Money Management | IMCA FUND MANAGER OF THE YEAR 2007 FINALIST Australian Shares (Small cap)

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June 2007 Quarterly Review

The Pengana Emerging Companies Fund posted a net return of 13.6% over the June quarter, compared with the benchmark performance of 10.8%. Since inception in November 2004, the fund has returned 44.1% p.a. outperforming the smallcap benchmark by 15.6%. The results are pleasing given that the fund does not invest in resources stocks, which have rallied over 170% since the formation of the fund.

Total return performance for periods ending 30 June 2007

	3 mths	6 mths	1 yr	2 yrs p.a.	Since inception* p.a.
Pengana Emerging Companies Fund	13.6%	28.9%	70.7%	53.2%	**44.1%**
S&P/ASX Small Ordinaries Acc Index	10.8%	18.9%	44.4%	34.6%	**28.6%**
Outperformance	2.7%	10.0%	26.3%	18.6%	**15.6%**
S&P/ASX Small Industrials Acc Index**	8.6%	15.5%	38.2%	28.8%	**23.7%**
Outperformance	5.0%	13.3%	32.5%	24.4%	**20.4%**

* 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 assumes reinvestment of income.

Market backdrop

The market's strength was unabated during the June quarter, with the All Ords up 8.6%, and Small Ords up 10.8%. The Small Resources sector was particularly strong (up 17.4%), aided by the largest stock, Fortescue Metals (up 70%). The underlying drivers for the overall market remain in place, being strong underlying earnings growth in the economy, high commodity prices, large cash injections into superannuation, and corporate speculation (especially private equity).

Key stock moves during the quarter

The key stock moves during the quarter were **Bradken** (up 23%), **Mineral Resources** (up 20%), **Incitec Pivot** (up 65%), **Macmahons** (up 51%), and **DKN Group** (up 39%). The IT services sector, in which we are heavily invested, was consistently strong with **ASG Group** up 37%, **DWS** up 32%, **Oakton** up 29%, and **SMS Mgmt** up 32%. We do not invest in resources stocks, hence not owning the largest stock in our index, **Fortescue Metals** (up 68%), was expensive from a relative point of view.

Incitec Pivot rallied strongly following it's interim result in which the company increased its targeted cost savings from the recent Southern Cross Fertiliser acquisition. Earnings have also being boosted by higher fertilizer prices. **Bradken**, **Macmahon Holdings**, and **Mineral Resources** continue to benefit from the boom in mining activity, which is unlikely to subside in the near term. **DKN** is well exposed to the strong flows into superannuation, and with a fixed cost base, enjoys strong earnings leverage to this growth.

Key detractors during the period were **Clive Peeters** (down 39%), and **Resmed** (down 23%). **Clive Peeters** warned of lower profits this year as its new NSW stores ramped up slower than expected. **Resmed** suffered from a product recall, plus price discounting by competitors during new product releases. Whilst the positions were already small we sold down both stocks in the belief that the issues facing both companies increased their risk profile over the coming 6-12 months. However both remain interesting growth stories longer term, hence when earnings risk dissipates we may repurchase.

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Portfolio activity

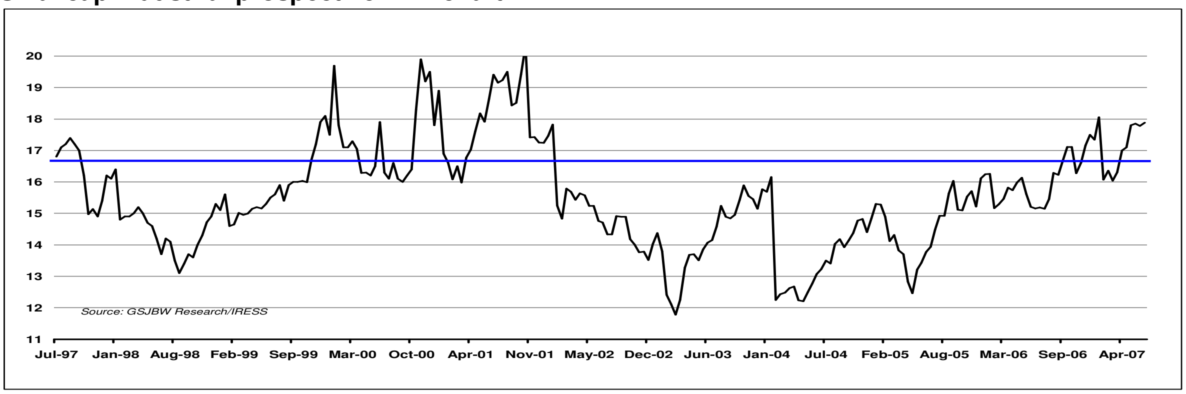
During the period we reduced our positions in Clive Peeters and Resmed (see above). We established new positions in **Automotive Holdings**, **CSG Group** (IPO), **IWL Ltd**, **Mac Services** (IPO), and **Spark Infrastructure** during the quarter.

Top 5 positions in the fund	
Australian Wealth	Mineral Resources
Bradken	Reverse Corp
MacMillan Shakespeare	

Outlook

The chart below shows that, over the past 6-9 months share prices have moved ahead of earnings growth, resulting in slight expansion of the PER versus the long term average (14% premium). As always, stock picking remains the key performance driver, hence a short term correction is not a major concern to our medium term investment outlook. We also note that our portfolio has an average prospective PER of around 17.0x versus 17.8x for the market.

Smallcap Industrial prospective PER chart



Source: Goldman Sachs JB Were

Our strong conviction in three key areas of the economy (IT services, Financial Services, and Non-residential activity) remains, hence our exposure to these sectors is still high. Around 40% of the portfolio (across 15-20 stocks) has direct exposure to these three strong growth sectors. These themes aside, the portfolio contains many stocks which do not neatly fit into a theme. We will profile three of those below:

MacMillan Shakespeare (MMS) is the leader in salary packaging services, which is a growing industry as more employees become aware of the benefits of paying pre-tax salary for eligible items. The company currently offers salary packaging to 200,000 employees and is developing new revenue streams by salary packaging car purchases, laptops, home loans, catering and potentially child care. MMS is four times the size of its nearest competitor Smart Salary, which provides a competitive advantage in scale. The capital cost to grow the business is relatively low, providing very strong cash flow. The company is debt free, which increases the chances of higher dividends over time. While on a relatively high PER, the high barriers to entry, conservative balance sheet, proven management and growth outlook are attractive to us.

Radio Rentals (RRA) operates 67 stores servicing the household equipment rental market to lower income earners. The company was floated in April at 50c, and now trades at 82c. RRA has a strong brand, and operates in a relatively stable marketplace. From a strong history in white goods and audio-visual equipment, the company is expanding into furniture, flat screen TVs and IT equipment to grow sales. Critically, management is confident that the existing store network can accommodate sales 30% higher than current levels. This is possible because each store largely contains display stock, hence expanding the range does not necessarily require a larger store (or more stores). The maiden result showed profit growth of 15%, and profit growth of 85% due to strong cost control.

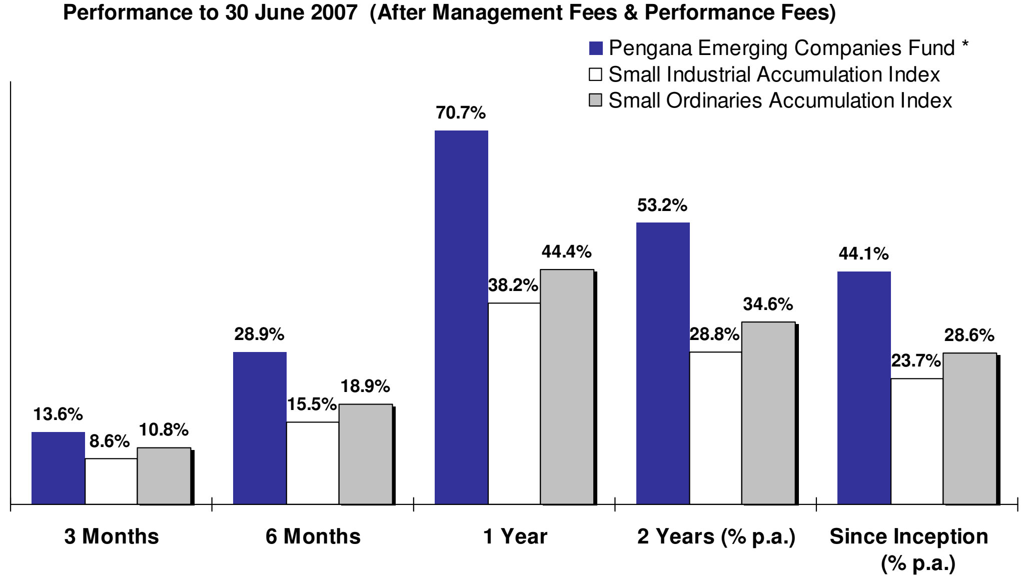
Dexion (DEX) is the largest domestic supplier of pallet racking for retailers and logistics players. In recent times the company has expanded its offering to include systems which control warehouse flows, and has also moved into commercial office furniture (primarily storage). To date management has acquired sensibly, and further acquisitions are likely. The outlook for the sector is strong based on increased focus on efficient supply chains, and outsourcing logistics to third parties such as Linfox and Toll Holdings. Dexion also has an operation in Malaysia which services customers in Asia and the Middle East. The stock trades on a PER of around 10x CY08.

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 72 companies and unlisted competitors of listed stocks. The table below shows the listed companies with which we had direct contact during the period.

ABB Grain	IM Medical	Rubicor
Acuron	Impact Capital	Ruralco
ARB Corp	Incitec Pivot	Slater & Gordon
ASG Group	Intrapower	SMS Mgmt
Aust'n Wealth	IWL Ltd	Spark Infrastructure
Automotive Holdings	IWL Ltd	Specialty Fashion
Avastra	MacMillan Shakespeare	Staging Connections
Becton	Macquarie Leisure	Structural Systems
Bluechip Financial	Mariner Financial	Style
Cabcharge	MFS Leisure	Swick Mining
Calliden	Mineral Resources	Tattersalls
Campbell Bros	Mitchel Comms	Telepacific
Commoditel	MYOB Ltd	TFS Corp
Dexion	Neptune Marine	Thinksmart
DKN Group	Norfolk	Timbercorp
Dolomatrix	NRW Corp	Transfield Infrastructure
Duet	Oakton	Trust Co
Entertainment Media	Oroton	Tutt Bryant
Fleetwood	Paladio	UCMS
FSA Corp	Plan B	UXC Ltd
GCS Group	Programmed Maintenance	VDM Group
Greencross	Quay Magnesium	Wattyl
Hastings Diversified	Radio Rentals	
Hyro	RAMS Home Loans	
IINet	Reject Shop	

Performance to 30 June 2007 (After Management Fees & Performance Fees)



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

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