 14.2x, compared with the overall smallcap average of 15.6x. The dividend yield on our portfolio is 4.8% which suggests a slightly defensive stance in the portfolio. Our top five positions are listed below.

Top 5 positions in the fund
Investor Group
Energy Developments
Healthscope
Primary Healthcare
Candle

Outlook

The strength in the market in the September quarter surprised us, so a mild short term correction cannot be discounted. Having said this we remain confident over the medium term given the strength of certain sectors of the economy, conservative balance sheets and supportive valuations. Our portfolio's average prospective PER and yield of 14.2X and 4.8%, respectively, adds confidence to this comment on valuations.

We remain wary of the consumer sector, especially given the rise in petrol prices. Retailers saw a dramatic slowdown earlier this year following the interest rate increase, and we see scope for another similar event based on petrol prices. Our only meaningful retail exposure is through the Reject Shop which tends to benefit in tougher times due to its lower price points.

On the other hand, spending by business and government is likely to continue to strengthen particularly in the areas of mining projects, infrastructure spending, and IT services. Companies serving the mining and infrastructure sector can be divided into three categories: contractors, service providers, and supplies of materials. We believe the contractors (eg construction companies) offer the highest risk as they invariably operate fixed price contracts, and generate lumpy unpredictable revenue streams. These stocks are also currently the highest priced which adds to our aversion. Our preference is for service providers such as labour hire groups such as Skilled Engineering, and Chandler MacLeod which offer well diversified exposure, and materials suppliers such as Smorgon Steel, Korvest, and Bradken where valuations are more modest.

The IT services sector remains in strong uptrend as shown by the very strong earnings from Candle, Oakton, SMS Mgmt etc in August. We see this trend continuing for another 2-3 years, driving earnings upgrades and share prices. Industry feedback suggests corporates are now moving beyond simply replacing old equipment in order to lower costs, to implementing new IT based strategies to drive their sales lines.

The federal budget highlighted the structural growth in the superannuation sector, with the removal of the contribution surcharge levied on high income earners. Hence we remain strongly exposed to the financial planning and superannuation administration industries through Investor Group and DKN Group.

Our exposure to the healthcare sector remains high (c11%). The attractions to this sector include a lack of economic sensitivity, exposure to the aging population, and consolidation opportunities. These opportunities are strongest in pathology, ophthalmology and hospital sectors, benefiting Sonic, Vision Group and Healthscope, which we hold stock in.

Company visits

Our central belief is that contact with management is the key to unlocking value within the smallcap sector, hence during the June quarter we made face-to-face contact with 97 companies and unlisted competitors of listed stocks. The table below shows the listed companies with which we had direct contact during the period.

ABC Learning	Epitan	Oroton
Adcorp	Equity Trustees	PCH Group
Adelaide Brighton	Espreon	Peet & Co
Adsteam Marine	Etrade	PeopleBank
Alesco	Fantastic Furniture	Piquant Blue
Allco Max	Forest Enterprises	Primary Healthcare
API Pharmaceuticals	Gropep	Promentum
ARB Corp	Gunns	Regional Express
Atlas Group	Hastie	Reject Shop
Austar	Healthscope	SAI Global
Austbrokers	Hostworks	Select Harvest
Austin Group	IBT Education	Servcorp
Babcock & Brown Infracor.	Integrated Research	SFE Corp
Biron Corp	Investor Group	Skilled Engineering
Boom Logistics	Investor Web	SMS Mgmt
Bradken	Invocare	Sonic Healthcare
Brazin	ITL Ltd	Symex
Candle	JB Hifi	Tassal
Challenger Infrastructure	Just Group	Transonic
Chandler MacLeod	K&S Corp	Travel Services Group
Clive Peeters	Kids Campus	UnderCoverWear
CO2 Ltd	Life Therapeutics	Village Roadshow
Coates Hire	M2 Communications	Viridis
Colorpak	MacMahon Holdings	Vision Group
Commander	Macmillan Shakespeare	Volante
Concept Hire	Mariner Financial	Wattyl
Corporate Express	McPhersons	Web Central
CPT Global	Medical Developments	Webster
DCA Group	Mortgage Choice	Wellcom
Dexion	MXL Ltd	Xtek
DKN Group	National Hire	
Domino Pizza	Nick Scali	
Energy Developments	Oakton	

For more information on the fund visit our web site on <http://www.pengana.com.au/>

Pengana Capital Ltd (ABN 30103800568) Australian Financial Services Licence no. 226566. This fact sheet was prepared by Pengana Capital Ltd and is only provided for information purposes. It does not contain investment recommendations nor provide investment advice. Neither Pengana Capital Ltd or its related entities, directors or officers guarantees the performance of, or the repayment of capital or income invested in the Fund. Professional investment advice can help you determine your tolerance to risk as well as your need to attain a particular return on your investment. We strongly recommend you obtain detailed professional advice and to read the relevant offer document in full before making an investment decision. Units in the fund will only be issued upon receipt of an application form accompanying a current Product Disclosure Statement. Included on this form is a declaration that direct investors into the fund must be "wholesale clients" as defined in section 761G of part 7.9 of the Corporations Act 2001.

Pengana Capital Limited ABN 30 103 800 568 Australian Financial Services Licence no. 226566

Level 29, 20 Bond Street, **Sydney**, 2000
Phone 02 8524 9900 **Fax** 02 8524 9901
 Level 31 360 Collins Street **Melbourne** VIC 3000
Phone 03 8602 0300 **Fax** 03 9600 0911