

Pengana Emerging Companies Fund

November 2008 Update



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Australian Equities - Small Caps

Fund Performance

Net performance for periods ending 30 November 2008 ¹							
	1 month	3 months	6 months	1 year	2 years p.a.	3 years p.a.	Since inception p.a. ²
Pengana Emerging Companies Fund	-12.2%	-34.8%	-38.4%	-54.3%	-18.2%	-0.4%	+6.3%
S&P/ASX Small Industrials Acc Index ³	-9.8%	-36.9%	-41.6%	-55.5%	-27.9%	-13.8%	-6.4%
Outperformance	-2.4%	+2.1%	+3.2%	+1.3%	+9.7%	+13.5%	+12.8%
S&P/ASX Small Ordinaries Acc Index	-9.6%	-42.2%	-50.6%	-56.1%	-26.0%	-10.5%	-3.5%
Outperformance	-2.6%	+7.4%	+12.3%	+1.8%	+7.8%	+10.1%	+9.8%

Fund Commentary

Global markets continued to slide in November as the economic outlook deteriorated. The weakness was widespread with the Dow Jones off 5.3%, All Ords down 7.8%, commodity prices under pressure and the Small Ords off 9.7%. BHP's decision to abandon the RIO takeover, and RIO's subsequent cost-cutting program further dented investor's confidence. Domestic companies continued to raise equity to repair balance sheets, especially in the Banking and Property sectors, which created pressure as investors sold other stocks to fund the raisings. This trend is likely to continue as banks reassess lending criteria which has dramatic implications at the company specific level (more on this below). Our fund fell slightly more than the market in November (2.6% below), however over a 3 and 6 month view, our defensive stance has insulated the portfolio from the worst of the market's falls. **Since the fund was opened four years ago, and not withstanding recent weakness, it has generated a positive return of 6.3% p.a., a strong 9.8% p.a. above the Small Ordinaries Index and 12.8% p.a. above the Small Industrials Index.**

Key stock price moves

Key successes included Greencap up 12%, Resmed (9%), Webjet (8%), RCG Group (4%), and Slater & Gordon (4%). Key detractors were mining services stocks such as Ausenco down 46%, Fleetwood (-33%), and Structural Systems (-31%). We had been quickly reducing our exposure to this sector however were not fully protected from the pain. Other stocks caught up in the volatility were Oroton down 27%, CSG Group (-25%) and Duet (-21%).

Market Commentary and Outlook

The relentless bad news and volatility of this year has removed any sense of optimism, and shortened investor time horizons from years to days. While we do not underestimate the risk to earnings, we firmly believe those with a medium term outlook will benefit greatly from a low risk exposure to quality smallcap industrial shares. The likelihood of a global and domestic recession seems reasonable, however the chances of the market now being "blindsided" by a recession is very small. The 44% fall in the All Ords and 60% fall in the Small Ords shows that on most measures share prices are already implying a 30-50% drop in earnings.

However, given the parlous state of many balance sheets, and credit rationing by the banks, active stock picking has rarely been as important. Thankfully we have always been averse to highly geared companies which has served us well during 2008. Not only have there been companies collapse (e.g. ABC Learning), we are seeing deeply discounted capital raisings in the current market (e.g. Incitec Pivot, Bluescope, Transfield Services, the listed property sector) where changing debt markets have created major losses for shareholders. To further understand this dynamic, we have spent time meeting with large domestic lenders and talking again to management teams about their balance sheets and refinancing timetables. Our conclusions at this stage are that refinancing risk remains very high, no-one can be sure the extent to which the tighter credit conditions are due to short term debt market dislocation versus structural changes,

¹ Net performance figures are shown after all fees and expenses, and assume reinvestment of income. Past performance is not a reliable indicator of future performance.

² Since November 2004

³ The fund does not invest in resource stocks.

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banks are far from complete in repositioning their portfolios and borrowers have far less choice as many international banks have withdrawn from Australia. Therefore many companies are yet to face the issue, and unfortunately we expect significant value destruction in some stocks over 2009 as a result.

Understanding how this affects individual companies is absolutely critical given how much it can affect share prices. On the flipside, of course, we need to be prepared to capitalise on any stocks which are forced to raise equity cheaply, as this often provides an opportunity to get set in a stock at a low price, with a repaired balance sheet. Less than 25% of our portfolio is invested in stocks with interest cover of under 10x (if we exclude regulated utilities companies which have highly certain income and therefore can sustain higher long term gearing). In other words the majority of our stocks either have no debt or are very conservatively geared and we will monitor this very closely.

We remain heavily invested in companies with low levels of economic sensitivity such as Sonic Healthcare, Slater and Gordon, Probiotec, Austbrokers, Reject Shop and Metcash which will continue to insulate the portfolio from the economic uncertainty. Valuations are at historically low levels, and once the volatility settles we expect investors to steadily refocus on valuations and quality business models throughout 2009. With the rapid decline in interest rates, the marginal investor will soon wake up to the negative return on cash (after tax and inflation), and appraise the returns available in high quality, appropriately geared companies.

Top 10 Positions (in alphabetical order)	
Austbrokers Holdings	Probiotec
CSG Group	Resmed
Fleetwood	Sonic Healthcare
McMillan Shakespeare	The Reject Shop
Metcash	Tox Free Solutions

Fund Description

The Pengana Emerging Companies Fund combines the skills of highly experienced small company investors (collectively 30 years experience) and a limited fund size with the objective of providing above market returns over the medium term. Our benchmark is the S&P/ASX Small Ordinaries Accumulation Index. The fund managers Steve Black and Ed Prendergast are part owners of the business and investors in the fund, providing a strong incentive to perform. The Fund has strong research ratings from all major research houses and over the period since its inception has delivered returns well above benchmark.

Fund Features

Style	Bottom up stock picker	Management Fees	1.3325%
Benchmark	S&P/ASX Small Ordinaries Accumulation Index	Performance Fees	20.5% of the performance above the Benchmark
Investors	Open to Retail Clients	Fund Raising	Maximum of 0.5% of the Benchmark capitalisation
Minimum Initial Investment Amount	A\$25,000 (direct)	FUM at Month End	A\$ 190m
Inception Date	1 November 2004	Application Price at Month End	A\$ 1.1073
Identification Codes	APIR PER0270AU ARSN 111 894 510	Redemption Price at Month End	A\$ 1.1007

Contact Details

Pengana Capital Limited • Level 29, 20 Bond Street, Sydney, NSW 2000, Australia • T +61 2 8524 9900 • F +61 2 8524 9901
ABN 30 103 800 568, AFSL 226566

For further information, please visit our website at www.pengana.com or contact:

Institutional Clients: Denis Carroll, +61 2 8524 9974, denis.carroll@pengana.com
Private Clients: Juliet Dunworth, +61 2 8524 9984, juliet.dunworth@pengana.com
Advisors & Retail Clients: Justin Brooks, +61 3 8663 7906, justin.brooks@pengana.com

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