

Pengana Emerging Companies Fund February 2009 Update



Australian Equities - Small Caps

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Fund Performance

Net performance for periods ending 28 February 2009 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	-1.7%	-3.9%	-37.4%	-43.6%	-25.9%	-5.1%	+5.1%
S&P/ASX Small Industrials Acc Index ³	-10.3%	-13.5%	-45.4%	-51.5%	-35.3%	-19.2%	-9.3%
Outperformance	+8.6%	+9.5%	+8.0%	+7.9%	+9.4%	+14.1%	+14.4%
S&P/ASX Small Ordinaries Acc Index	-6.7%	-7.4%	-46.5%	-53.1%	-31.2%	-14.8%	-5.1%
Outperformance	+5.0%	+3.4%	+9.1%	+9.5%	+5.3%	+9.7%	+10.2%

Fund Commentary

Our risk averse strategy continues to protect the fund from some of the market volatility. While global markets tumbled further in February, including a 10%+ fall in the Small Industrials, our fund only fell 1.7%. Global economic indicators have worsened, and the impact of credit rationing is now starting to impact certain stocks very badly, with no signs of abatement in the short term. As we remain averse to economically sensitive stocks the recent results season was fairly benign for most of our stocks.

While some smallcaps have fallen by 80%+ and appear enticingly cheap, unless there is some certainty around earnings, and a low risk balance sheet, we will not be tempted. Should earnings come under further pressure and/or difficulties in refinancing emerge, these "value traps" can prove highly costly for the inexperienced investor.

Our portfolio largely comprises defensive business models which can grow. In fact, the medium term growth potential on some of our stocks is very sound, however the market right now is very short term focussed, hence this potential is not currently being rewarded. Lower volatility at some point will bring investors back to a medium term focus which should greatly benefit these stocks assuming the management teams deliver.

While the past year has been a disaster for markets, history shows that equity markets recover well ahead of the economy, and that smallcaps tend to outperform into such a recovery. Given the cheap valuations and universally poor sentiment, once a recovery emerges it is likely to surprise investors in speed and size. Many of the stocks which we own could conceivably trade at 2-3 times current prices given a return to "normal" sentiment. In the meantime we believe our aversion to risk will give our investors a less bumpy ride compared to the market.

Key stock price moves

Key successes included Thinksmart up 100%, ASG Group up 39%, MacMillan Shakespeare up 28%, Fleetwood up 20% and JB Hifi up 16%. Key detractors were Duet down 24%, Sonic Healthcare down 14%, Spark Infrastructure down 11%, and Transfield Services down 7%.

Market Commentary and Outlook

Despite the further leg down in markets recently, our outlook has not changed. The two key risks to avoid right now are companies whose earnings are susceptible to a rapidly contracting economy, and those with shaky balance sheets. The recent results period highlighted these two risks across the board. The most obvious examples of this in large caps were found in such stocks as Boral, Fairfax, and Leightons where share prices were hit very hard. Interestingly, the warning signs on such stocks were fairly obvious (deteriorating earnings outlook and in some cases stretched balance sheets). Therefore, assuming the bad news is already in the shareprice is clearly a dangerous and complacent action to take.

Risk aversion need not, however, imply resignation. Our view is that defensive stocks must also show some capacity for growth, and must equally be reasonable value. For example healthcare stocks are defensive in that they are not tied to the economy,

¹ Net performance figures are derived from Manager's records and are shown after all fees and expenses, and assume reinvestment of income. Past performance is not a reliable indicator of future performance. The value of investments can go up and down.

² Since November 2004

³ The fund does not invest in resource stocks.

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however the stocks we own also show solid avenues for growth (Sonic Healthcare via acquisitions, Resmed through 15-20% industry growth and new products, Ramsay Healthcare and Healthscope through expansion of existing hospitals). Other defensive industries (and stocks) include industrial waste (Toxfree), insurance broking (Austbrokers), accounting services (WHK Group), and grocery retailing (Metcash).

Some stocks actually benefit from a contracting economy such as Dominos Pizza (as consumers look for a cheaper meal option), The Reject Shop (shoppers looking for lower price points), Navitas (higher demand for tertiary education due to fewer employment opportunities for school leavers), and Slater & Gordon (legal actions can increase in recessions).

The single best long term investments in small caps are made by backing capable management teams who are able to grow a business rapidly and conservatively in any circumstance. Obvious examples of this in the past are Toll Holdings, Cochlear and Flight Centre. In the current market which is obsessed with short term factors, stocks with very sound medium term growth potential are being ignored. This has allowed us to build positions in stocks which, over the coming 2-3 years have excellent upside potential from current very cheap prices. Time will tell if the management teams deliver, but we remain highly confident.

As short term volatility remains high, so does the risk of being in the wrong stocks. We are currently avoiding stocks with earnings and balance sheet risk, but are heavily exposed to lower risk defensive and growth stocks which we believe should not only protect capital, but provide strong medium term upside for the patient investor.

Top 10 Positions (in alphabetical order)	
Austbrokers Holdings	Resmed
Austar	Sonic Healthcare
CSG Group	The Reject Shop
McMillan Shakespeare	Tox Free Solutions
Ramsay Healthcare	Transfield Services

Fund Description

The Pengana Emerging Companies Fund combines the skills of highly experienced small company investors (collectively 30 years experience) with a limited fund size to provide 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	Fund Raising	Maximum of 0.5% of the Benchmark capitalisation
Minimum Initial Investment Amount	A\$25,000 (direct)	FUM at Month End	A\$ 174m
Inception Date	1 November 2004	Application Price at Month End	A\$ 1.035
Identification Code(s)	APIR PER0270AU ARSN 111 894 510	Redemption Price at Month End	A\$ 1.029

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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