December 2005 Quarterly Review

The Pengana Emerging Companies Fund posted a net return of 3.6% over the December quarter, compared with the benchmark performance of 0.6%. Since inception in November 2004, the fund has returned 32.3% outperforming the smallcap benchmark by 11.0%.

The fund now has over $45m invested, and is rated "Strong Buy" by **InvestorWeb**, adding to positive 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 31 December 2005

	3 months	6 months	1 Year	Since inception*
Pengana Emerging Companies Fund	3.6%	17.2%	21.2%	**32.3%**
S&P/ASX Small Ordinaries Acc Index	0.6%	13.6%	19.6%	**22.5%**
Outperformance of benchmark	3.0%	3.6%	1.6%	**9.8%**
Pengana Emerging Companies Fund	3.6%	17.2%	21.1%	**33.5%**
S&P/ASX Small Industrials Acc Index**	2.1%	13.1%	15.9%	**20.2%**
Outperformance of benchmark	1.5%	4.1%	5.2%	**13.3%**

* 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 December quarter saw the All Ords again reach record highs, up 2.5% over the period. Smallcaps rallied 0.6% during the quarter, with a sharp correction in resources offsetting a stronger industrial sector. The smallcap industrial market rose 2.1% driven by reasonably positive commentary during AGM season. The 10% correction in mining related stocks during October was driven by profit taking, however this was largely reversed later in the quarter as commodity prices recovered.

Review of quarterly performance

Key successes for the fund during the period were Alesco, Bradken, Cabcharge, Peet & Co, Record Investments, Skilled Engineering and Undercover Wear.

Alesco rose 25% following two small acquisitions and confidence that the housing market has potentially seen its worst. **Bradken** rallied 25% driven by increasing demand from the mining industry for its rail and consumable products. **Cabcharge** rallied a further 12% as the market anticipates a strong interim result. Property developer and syndicator **Peet & Co** rose 26% due to an increased dividend payout and a favourable zoning decision on its Victorian landbank. **Record Investments** rose 15% following its proposed merger with its unlisted parent company, Allco Finance. **Skilled Engineering** rose 30% as the national skills shortage drives earnings upgrades. Party plan company, **Undercover Wear** rallied 24% following indication at its AGM that sales were tracking ahead of budget.

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 **Alesco**, **Energy Developments**, **Espreon**, **Regional Express**, and **Transonic Travel.**

New additions to the portfolio include **Australian Wealth Management**, **Transfield Services**, and **Undercover Wear**.

The weighted average PER of our portfolio for the FY06 year is estimated at 14.8%, compared with the overall smallcap average of 15.6%. The dividend yield on our portfolio is 4.5% which suggests a slightly defensive stance in the portfolio. Our top five positions are listed below.

Top 5 positions in the fund
WHK Group
Cabcharge
Primary Healthcare
Oakton
Candle

Outlook

The mild correction in October was not surprising given the 13% rally in smallcaps during the September quarter. Overall we remain confident that medium term money making ideas remain plentiful given the strong economy and healthy balance sheets backed by fair valuations and solid dividend yields.

On the negative side, the consumer sector still looks patchy, especially given the rise in petrol prices, hence our only meaningful retail exposure is through **The Reject Shop** which tends to benefit in tougher times due to its lower price points. The correction in house prices (especially NSW) may also keep demand soft in renovation and housing construction markets for longer than is currently expected, hence we are averse to housing related stocks.

On the other hand, spending by business and government remains strong, and is likely to continue for another 2-3 years. The labour shortage may impede the growth at the margin, but will also serve to prolong the cycle. We see a strong outlook in project related expenditure in the mining and infrastructure sectors. In this sector we favour stocks which provide services and consumables (such as labour, steel, etc) versus those which provide fixed-price project type services given the higher risk nature of the work. Given this we are holders of **Bradken**, **Korvest**, **Skilled Engineering**, and **Smorgon Steel**.

The IT services sector also remains in strong uptrend with AGM commentary from most companies positive. 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. Our holdings in this sector include **Candle**, **CPT Global** and **Oakton**.

Financial services remains fertile, especially companies which derive income from the superannuation sector which has government mandated growth. Our favoured stocks are **Australian Wealth Management**, **DKN Group**, **MacMillan Shakespeare** and **WHK Group** (formerly Investor Group).

Our exposure to the healthcare sector remains high. 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 **Ramsay**, **Sonic** and **Vision Group** 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 quarter we made face-to-face contact with 61 companies and unlisted competitors of listed stocks. The table below shows the listed companies with which we had direct contact during the period.

Access Providers	Espreon	Ramsay Healthcare
Allco Max	GLG Group	Run Corp
ABC Learning	Fleetwood	SP Ausnet
APN Group	Goodman Fielder	Saferoads
ASG Group	GPS Online	Senetas
Astron	Hyro Ltd	Silverchef
Austbrokers	ICS Global	Smorgon Steel
Australian Wealth Mgmt	Institute of Drug Tech	Stericorp
AV Jennings	Invocare	Timbercorp
Avatar	Iress	Toxfree Systems
Bank of Qld	JB Hifi	Transfield Services
Baxter	Just Group	Treasury Group
Cabcharge	Macquarie Media	Tutt Bryant
Campbell Bros	MFS Ltd	Vision Group
Challenger	Network Ltd	Vision Group divisional
Chiquita	Peet & Co	WHK Group
Codan	Pipe Networks	WSS Group
Count	Plaspak	Reverse Corp
Ellex	Programmed Maintenance	

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