

October 2011

Market Communication





INVESTMENT MANAGERS
Wealth is nothing without wisdom

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CEO's Prologue



Dear Investor,

The cheer surrounding the festival season was apparent among investors as market indices showed recovery in the month of October after a 3 month losing streak. The Nifty posted a gain of 7.76%, while the gains in the mid and small cap segment remained relatively limited with the BSE Midcap and BSE Smallcap indices moving higher by 2.75% and 1.36%. Foreign flows remained muted for the month with net inflows of USD 350 mn.

All major global markets posted gains during the month led by Russian RTS, Hang Seng, German Dax and Brazil Bovespa all posting more than 10% gains. The agreement of European Union countries on the bailout package for the nations in distress came as a relief to the global markets towards the end of the month. The domestic market continued to take strong cues from the movements in global market indices.

Among the domestic sectoral indices Auto and IT sectors led the pack, moving higher by 11.5% and 10.5% respectively. The announcement of 2nd quarter results helped sentiments as the numbers from index heavy weights were overall on the expected lines with no major disappointments.

Inflation continues to remain stiff as the data for September stood at 9.7%. The interest rate hike by 25 bps by the RBI in its October credit policy did not come as a surprise as the inflationary pressures do not exhibit any signs of abating so far. However, the Central Bank mentioned that the inflation could ease down to 7% by March 2012. High global oil prices continue to exert tremendous pressure on the Indian economy and there are already talks of another round of hike in petrol and diesel prices, which can be a dampener for the inflationary outlook going forward.

Currently the markets are trading a forward P/E of around 16 based on expected FY12 Sensex earnings which is lower than its long term average of 18.7. We believe that it would be wise for an investor to build the equity book during times of distress when the valuations are low and the noise is high. All the same, we also believe that getting the timing right is a futile exercise and entering the market in various tranches can prove to be a good risk mitigating measure. *"The biggest bull markets are born out of the highest pessimism".*

Regards,

Sameer Kamdar
CEO & Managing Director



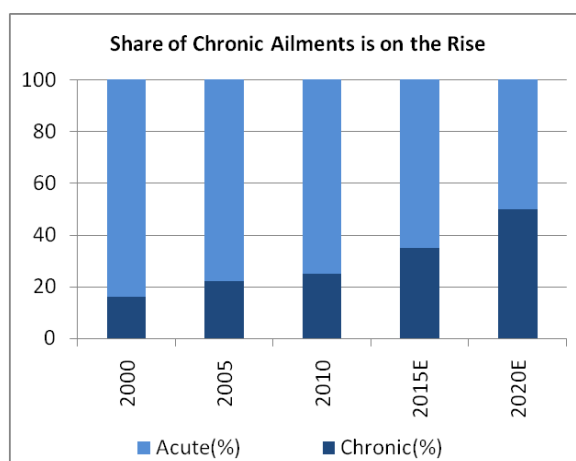
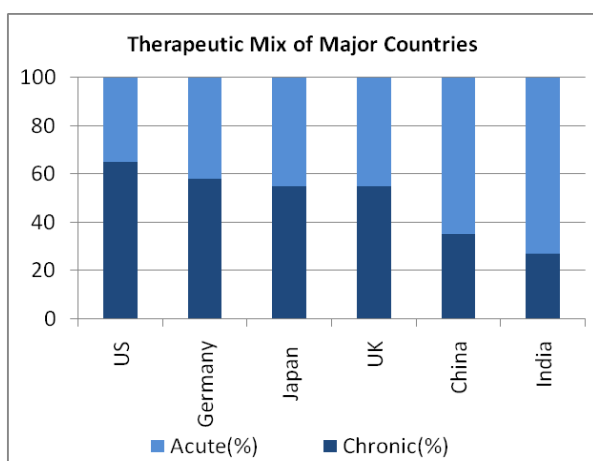
Therapy for Chronic Diseases to be the Growth Driver for Indian Pharma Companies

Background

The global pharma market stood at \$856 bn in 2010. According to IMS Health, the Pharmaceutical Market in India grew by 16% to reach \$12.3 bn in 2010 and is expected to be around \$20-22 bn by 2015 and \$55 bn by 2020. Globally, the Indian pharmaceutical market ranks 10th in terms of value and third in terms of volume.

Changing disease profile to heighten demand for chronic therapies

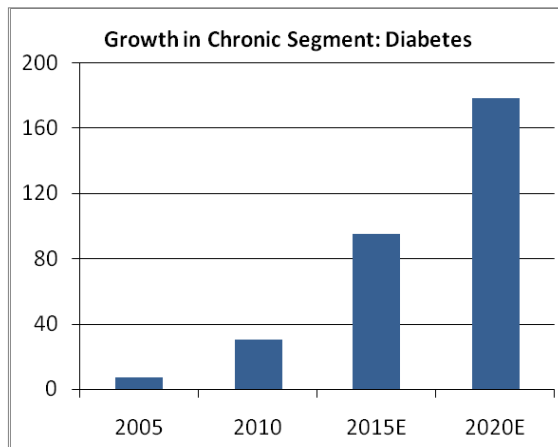
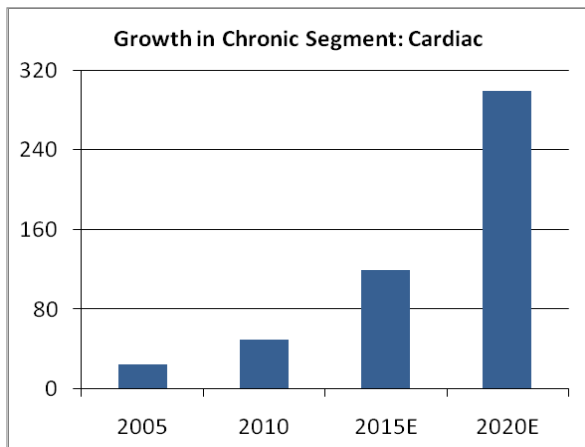
Due to relatively poor sanitation conditions, drugs addressing infectious diseases are predominant in developing countries when compared to developed countries. India is one of the fastest growing pharma markets due to several factors such as rising disposable incomes, growing insurance penetration, greater life expectancy and an increased rural opportunities. India is undergoing a transition in terms of its disease profile. Traditionally, drugs related to acute diseases such as anti malarial, anti-bacterial, cough & cold and pain management etc. have held a significant share of the Indian Pharmaceutical market. The acute segment, which is already quite large, is growing in double digits. The chronic market, on the other hand, is relatively small but is on a rapid growth path. The higher incidence of chronic diseases such as diabetes, cardiovascular ailments, neurological & psychological disorders can be attributed to an ageing population, increasing pressures of urbanization, lifestyle changes and work stress. The increasing share of the chronic segment is expected to improve realizations for several pharma companies as it is a higher value segment.



Cardiovascular and diabetes to be big segments in India

Anti Infectives (anti malarial and anti bacterial) is the largest therapy segment occupying 17.1% of the total Indian pharmaceutical market. Cardiovascular disorders and diabetes therapy segments account for 11.4% and 5.7% of the market, respectively, and are growing much faster than the average market growth. We expect cardiovascular therapies to comprise approximately 20% and anti-diabetics more than 10% of the total market value by 2020.

Cardiovascular drugs is the second largest therapy segment in the Indian Pharmaceutical market with an estimated INR 65 bn sales in 2011 and is expected to reach INR 300 bn+ by 2020. The Indian diabetic drug sales was at INR 32 bn in 2011 and is expected to reach INR 180 bn by 2020 and will be the fastest growing segment going forward.



Companies with chronic therapy focus to grow faster

We believe that therapies like Cardio Vascular, Diabetes, Central Nervous System(CNS) will account for a major chunk of the incremental market over the next 5-10 years. These three will be the key segments in the future, and garner more than 50% of the incremental revenues in the Indian pharma market.

Indian pharma market offers prospect for strong growth for companies like Sun Pharma, Lupin, Cadila and Dr Reddy’s which enjoy strong positioning in chronic segments. With over 60% of revenues from overseas operations, Sun pharma, Lupin and Dr Reddy’s are better placed to gain in coming years. Sun Pharma has been the strongest performer over last 5 years led by high exposure to chronic therapies and a strong track record in execution. Lupin has a very strong presence in export markets like US & Japan. These markets will deliver significant growth for Lupin, as it has several exclusive products in its pipeline that shall unfold in years to come.

With the growing incidence of cardiac arrest, a company like Opto Circuits, which is into making of stents and medical equipments, is better placed to tap the market opportunity. With the acquisition of Cardiac Science, we expect Opto Circuits to see strong growth in its businesses due to a large market opportunity, an expanding distribution network and new product launches in cardiac care space.

Portfolio Manager's Commentary

The Month of October saw Nifty gaining 7.76% and breaking away from the negative trends of the previous four months. Despite this rally, the Nifty index is down -11.5% for the trailing 12 months. Also, Nifty's performance in October was relatively muted relative to major markets. The midcap index performance with a 2.44% return continues to be relatively lacklustre to the Nifty. The midcap index is now underperforming the Nifty by 11% during the trailing 12 months.

Continuing from the pickup in September, the IT sector returned 10.5% for the month and Autos jumped 11.5%. These were the two top performing sectors for the month. The results and outlook from the IT majors and especially Infosys helped the sector performance. We have adequate representation to this sector through our holdings in Infosys and TCS.

October did not see more cuts to global growth and earnings season globally has been in line (ahead in the US) with expectation. News flow from the Eurozone dominated and especially the agreement reached within the EU on 1) 50% haircut on Greek debt, 2) leverage the European Financial Stability Facility 4-5x, 3) bank recapitalisation and 4) medium/long term fiscal measures, gave a boost to the global markets. While there is clearly a lot of details to be filled in and the risk of wrong policy direction remain, we think that the chances of a major disruption to the system have receded. Similarly, we believe that a major off the cliff sort of fall for global growth is unlikely. This is because of the already low levels of activity which is prevalent in the West and Japan. On China, a slower growth is expected but a disruption to their growth or banking system is unlikely because of the fiscal, monetary and reserve strength of the Chinese government.

Inflation remains high in India at 9.7% for September. There has been a pickup in fuel and electricity inflation sub indices with a slight moderation in core inflation. The fuel/electricity uptick is being driven by the hike in transportation fuels and electricity rates across states. This along with the rupee depreciation and likely Government fiscal slippages will create upward pressure on inflation despite a favourable base effect coming into play from December onwards. The fall of Muamar Gaddafi in Libya should help check crude prices in the next few quarters.

There have been no further cuts to Indian growth outlook for the current year. Given the good monsoons and the recent increase in MSP's (minimum support price) we expect consumption/rural led growth to sustain. Our portfolio's are reasonably aligned to this growth vector.

The RBI continued with its tightening in the October policy but hinted at a pause in December. The RBI also deregulated savings rate and the impact of this move is being widely debated. We have exposure to young private sector banks like Yes Bank and Indusind bank which should benefit in improving their savings account deposits. However the impact on our larger private sector bank holdings is uncertain.

In October, the draft policies on Telecom and Pharma were released by the Government. While the Telecom policy (allowing network sharing, unified national license though with abolition of roaming charges) was directionally positive, the Pharma policy sought to increase government control. The domestic pharma industry is amongst the most competitive in the world with annual inflation at sub 2%. Increased controls are likely to lead to malpractices which might mean a benefit to only few firms. Consumers, however, are unlikely to gain from such a policy.

Against a muted 2QFY12 earnings expectation, results of the 21 out of 50 Nifty companies which were out till October end have been broadly in line. Revenue and earnings growth for this set of firms is 25% and 15% yoy respectively. The performance of our portfolio companies has been expectedly better. FY12 earnings growth expectation, for Nifty, at the start of October has been in the 13% to 15% range and this should not change much after this result season.

After the heavy selling in Aug and Sep, FIIs bought USD 350 m in October while domestic institutions were sellers for the month. Post the month end rally the index trades at around 18.8 x FY11 historical earnings, a slight 5% discount to its average. On a historical PBV basis the market trades at 22% discount. We have been saying in the past few months that short term swings in the market will be driven by immediate term FII flows. Fickleness in FII activity could drive the markets either way but given the lower than average valuation levels investors should consider India for its long term growth opportunity.

Portfolio Strategy

Growth Portfolio

The portfolio performance for the month, was driven by Infosys, Bajaj Auto, Hero Motocorp, Hindustan Unilever and Dr Reddy's in the Nifty category. Each of these stocks returned over 10% for the month. In the non Nifty segment Opto Circuits, Muthoot Finance and Yes Bank returned over 10% each for the month partly recovering from the hit in the previous month.

During the month, we added to our holding in Hero Motocorp and exited from L&T. We exited L&T after management unexpectedly lowered their order inflow guidance for FY12 to 5% from their recently stated 15% level. The management also suggested greater margin pressure in the coming quarters. Continuing with our stance of being focussed on the domestic and consumption oriented space, we increased our weight in Hero Motocorp.

In the ongoing result season, of the 14 portfolio companies which have declared results only one firm gave a below estimate result. In aggregate the portfolio companies have registered an inline 21% yoy growth in revenues and a 18% yoy growth in earnings. Results in consumer staples, consumer discretionary, financial services and healthcare firms have been in line. Exide industries reported below estimates as they were impacted by forex movements and on raw material/inventory and we are reviewing the situation.

As in the past months, the portfolio remains a domestic and consumption oriented one. We pick up our stocks from a predominantly bottom up approach with an overlay of top down factors as well. The portfolio earnings growth outlook and visibility remains superior to the market as does its profitability profile. We believe that in the current environment the portfolio will do well even as we continually evaluate the prospect of further improving the portfolio on the back of our stock selection filters.

Life Portfolio

Life Concept revolves around the four tenets 1) Consistent Operating History 2) Strong Operating Cash Flows 3) Low Capital Intensity 4) High Return Ratios leading to strong dividend payouts. In this Portfolio we invest in companies that have strong business models with high entry barriers and high quality management. Life Portfolio is positioned as a portfolio with low volatility, long term compounding and steady returns.

In Life Portfolio, stocks including Infosys, HUL, Bajaj Auto, Opto Circuits delivered positive returns in the range of 10 – 14% during October. These were followed by Sun Pharma, ITC, HDFC and TCS that gave returns in range of +7 - 9 % vs 6.28% return by the benchmark BSE 200.

Stocks that performed below expectations were Clariant, Cummins, Indraprastha Gas, Dabur and Glaxo Pharma. Clariant underperformed due to weak quarterly results, which we believe is a short term aberration and the business should do well over the long term.

We added Hero Motocorp in our portfolios, which is the leader in the domestic 2 wheeler/motorcycle segment, specifically the executive segment. In this segment, we remain confident of reasonable growth in the medium

term given the strength in rural incomes and the unmet public transportation needs. More importantly, HeroMotocorp is characterised by a strong brand franchise which translates into very healthy ROCEs and payout ratios.

Among other portfolio actions, we booked part profits in ITC, Indraprastha Gas & Crisil and trimmed weights in Glaxo Pharma. We increased weights in Titan.

The portfolio currently has 22 stocks with a diversified exposure to FMCG, Auto, Pharma and Banking & Finance businesses.

We believe that the consumption sectors, in which our Portfolio has over 65% exposure, will continue to do well. We expect the companies to continue with strong payout which will complement the portfolio returns by around 1.75% – 2% in the form of dividend yields. Also we believe that the portfolio will be partly cushioned from the impact of increases in interest rates and uncertain global environment.

Indian Entrepreneur Portfolio

October had been a very strong month for the markets with the benchmark BSE 500 delivering 5.91% during the month. However, CNX Midcap Index was up only 2.4% during the month. Indian Entrepreneur Portfolio outperformed CNX Midcap Index during the month.

Key outperforming stocks during the month were Yes Bank, Opto Circuits and Bajaj Auto, while Exide and Rallis underperformed. Yes Bank was the beneficiary of the savings rate deregulation by the RBI. Bajaj Auto's results were largely in line with expectation and the company continues to remain a strong play in the growing two wheeler space in the country.

Exide underperformed largely due to disappointment in its Q2 FY12 performance. However, we continue to believe in the power of its brand and its ability to regain its market share in the long term. Rallis also underperformed due to lower than expected performance in the quarter. The disappointment was largely due to lower than expected revenues from Metahelix (the seed company) and slower ramp-up in its Dahej plant. However, we remain positive on the company as the long term growth prospects of the company continues to remain intact.

Overall, the quarterly results declared so far by the portfolio companies have been satisfying, with particularly stellar performance from Muthoot Finance and Coromandel International.

On the portfolio front we have increased our weight in Hero Motocorp and TCS. We have exited out of Tulip Telecom and reduced our exposure in Havells. In the portfolio we have a fair mix of large cap and mid cap businesses. Predictability, replicability and sustainability quotient of the businesses remains very high. Health care and Auto continue to remain top two themes in the portfolio. The portfolio FY12 PE currently stands at 19x with RoCE upwards of 35%.

India Select Portfolio

In India Select Portfolio, stocks including Infosys, HUL, Bajaj Auto, Opto Circuits, Hero Motocorp, Muthoot Finance & Axis Bank delivered Positive returns in the range of 10 – 14% during October. These were followed by stocks like Sun Pharma, ITC and TCS that gave returns in range of +7 - 9 % vs 6.78% return by the benchmark BSE 100.

On the other hand, Exide, Clariant, Dish TV and Glaxo Pharma underperformed. Clariant underperformed due to weak quarterly results, We believe that this is a short term aberration and the business should do well over the long term.

Among portfolio actions during the month, we completely exited Coal India & Lupin, booked part profits in Infosys and trimmed weights in Glaxo Pharma. We added weights in TCS, Titan & Divis Labs.

The portfolio currently has 20 stocks with a diversified exposure to FMCG, Auto, Healthcare and Banking & Finance businesses.

The India Select Portfolio is centered around four themes :- Size of opportunity, Quality, Price-Value Gap and Earnings Growth. We believe that while each of these themes are central to investing, an assortment of stocks meeting each of the criteria (but dominant in one of the four) will lead to a balanced portfolio with adequate diversification.

Strategic Portfolio

As the global turmoil remains at heightened risk with high volatility, we remain committed to our endeavor of restructuring the portfolio in such uncertain environment and focus on improving the quality as well as reducing sources of risks to the portfolio. Over the last one month the volatility remained high with the indices moving up sharply in the last few days of October.

We have added new businesses like Blue Dart, Castrol, Crisil and 3M India while have exited ICICI Bank, Yes Bank, Exide and Havells in line with our focus on increasing the diversity and reducing the volatility of the portfolio.

Blue Dart is a market leader in express cargo delivery and is committed to make substantial investments over the next 4-5 years in building requisite infrastructure to cater to huge growth opportunity as well as improving its market share. The company has delivered a top-line and a bottom-line growth of 17% and 20% CAGR respectively over the last 9 years and is adequately positioned to ride on the growth path.

Castrol India is a leader in lubricant oil space in value terms. The company is a price leader with a high brand recall and has technological edge over its competitors. The return ratios are commendable with ROCE in excess of 100% and pay-out of 75-80%. We expect the company to maintain its leadership position and continue to deliver strong earnings growth going forward.

Crisil is the leading credit rating agency in the country. The credit rating business provides a large growth opportunity both domestically, as the market is at a nascent stage, and through global outsourcing from S&P. Profitability ratios are impressive with ROCE in excess of 50%.

3M India has a strong pedigree. 3M Inc is a diversified manufacturer, technology innovator and marketer of a wide variety of product. Their product range has applications for diverse industries namely; industrial, transportation, healthcare, defense, mining, etc. Globally, they have ~60,000 products along with patents worth \$550 mn. 3M India has large scope of increasing its product basket along with increasing revenue per product from Rs. 15 lac per product currently.

The portfolio is largely focused on domestic consumption story with expectations of long term compounding and steady returns. We have adequate sector diversification with reasonable exposure in sectors like Auto, Agriculture, FMCG and Healthcare.

Value Growth Portfolio

The portfolio performance for the month, was driven by Infosys, Bajaj Auto, Hero Motocorp, Axis Bank and Dr Reddy's in the Nifty category. Each of these stocks returned over 10% for the month. In the non Nifty segment Opto Circuits, Muthoot Finance and Yes Bank returned over 10% each for the month partly recovering the hit in the previous month.

During the month, we added to our holding in Hero Motocorp and exited from L & T. We exited L & T after management unexpectedly lowered their order inflow guidance for FY12 to 5% from their recently stated 15% level. The management also suggested greater margin pressure in the coming quarters. Continuing with our stance of being focussed on the domestic and consumption oriented stance we increased our weight in Hero Motocorp.

In the ongoing result season, of the 12 portfolio companies which have declared results only one firm gave a below estimate result. In aggregate the portfolio companies have registered an inline +20% yoy growth in revenues and in earnings. Results in consumer staples, consumer discretionary, financial services and healthcare firms have been in line. Exide industries reported below estimates as they were impacted by forex hits and on raw material/inventory and we are reviewing the situation.

As in the past months, the portfolio remains a domestic and consumption oriented one. We pick up our stocks from a predominantly bottom up approach with an overlay of top down factors as well. The portfolio earnings growth outlook and visibility remains superior to the market as does its profitability profile. We believe that in the current environment the portfolio will do well even as we continually evaluate the prospect of further improving the portfolio on the back of our stock selection filters.

Eagle Portfolio

As the global turmoil remains at heightened risk with high volatility, we remain committed to our endeavor of restructuring the portfolio in such uncertain environment and focus on improving the quality as well as reducing sources of risks to the portfolio. Over the last one month the volatility remained high with the indices moving up sharply in the last few days of October.

We have added new businesses like Blue Dart, Castrol, Crisil and 3M India while have exited Dish TV, Divi's Lab, Yes Bank, Exide, Coal India and Muthoot Finance in line with our focus on increasing the diversity and reducing the volatility of the portfolio.

Blue Dart is a market leader in express cargo delivery and is committed to make substantial investments over the next 4-5 years in building requisite infrastructure to cater to huge growth opportunity as well as improving its market share. The company has delivered a top-line and a bottom-line growth of 17% and 20% CAGR respectively over the last 9 years and is adequately positioned to ride on the growth path.

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The portfolio is largely focused on domestic consumption story with expectations of long term compounding and steady returns. We have adequate sector diversification with reasonable exposure in sectors like Auto, Agriculture, FMCG and Healthcare.

Lighthouse Infrastructure Portfolio

Infrastructure theme continued to bear the brunt of policy inaction, elevated interest rate and global macro uncertainty. CNX Infrastructure Index continued to trail the broad indices.

During the month we exited out of Blue Star and trimmed exposure to Havells. Blue Star was impacted due to continued slowdown in infrastructure buildup activity. Consequently, execution and order inflow activity was impacted significantly. We have trimmed Havells largely to reduce the international quotient in the portfolios.

We have bought Cummins India and Bosch Ltd during the month. Cummins India, the flagship entity of Cummins Inc is the largest manufacturer of powergen and industrial engines in the country. Continued growth in industrial engines business and exports coupled with stable growth in its distribution business augurs well for the company. Bosch Ltd is the flagship company of Robert Bosch GmbH in India. Bosch is the largest manufacturer of diesel fuel injection system in India. It operates in a near monopolistic environment in the country. The company has historically seen an innovation led growth in the country. Continued growth in automobile sales coupled with growth in service business should enable the company to show continued profitable growth.

Overall the portfolio bias remains towards strong product franchises that are unleveraged and have superior capital efficiency and benefit from the long term infrastructure build up activity.

Disclaimer:

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