

Pengana Emerging Companies Fund

15 takeover offers in four months is telling us something



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CAPITAL

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September, 2010

Dramatic increase takeover activity

Over the past few months, there has been a dramatic increase in takeover activity in domestic smallcap stocks. Since May there have been fifteen takeover offers announced in smallcap industrial stocks in Australia, which is a sign that longer term investors see value in the sector, have access to funding, and are confident enough to do deals.

This significant theme has been largely overshadowed by the global economic uncertainty of late. We do not invest in stocks solely based on corporate appeal, however such activity is often a catalyst for stocks where value is being ignored due to extreme short term focus. Below we discuss recent activity and what it might be telling us about markets in general.

Recent smallcap industrial deals announced

Stock	Bidder	Approx size of deal (equity)
Aevum	Stockland	\$320m
Ammtec	Campbell Bros	\$145m
AWB	Agrium	\$1.2bn
Boom Logistics	Private equity	\$200m
Dexion	GUD Holdings	\$100m
Healthscope	Private equity	\$1.7bn
Keycorp	Archer	\$45m
Mitchell Communications	Aegis Group	\$380m
Prime Infrastructure	Brookfield Infrastructure Partners	\$1.6bn
Redflex	Macquarie Bank	\$260m
Ross Human Directions	People Bank	\$60m
Sigma Pharmaceuticals	Aspen Pharmaceuticals*	\$600m
Tutt Bryant	Tat Hong	\$135m
Wridgways	Santa Fe Holdings	\$90m
Wattyl	Valspar	\$140m

* This deal was subsequently amended where Aspen acquired half of Sigma's operating businesses.

Key messages from this activity

Corporate balance sheets generally appear to be in good condition. Throughout 2009 there was a large amount of capital raised by listed companies in the fear that debt markets would remain closed for longer. Based on recent balance sheets, the top 500 listed companies in the US have US\$890bn in cash, which is up 26% over 12 months.

Funding channels are open again. In the meantime, debt markets have opened up again, with demand for corporate bonds increasing as risk averse investors focus on yield markets, and are faced with historically low government bond yields. Recently, IBM raised US\$1.5bn in 3 year bonds at a 1% yield which illustrates healthy demand despite low yields.

Private equity may also be funded. After struggling to access finance during the GFC it seems anecdotally that well structured deals will gain bank support. For example, Healthscope was recently taken over with the bidding group accessing \$1.2bn of debt.

Corporate confidence is generally increasing. Boardroom sentiment was severely hit during the GFC, with non-executive directors reluctant to approve any perceived risky venture. The primary focus became cash preservation and balance sheet repair. Now we appear to be 18 months past the worst of this sentiment, with non-executives prepared to appraise growth opportunities and approve deals to facilitate this growth.

Longer to medium term investors are seeing value in the market. Investors globally have been so heavily scarred by the GFC that investment horizons have shortened dramatically. The Small Industrials is still 47% below its pre GFC peak, and valuations are well below long term averages. Clearly investors are reluctant to price in too much medium term earnings growth potential. On the flipside, corporates and private equity take a much longer term view, and are clearly seeing value given the recent uptick in corporate activity.

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Pengana Emerging Companies Fund



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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 and an 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	Fund Raising	Maximum of 0.5% of the Benchmark capitalisation
Minimum Initial Investment Amount	A\$25,000 (direct)	FUM at Month End	A\$402m
Inception Date	1 November 2004	Application Price at Month End	A\$ 1.7368
Identification Code(s)	APIR PER0270AU ARSN 111 894 510	Redemption Price at Month End	A\$ 1.7264

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