Pengana Emerging Companies Fund
June 2010 Quarterly Review

Fund Performance

Net performance for periods ending 30 June 2010 [1]

	3 months	6 months	1 year	3 years p.a.	5 years p.a.	Since inception p.a.[2]
Pengana Emerging Companies Fund	-8.9%	-6.1%	36.4%	-8.3%	12.6%	13.4%
S&P/ASX Small Industrials Acc Index [3]	-12.8%	-14.0%	10.3%	-18.1%	-1.8%	-0.6%
Outperformance	**3.9%**	**7.9%**	**26.1%**	**9.8%**	**14.4%**	**14.0%**
S&P/ASX Small Ordinaries Acc Index	-11.6%	-13.0%	11.2%	-14.2%	2.7%	3.8%
Outperformance	**2.7%**	**6.9%**	**25.2%**	**5.9%**	**9.9%**	**9.6%**

Fund Commentary

The Fund fell 8.9% over the June quarter, outperforming the Small Ordinaries Index by 2.7% and the Small Industrials Index by 3.9%. **For the 12 months to June, the Fund returned 36.4% (after fees), which was 25.2% above the Small Ordinaries Index and 26.1 % above the Small Industrials Index.**

The June quarter saw a sharp retracement in markets as concerns again surfaced as to the speed of the global economic recovery. In particular recent patchy economic data out of the US suggests its recovery may be losing momentum and lower growth expectations out of China are raising concerns. In addition the indebtedness of European countries has again reared its head adding to the general level of nervousness. We believe the risks of a global "double-dip" into recession are overstated, as Governments around the world have collectively taken steps to repair the excesses of the previous cycle and stimulate the current one. What is becoming clear however is that the time for these actions to bear fruit will take longer than many had hoped.

In Australia the Government's proposed Resources Super Profits Tax (RSPT) compounded the general anxiety leading to the Australian market underperforming global indices. Whilst the RSPT dominated the headlines over June our principal concern was the repercussions for industrial companies that service the mining industry[3]. Whilst agreement between the Government and the mining industry appears likely we still believe there will be delays to new mining projects whilst the details are finalised. The mining service companies most exposed are those that rely on shorter term project work which we typically avoid.

Against this backdrop of market nervousness investors have been selling higher risk beta stocks and companies with cyclical exposure. Fortunately our process of stock selection tends to direct us to companies with predictable earnings streams that are less exposed to the whims of economic cycles and accordingly the Fund was less buffeted through both the worst of the GFC and over the recent quarter.

After the recent selloff in markets the Small Industrial market Price Earnings Ratio (PE) is trading back to around 11.5 times 2011 earnings compared to the longer term average of greater than 13.5 times. Our view is that at current levels the market represents excellent value for those investors taking a three to five year view.

Recent portfolio activity

New stocks added to the portfolio over the quarter included **Miclyn Express Offshore, Breville Group** and **Australian Infrastructure Fund.**

Miclyn Express Offshore is a vessel operator to the offshore oil and gas industry. After listing in March this year at an issue price of $1.90 the share price fell sharply. At around $1.45 we bought into the stock. At these levels Miclyn trades on a PE of around 5.5 times, a valuation we believe is very attractive given the predictability of their income stream that comes from having serviced many of their customers for over 20 years. A holding in **Breville Group** was also recently purchased. In the US Breville is now enjoying strong retailer support for their high end kitchen appliances, leading to underlying sales growth of 28% in the first

[1] All performance figures are calculated net of fees and assume reinvestment of income distributions. Past performance is not a reliable indicator of future performance.

[2] Since November 2004

[3] The Fund does not invest in resource stocks.

half of 2010. **Australian Infrastructure Fund** part owns a portfolio of domestic and international airports, including Melbourne and Sydney. This wonderful set of infrastructure assets provides both a defensive income stream and growth as global patronage of airlines continues to increase. The recent share price fall enabled us to enter the stock at what we think is an attractive price.

In addition we increased our weighting in **McMillan Shakespeare, Talent Two, Mastermyne Group** and **Flight Centre** after gaining greater confidence in their prospects. We reduced our weightings in **Navitas** and **Customers** as their share prices approached our valuations.

We sold our holdings in **Skilled Engineering, Premier Investments** and **Specialty Fashion.** We became increasingly nervous with Skilled Engineering after the departure of their CEO and appointment of Goldman Sachs JB Were to undertake a strategic review. Early in the quarter we sold the balance of our holdings in Premier Investments and Specialty Fashion after revising down our valuations to take account of what we expect to be a very difficult trading period following the removal of the Government sponsored stimulus and higher interest rates.

Key stock moves during the quarter

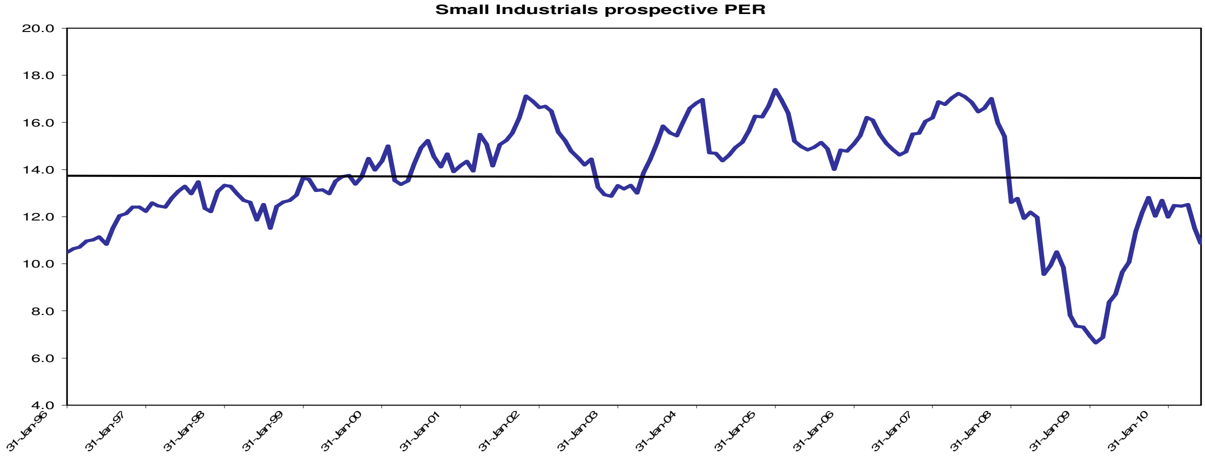
Key successes in the portfolio during the period included **McMillan Shakespeare (up 38%), Mineral Resources (up 9%), Thorn Group (up 12%)** and **Matrix Composites' (up 10%).**

McMillan Shakespeare was rerated by the market after announcing they had purchased a motor vehicle operating lease business, Interleasing. This acquisition has given the company a new arm for growth and improves the product offering for existing customers of the Group. **Mineral Resources'** shares bounced after the market digested the importance of securing the iron ore stockpiles of Polaris Metals which the company successfully acquired. **Thorn Group** announced a profit result that exceeded market expectations during the quarter and **Matrix Composites** share price was positively rerated after announcing the raising of capital to fund the expansion of their manufacturing facility n WA.

The laggards included **Transfield Services (down 23%)** and **DKN Financial Group (down 26%). Transfield Services** performed poorly despite reiterating its full year guidance and announcing the winning of some large maintenance contracts. The share price appears to have reacted to a slight paring back by analysts of their 2011 profit numbers. **DKN Financial** drifted back after rising solidly in the previous six months as Count Financial become a substantial shareholder. The market had been hoping for a takeover bid that has yet to eventuate.

Outlook

Despite the global macro concerns probably leading to a lower growth outlook in the short term we firmly believe markets to represent good value at present. The current forecast PE of 11.5 times for the Small Industrials compares favourably with the average of 13.7 times since January 1996. This discount seemingly provides a sufficient buffer for any near term earnings downside resulting from any cautionary outlook comments by management over the August reporting season. It is worth noting that the weighted average PE of the stocks in our Fund is around 11 times, and over 40% of the Fund is invested in stocks with a single digit PE multiple – a rare occurrence in our 15 year history of investing in small cap stocks.



The upcoming reporting season is likely to see downgrades to 2011 analyst expectations. At present 2011 profit growth for small industrial stocks is expected to be in the vicinity of 15-20% - this may prove too great a task given the recent softness in economic conditions both domestically and abroad. Leading Australian indicators such as finance commitments and building approvals for housing and non-residential construction are all suggesting slower activity levels than had been previously expected.

As long as growth does not collapse in 2011, which we doubt very much, and earnings forecasts are trimmed rather than slashed we think small industrial stocks are well placed to deliver meaningful profit growth over the next few years.

Over the 18 month period between early 2008 and late 2009 earnings of small industrial companies fell by around 30%, so that the current level of earnings are already at depressed levels. This coupled with the many changes implemented by corporate board rooms across Australia has led to aggressive cost cutting, improved management practices and enhanced balance sheet quality for small industrial companies. As the economy improves our view is that analysts are likely to be pleasantly surprised as to the extent of the improved operating leverage and corresponding profit growth that small caps will deliver.

At a stock level we remain concerned with some mining service companies (as highlighted earlier) and certain retail stocks. Retail stocks will face the headwind of higher interest rates on household spending and the withdrawal of Government stimulus pumped into the economy though the first six months of 2009. Shorter term we are a little nervous with the profit results that some of the specialty retail stocks are about to report. During 2009 retailers received an enormous free kick from the Government sponsored cash handouts to consumers, forming part of the Government initiated stimulus program, which acted to cushion the effects of the economic downturn. Whilst not as obvious at the time it is now abundantly clear that much of this handout ended in shop cash registers. This year, without these handouts, profit growth will be muted. That said we would see a retracement of share prices as a potential buying opportunity.

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 **direct contact (one on one) with 54 companies** and unlisted competitors of listed stocks. The table below shows the listed companies with which we had direct contact during the period.

ARB Corp	Equity Trustees	Photon
ASG Group	Firstfolio	Port Bouvard
Ausdrill	Flexirent	RCG Corp
Australia Infrastructure Fund	Forge Group	Realestate.com
AV Jennings	IPGA	Redflex
Bradken	ISS Group	Restaurant Brands
BT Investment Management	Keycorp	RP Data
Campbell Brothers	Ludowici	Salmat
Capral	M2 Telecommunications	Seek
Charter Hall	Matrix Composites	Slater and Gordon
Codan	McMillan Shakespeare	Talent Two
Connxion	Melbourne IT	Thakral
Coretrack	Mermaid Marine	Thinksmart
CSG Group	Michael Hill	Thorn Group
Customers	Miclyn	Virgin Blue
Devine	Myer	VMG Group
Dulux	Oakton	WDS Holdings
DWS Holdings	Oroton	Wellcom Group

Fund Description

The Pengana Emerging Companies Fund seeks to combine the skills of highly experienced small company investors (30 years experience between the two fund managers) 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[1].

Fund Features

Style	Bottom up stock picker	**Management Fees** [4]	1.3325%
Benchmark	S&P/ASX Small Ordinaries Accumulation Index	**Performance Fees** [4]	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**	$371m
Inception Date	1 November 2004	**Application Price at Month End**	A$ 1.6723
Identification Code(s)	APIR PER0270AU ARSN 111 894 510	**Redemption Price at Month End**	A$ 1.6623

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[4] All percentages are on a GST inclusive basis less applicable reduced input tax credits. Please refer to the Product Disclosure Statement for a more detailed explanation.