



March 2008 Quarterly Review

The March quarter was the worst for the Australian share market since December 1987. Since the market peak in November 2007, the industrial Smallcap benchmark has fallen 27%, with our fund falling 29%. The March quarter was tougher, with our fund underperforming the industrials by 6.3%. While we avoided high profile blow-ups such as Allco, ABC Learning, MFS, Credit Corp etc, our fund has suffered at the margin from indiscriminate selling in some of the smaller stocks we own. For perspective, since inception over three years ago, our fund has outperformed the industrial smallcap sector in 32 of 41 months. The fund has now outperformed the Small Industrials Index by 72% since inception on 1 Nov 2004, which annualizes at 14.8% pa.

The market is currently being dominated by negative sentiment, with valuations at record lows. This has opened up very attractive medium term opportunities in the sector.

Total return performance for periods ending 31 March, 2008

	3 mths	1 yr	2 yrs p/a	3 yrs p/a	Since inception p/a*
Pengana Emerging Companies Fund	-27.5%	-13.9%	15.4%	21.1%	22.7%
S&P/ASX Small Industrials Acc Index**	-21.2%	-20.3%	-0.6%	7.6%	7.8%
Outperformance	-6.3%	6.5%	15.9%	13.5%	14.8%
S&P/ASX Small Ordinaries Acc Index	-15.3%	-7.6%	8.6%	15.7%	15.3%
Outperformance	-12.2%	-6.2%	6.7%	5.4%	7.3%

* 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 both management fees and performance fees, and assumes reinvestment of income.

Market backdrop

The ASX200 fell nearly 16% during the March quarter, the worst quarterly performance since the stock market crash of 1987. No sectors were spared from the volatility although the Small Resources Index did fare better than most falling only 3.4% compared with the Small Industrials Index's fall of 21.2%, and small micro caps that are not included in the Small Industrials index fell a lot further. Company earnings season dominated news flow in February. Overall results came in around expectations although the market was very sensitive to surprises or significant shifts in outlook statements.

Key stock moves during the quarter

Key successes during the period included **ARP Corp**, **Ausenco**, **Cabcharge**, and **Dexion**. Key detractors were **CSG Group** and **HFA Holdings**.

The common theme amongst all four positive contributors for the quarter was the quality of their profit results reported during the period. **Cabcharge's** competitive position within the taxi market is near unassailable and with the continual migration from cash to electronic payment as the preferred means of paying for cab fares Cabcharge should continue to grow earnings at rates of 10%-15% for many years to come. **Dexion** had seen its share price fall quite dramatically in the lead up to its profit release and a good result saw buyers return to the stock. **ARP Corporation's** profit continued to demonstrate the value of its brand with

earnings growing by 20%, a rate not too dissimilar to that which it has achieved over the last 10 years. In addition to a solid result **Ausenco** also announced the acquisition of

three businesses over the quarter which provide beach heads for further expansion into North and South America.

CSG Group's share price fell almost 50% over the quarter despite delivering a result above market expectations followed by a separate announcement upgrading the market's profit expectation for the full year. The severe derating of the stock surprised us, leaving the stock on a PE of 9 times, which in our view dramatically undervalues a high quality earnings stream. **HFA's** share price fell 45% as the market aggressively sold down all stocks with exposure to the financial services sector. HFA is a specialist fund manager that continues to attract a solid level of retail inflows into its funds (despite the market's malaise) and has delivered fund performance materially better than its peers. In terms of valuations it currently trades on a PE ratio of only 6 times next years earnings, which looks unsustainably cheap to us. In the current volatile market these are two examples of the valuation anomalies occurring that has presented the fund with very good buying opportunities. We have added to our holding in both of these companies in recent times.

Portfolio activity

During the period, we reduced our exposure to the financial services sector after changing our valuations to allow for the effect that the fall in the stock market would have on the earnings of many of these stocks. We increased our weighting to many quality names in our portfolio where we remained very comfortable with the financial strength of the company and its earnings prospects. Companies that fit into this category include: **CSG Group, Tox Free Solutions, The Reject Shop and Cardno.**

Top 5 positions in the fund
CSG Group
Fleetwood
Mac Services
Mineral Resources
McMillan Shakespeare

Outlook

Whilst market instability continues we firmly believe that the Pengana Emerging Companies Fund is well positioned to ride out these difficult times. From here, it is difficult to imagine sentiment getting any worse, and we expect earnings and valuations to resume their role in stock performance during the coming 3-6 months.

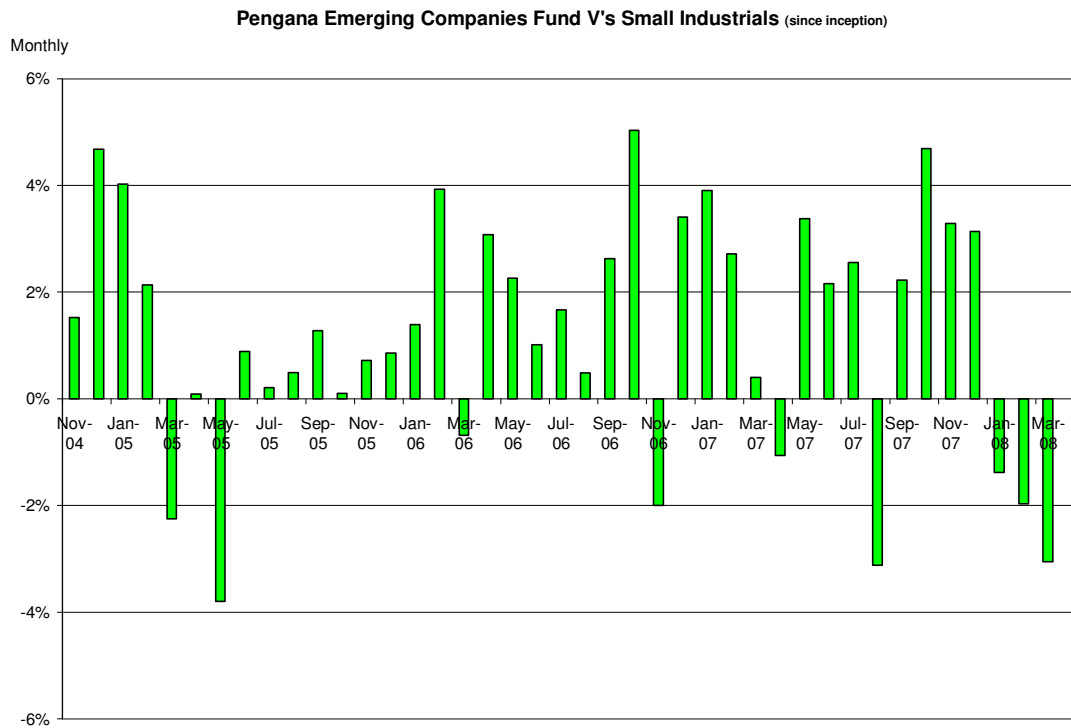
Assuming short term volatility continues, the fund has many defensive qualities that should provide comfort:

- The forward **PE ratio is 10 times 2009** earnings (v's the Small Industrials long term average of around 13 times);
- The expected **dividend yield for 2009 is over 6%** (mostly fully franked);
- **Only 15% of the fund is invested in companies with corporate debt** (ie where the interest cover is less than 10 times);
- There are no loss making companies in the fund; and
- The fund does not own resource stocks

Most encouragingly is that the fund **successfully avoided holding the worst performing stocks** in the market over the quarter. With each of these stocks we have spent time with management.

Markets worst performing stocks over the quarter	
Allco Finance Group	- 92%
Credit Corp	- 81%
MFS	- 78%
ABC Learning	- 73%
Flexigroup	- 73%
City Pacific	- 67%
Challenger Group	- 64%

Each of these companies has suffered from having excessive levels of debt and/or running business models that are not transparent and thus difficult to model and value. The value of our investment philosophies and stock selection process is best demonstrated by the below chart which tracks the relative performance of the fund to the Small Industrials index on a monthly basis since inception on Nov 1, 2004. We are encouraged by the consistency of the fund's performance where over the 41 months on only 9 occasions has the fund underperformed the Small Industrials Index.



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

Ambition	DWS	Oakton
Ammtec	Fantastic Furniture	Peoplebank
APN Property	FKP Ltd	Plan B Financial
ARB Corp	Fleetwood	Probiotec
ASG Group	Flight Centre	Reckon
Ausbrokers	Freightways	Reject Shop
Ausdrill	Global Construction	Reverse Corp
Ausenco	GBST	Saferoads
Austin Engineering	Greencap	seem.com.au
Australand	Healthscope	Sigma
Australian Wealth	HFA Ltd	SMS Mgmt
Auto Holdings	Imdex	Spark Infrastructure
Bradken	Industrea	Structural Systems
Brierty	Intrapower	Style Ltd
BSA Ltd	Keybridge Capital	Talent Two
Burrup Fertilizers	Kresta	Tassal Group
Cabcharge	Logicamms	Thinksmart
Cardno	M2 Communications	Toxfree Solutions
Commquest	Mac Services	Transfield Services
Comops	MacMahons	Transpacific
Coote Engineering	MacMillan Shakespeare	Treasury Group
Count	Mainfreight	Webjet
CPT Global	Mariner Financial	Welcomm
CSG Group	McPhersons	WHK Group
Duet	Mineral Resources	Wridgways
Dexion	Neptune Marine	
DKN Group	Nomad	

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

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