RHH Model Portfolio

Mid caps to the fore

- The RHH model portfolio continues to outperform its benchmark Nifty index by 2.2% for the July–September '09 period. This outperformance stems from sector allocation - an underweight position on defensives and oil & gas, and an overweight stance on realty – with a preference for few mid caps such as Ahluwalia Contracts and Anant Raj Industries while keeping the portfolio beta at 1.05.

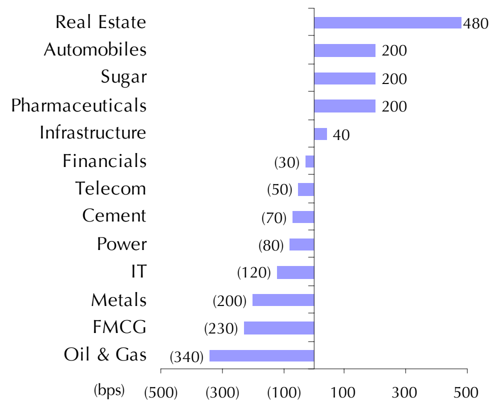
- We have analysed key market and sectoral indices to compare their levels in 2009, 2008, and 2007, when the Sensex reached ~16850 levels. Predictably, different sectors have emerged as outperformers. In our view, one could get outperformance by investing in the underperforming sectors. For instance, the realty sector is still at 41.3% and 51.8% below its 2008 and 2007 levels respectively, and so is the BSE midcap index. Similarly, Bharti Airtel has underperformed Nifty by 52% since March this year. We are overweight on Bharti Airtel, real estate, auto, sugar and mid cap pharma, and underweight on oil & gas and FMCG. We recommend equal weight on financial services.

- We reiterate our growth-oriented portfolio with a focus on domestic demand driven sectors, as we believe the earnings upgrade momentum will gather pace. Post the Q1FY10 results, we have upgraded our Sensex EPS estimates by 4% to Rs 883 for FY10 and by 7% to Rs 1,062 for FY11. We do not rule out the possibility of further earnings surprises in Q2FY10, but believe that the market has largely factored in the probability.

- In our view, large cap valuations appear stretched and could hinder index movement; this, however, is no cause for alarm as the broad market still provides select lucrative opportunities. Today, the Sensex is trading at 19x FY10E and 16x FY11E, BSE Mid cap at 14x one-year forward, and BSE Small cap at 10x one-year forward.

- Based on the thesis that mid caps are the order of the day, we are increasing the weight of these stocks in the RHH model portfolio to 20% from 12%. Stocks recommended are **Thermax** and **IVRCL Infrastructures** (infrastructure), **Shree Cement** (cement), **Patni Computer Systems** (IT services), **Aban Offshore** (oil & gas), **Biocon** (pharmaceuticals), **Anant Raj Industries** and **Phoenix Mills** (real Estate), and **Bajaj Hindustan** (sugar). This mid cap basket is expected to grow earnings at 42% in FY10 and 21% in FY11, and currently trades at 15x and 12x on these two years respectively.

Sector overweight/underweight w.r.t. Nifty



Portfolio restructuring

What's in	What's out
Aban Offshore	Axis Bank
Bajaj Hindustan	Punjab National Bank
Phoenix Mills	Suzlon Energy
HDFC Bank	IRB Infrastructure
OBC	JSW Steel
Thermax	Cairn India
IVRCL Infra	Sun Pharma
Jindal Steel & Power	Dishman Pharma
BPCL	JP Associates
Dr Reddy's Labs	Infotech Enterprises
Biocon	TCS
Shree Cements	Hindustan Unilever
Patni Computer	GVK Power
Wipro	

Portfolio valuation

Particulars	FY10E	FY11E
Earnings growth (%)	31.8	18.8
P/E (x)	15.7	13.3
EV/EBITDA (x)	11.9	10.0

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RHH Model Portfolio (September – December 2009)

Fig 1 - Model portfolio

Sector	Nifty Wtg (%)	RHH Wtg (%)	PAT Growth (%)		P/E (x)		Sector View	Stocks	Wtg (%)	P/E FY10	Beta
			FY10	FY11	FY10	FY11					
Automobiles	5.0	7.0	77.3	18.1	17.9	15.1	Positive	Bajaj Auto	4.0	14.3	1.0
								Maruti Suzuki	3.0	18.9	0.8
Financials	22.3	22.0	6.3	19.7	12.5	10.4	Positive	HDFC Bank	5.0	15.3	1.0
								ICICI Bank	5.0	0.0	1.5
								SBI	5.0	11.9	1.0
								OBC	5.0	6.4	1.0
								REC	2.0	11.0	1.0
Infrastructure	12.6	13.0	23.9	18.1	25.3	21.4	Positive	BHEL	3.0	24.1	1.1
								Thermax	2.0	20.4	1.1
								L&T	4.0	30.6	1.2
								IVRCL	2.0	18.6	1.6
								Ahluwalia Cont.	2.0	12.4	1.0
Cement	2.7	2.0	22.5	(11.2)	9.1	10.2	Neutral	Shree Cements	2.0	6.5	0.8
FMCG	6.3	4.0	7.7	15.6	24.3	21.0	Neutral	ITC	4.0	22.2	0.6
IT Services	12.2	11.0	6.8	10.0	19.7	17.9	Neutral	Infosys	5.0	21.9	0.7
								Patni Computers	2.0	12.1	0.7
								Wipro	4.0	20.2	0.9
Metals	8.0	6.0	(10.0)	18.5	13.1	11.0	Neutral	Tata Steel	2.0	17.6	1.4
								JSPL	2.0	2.7	1.4
								Sterlite Industries	2.0	18.5	1.3
Oil & Gas	16.4	13.0	39.4	18.3	13.1	11.1	Neutral	BPCL	2.0	10.3	0.8
								Reliance Ind	7.0	16.7	1.1
								Aban Offshore	2.0	4.3	1.6
								ONGC	2.0	11.4	0.9
Power	3.8	3.0	6.5	17.1	22.0	18.8	Neutral	NTPC	3.0	19.9	0.8
Pharmaceuticals	2.0	4	0.2	15.7	16.5	14.3	Positive	Dr Reddy's Labs	2.0	15.6	0.6
								Biocon	2.0	15.2	0.8
Telecom	6.5	6	9.7	12.6	15.5	13.8	Neutral	Idea	2.0	20.5	1.0
								Bharti Airtel	4.0	15.2	0.8
Real Estate	2.2	7.0	(37.6)	10.8	26.8	24.2	Positive	Unitech	3.0	30.7	1.8
								Phoenix Mills	2.0	26.0	1.1
								Anant Raj Ind	2.0	12.6	1.2
Sugar	-	2.0	175.2	(18.5)	10.8	12.1	Positive	Bajaj Hindustan	2.0	15.0	1.3

Source: RHH

Key portfolio characteristics

Overweight on real estate; financials services share increased in line with Nifty weight

We continue to recommend a portfolio that is growth oriented and domestic demand driven. Given the relative valuation differential between large and mid cap stocks, we recommend a higher proportion of mid caps at 20% (from 12% earlier) as we believe that broad market fundamentals remain intact. Despite a high mid cap share, the key parameters of our portfolio remain largely in tune with Nifty.

Despite higher exposure to growth-oriented mid caps, beta remains low at 1.05

Fig 2 - Portfolio characteristics

	Nifty	New RHH Portfolio	Old RHH Portfolio
Weighted Avg. Beta	1.00	1.05	1.05
Cyclical (%)	**69**	**72**	**69**
Value	9	16	12
Growth	60	56	57
Defensive (%)	**31**	**28**	**31**
Value	12	9	13
Growth	19	19	18

Source: RHH

Recommend more value plays, higher beta exposure on select mid caps, and lower weight on defensives

Fig 3 - Portfolio beta composition

	High Beta*	Low Beta
Cyclical (%)	**26**	**46**
Value	-	16
Growth	26	30
Defensive (%)	**-**	**28**
Value	-	11
Growth	-	17

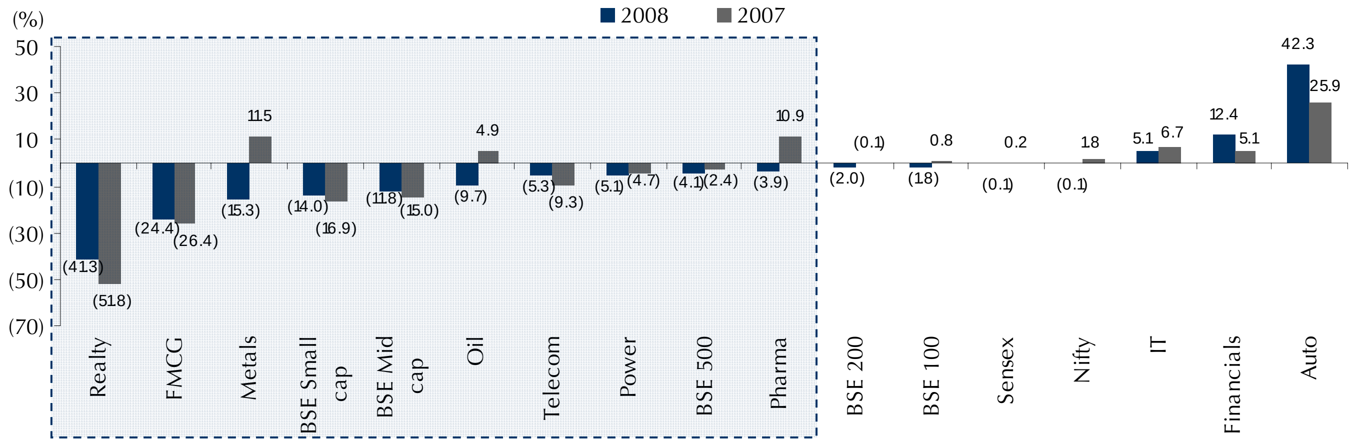
Source: RHH **High Beta = > 1.2*

Fig 4 - Changes in model portfolio

Sectors	Addition	Deletion	Replaced	Replaced by	Old Sector Weight (%)	New Sector Weight (%)
Automobiles					6	7
Financials			Axis Bank	HDFC Bank	18	22
			PNB	OBC		
Infrastructure			Suzlon Energy	Thermax	15	13
			IRB Infra	IVRCL		
FMCG		HUL			4	4
Metals			JSW Steel	Jindal Steel & Power	8	6
Oil & Gas	Aban Offshore		Cairn India	BPCL	13	13
Power		GVK Power			5	3
Pharma			Sun Pharma	Dr Reddy's	4	4
			Dishman Pharma	Biocon		
Telecom					7	6
Cement			JP Associates	Shree Cements	3	2
Sugar	Bajaj Hindustan				0	2
IT			Infotech Enterprises	Patni Computers	11	11
			TCS	Wipro		
Real Estate	Phoenix Mills				6	7

Source: RHH

Fig 5 - BSE realty index is 41.3% below its 2008 levels when the Sensex was at the same current levels in 2008



Source: RHH

Sectors like realty, FMCG, metals, telecom, power, pharma and mid/small caps hold upside potential

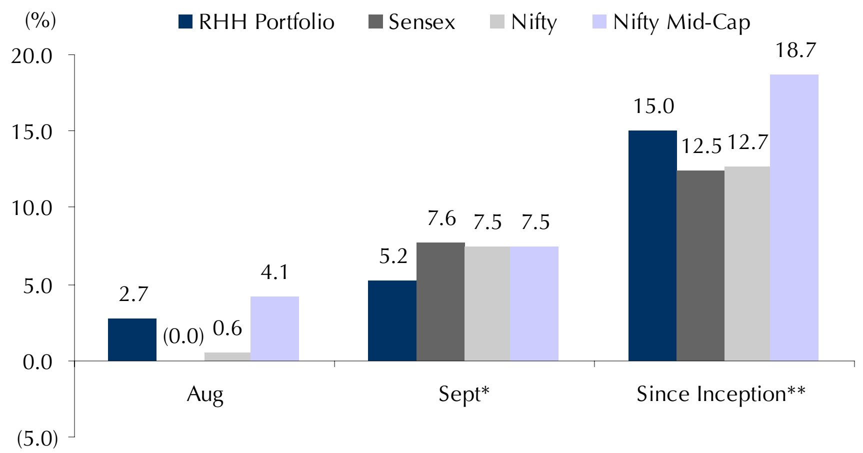
We have analysed key market and sectoral indices to compare their levels in 2009, 2008, and 2007, years when the Sensex reached ~16850 levels. In this exercise, we recorded the values of various BSE indices as on 22nd September 2009, when the Sensex closed at its 52-week high of 16,886 after a year-and-a-half of downward rally. We then recorded the values of various BSE indices on days when Sensex reached ~16850 levels in 2007 and 2008. This was followed by the calculation of the variances of indices in the current year over their values in 2008 and 2009. We observe that sectors such as Realty, FMCG, Metals, Telecom, Power and Pharmaceuticals and Mid caps and Small caps are below the levels seen in 2007 and 2008. For instance, BSE realty index is 41.3% and 51.8% below its 2008 and 2007 levels respectively, when the Sensex was at the same current levels in 2008 and 2007. We, therefore, believe that stocks belonging to the aforementioned sectors have still some steam left in them; these stocks are expected to reach the levels seen in 2008 and 2007 even if the Sensex stabilises at current levels.

RHH portfolio outperforms Nifty by 2.2%

RHH portfolio outperforms its benchmark Nifty by 3.4%, a comfortable margin

Our model portfolio has generated returns of 15.0% for the July–September '09 quarter (two months), outperforming its benchmark Nifty by a comfortable margin of 2.2%. This outperformance stems from judicious stock selection – a preference for mid-cap stocks like Ahluwalia Contracts and Anant Raj Industries, an underweight stance on defensives and oil & gas, and an overweight position on realty.

Fig 6 - Model portfolio performance



Source: RHH **Up to 29 Sept 2009* *** Since 22 July 2009*

Portfolio structuring: Growth and mid cap bias

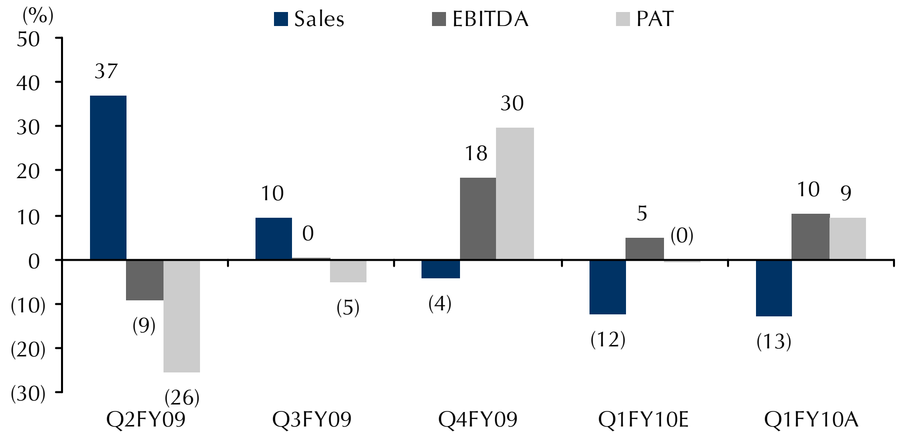
Earnings upgrades and surprises over next 6–9 months support growth bias

Go for high beta stocks – despite near-term hiccups

Our long-term view on the Indian market remains positive, supporting our recommendation of a relatively higher beta portfolio, consistent with our Q1FY10 strategy. Q1FY10 results took the market by surprise and Q2FY10 is likely to be no different. Post Q1FY10, we have upgraded Sensex EPS estimates for FY10 by 4% and for FY11 by 7%, while we have seen upgrades of 5–9% for FY10 across a section of other brokers.

Our basket of recommended high beta stocks includes **ICICI Bank** in financial services, **IVRCL Infrastructures** in infrastructure, **Tata Steel**, **Jindal Steel & Power** and **Sterlite Industries** in metals, **Aban Offshore** in oil & gas, **Unitech** and **Anant Raj Industries** in real estate, and **Bajaj Hindustan** in sugar. These stocks together constitute 26% of the portfolio.

Fig 7 - RHH universe: Q1FY10 corporate performance (140 companies)



Source: RHH

Exposure to mid caps increased from 12% to 20%

Include a strong set of mid caps

We increase our weightage on mid caps from 12% to 20% with stocks such as **Thermax, Ahluwalia Contracts** and **IVRCL** in the infrastructure space, **Patni Computer Systems** in IT, **Shree Cements** in cement, **Dishman Pharmaceuticals** in pharmaceuticals, and **Anant Raj Industries** and **Phoenix Mills** in real estate. This mid cap universe is expected to grow earnings at 42% in FY10 and 21.4% in FY11, and is currently trading at 15x and 12x on these two years respectively.

Fig 8 - Recommended mid cap stocks

Company	Earnings growth (%)		P/E (x)		P/BV (x)	
	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E
Thermax	(25.5)	27.4	23.4	18.3	5.7	4.6
IVRCLInfra	34.2	18.7	20.3	17.1	2.7	2.3
Shree Cements	32.1	(5.3)	7.3	7.7	3.0	2.2
Patni Computers	8.6	25.3	13.1	10.4	1.6	1.4
Aban Offshore	210.5	14.7	4.4	3.8	2.4	1.5
Biocon	25.0	21.2	14.9	12.3	2.6	2.2
Anant Raj	(17.6)	31.6	13.5	10.2	1.3	1.1
Phoenix Mills	27.5	56.8	26.3	16.8	1.6	1.6
Average	**36.9**	**23.8**	**15.4**	**12.1**	**2.6**	**2.1**

Source: RHH

Fig 9 - Stocks overweight

Company	Nifty Weight (%)	RHH Weight (%)	RHH Overweight (bps)	CMP (Rs)	Target (Rs)
Wipro	1.1	4.0	290	582	579
Unitech	0.9	3.0	214	108	90
Maruti Suzuki	1.3	3.0	173	1,636	1,381
Bharat Petroleum Corp	0.5	2.0	148	568	454
NTPC	1.5	3.0	148	211	200
State Bank of India	3.6	5.0	136	2,098	1,710
Idea Cellular	1.0	2.0	100	77	90
HDFC Bank	4.1	5.0	87	1,605	1,370
Jindal Steel & Power	1.4	2.0	58	588	2,957
Sterlite Industries	1.5	2.0	50	747	-
Tata Steel	1.6	2.0	40	504	-
BHEL	2.9	3.0	5	2,268	2,301

Source: RHH

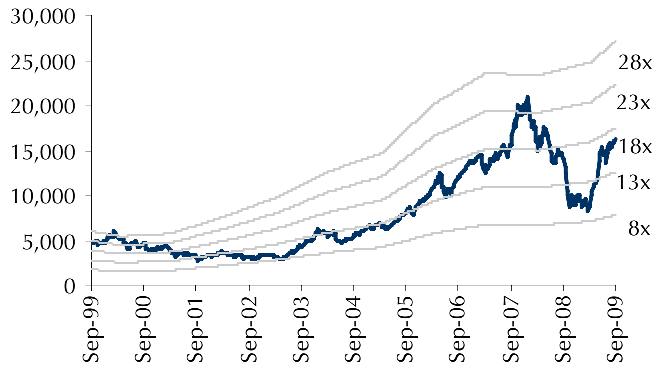
Fig 10 - Stocks underweight

Company	Nifty Weight (%)	RHH Weight (%)	RHH Overweight (bps)	CMP (Rs)	Target (Rs)
Reliance Industries	11.5	7.0	(451)	2,176	1,869
Larsen & Toubro	7.3	4.0	(328)	1,651	1,530
Infosys Technologies	7.5	5.0	(253)	2,294	2,191
ICICI Bank	6.7	5.0	(167)	864	770
ONGC	3.0	2.0	(103)	1,166	1,246
ITC	4.8	4.0	(81)	234	237
Bharti Airtel	4.4	4.0	(37)	422	445

Source: RHH

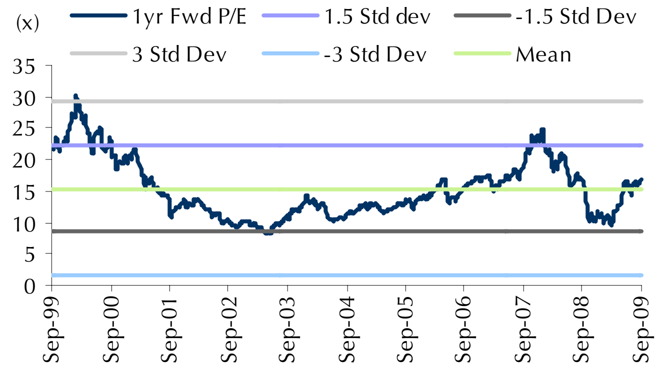
Broad market valuation: still compelling

Fig 11 - Sensex 1 year forward P/E band chart



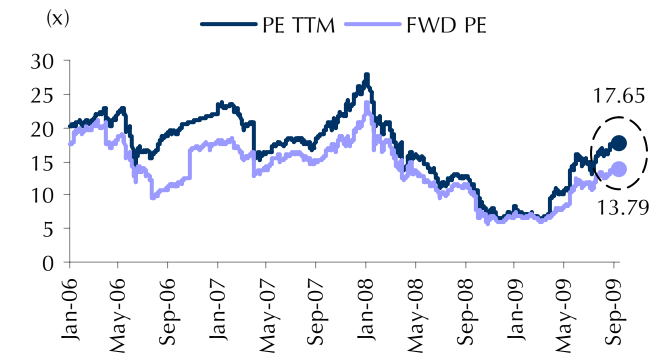
Source: RHH

Fig 12 - Fig 10 - Sensex 1-year forward P/E



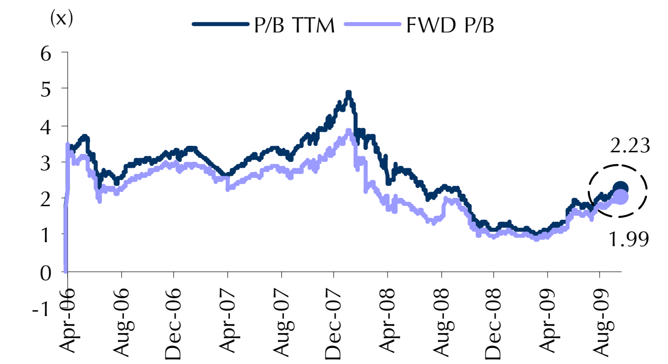
Source: RHH

Fig 13 - BSE Mid Cap P/E



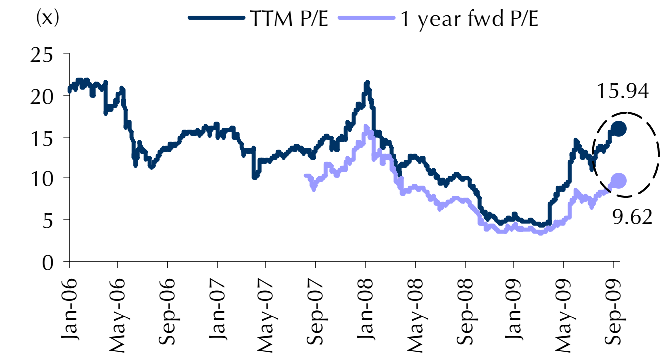
Source: RHH

Fig 14 - BSE Mid Cap P/BV



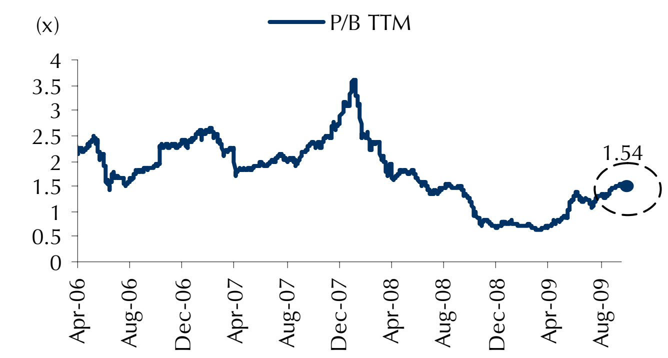
Source: RHH

Fig 15 - Fig 12 - BSE Small Cap P/E



Source: RHH

Fig 16 - BSE Small Cap P/BV



Source: RHH

Sector view

Fig 17 - RHH portfolio's sector-wise overweight/underweight w.r.t. Nifty

AUTOMOBILES — POSITIVE

RHH Weight: 7%

Nifty Weight: 5%

Chg: 200bps

- Domestic automobile demand remains buoyant, fuelled by lower interest rates, an improved appetite of PSU banks to finance vehicle purchases, and new launches.
- Recovery in the commercial vehicle (CV) segment has been faster-than-anticipated with M&HCV volumes back on track and the LCV segment posting robust growth.
- Exports of passenger cars remain strong due to continued demand from Europe. Two-wheeler exports are also expected to improve QoQ, in line with the recovery in some markets.
- Bajaj Auto is our top pick of the sector. We expect the company to gain market share in the motorcycle segment on the back of new launches. It is also set to report a strong performance in the three-wheeler and export segments.

CEMENT — NEUTRAL

RHH Weight: 2%

Nifty Weight: 2.7%

Chg: (70bps)

- In the last quarter, cement sector demand has remained buoyant (10 %+) on account of the government's strong infrastructural push and rural demand. Lower rainfall has also supported increased infrastructure activity; this has led to higher demand for cement.
- Currently, the cement sector has become a regional play with north, central, and eastern India emerging as the preferred regions on account lower capacity additions and buoyant demand. South India is the most vulnerable region with a bulk of the projected fresh capacities in FY10. In FY09, out of 20mn tonnes (mt) of capacity addition across India, 18mt were added in South India.
- We, therefore, prefer north-based players like Grasim Industries, Shree Cement and Prism Cement.

FINANCIAL SERVICES — POSITIVE

RHH Weight: 22%

Nifty Weight: 22.3%

Chg: (30bps)

- Credit growth, which remains muted YTD, is expected to revive in H2FY10. Systemic credit growth of 20% seems difficult to achieve; PSU banks, however, are expected to post higher growth than their private sector counterparts.
- A lower incremental C/D ratio would continue to strain NIMs in Q2FY10. However, re-pricing of bulk deposits and higher credit growth in H2FY10 would boost NII growth during this period.
- Increasing inflationary pressure and a resulting increase in benchmark yield would limit treasury gains. Slippages from restructured accounts (especially export-oriented units) could increase the provisioning requirement.
- The sector outlook seems positive from a long-term perspective; valuations, however, are not compelling. Fresh investments should thus be made only at declines.

FMCG — NEUTRAL

RHH Weight: 4%

Nifty Weight: 6.3%

Chg: (230bps)

- We expect volumes for the FMCG sector to recover in FY10 as compared to the pricing-led growth that was seen in FY09. The recovery will be on account of price cuts and grammage increases undertaken by most companies in the sector.
- The weak monsoon, however, is likely to be a dampener as it will lead to a decline in area under cultivation, lowering rural income. Therefore, for most companies, rural demand will be impacted.
- The decline in crop production will increase prices for certain commodities (such as tea, sugar, and paddy) that serve as key inputs for FMCG companies. Commodity price inflation may dent margins of some players as they may find it difficult to pass on the entire price increase to customers; this is because pricing power remains limited post the economic downturn.
- The topline growth for FMCG companies will be in the 8–10% range; bottomline growth for most companies, however, is likely to be higher, in the 15–20% range, on account of margin improvement led by a YoY drop in the prices of most commodities. We believe that a volume-led recovery for the sector is in sight on account of some price cuts and grammage increases; increased advertising and promotion by companies is also likely to support this recovery.

INFRASTRUCTURE — POSITIVE

RHH Weight: 13%

Nifty Weight: 12.6%

Chg: 40bps

- Infrastructure spending of US$ 500bn in the 11th Five-Year Plan and additional spending through the government stimulus packages provide strong revenue visibility for infrastructure players over the next five years.
- We expect substantial investments in roads, power, irrigation, and urban infrastructure. Robust spending in the power sector will drive the order book, both, on the generation and transmission side.
- We expect stock performance to be volatile, going forward. We see opportunities for above-average returns for companies that have a strong track record, a sturdy financial backbone, and robust risk-management systems with an ability to scale up operations. Softening commodity prices and lower interest costs offer potential for earnings upgrades.

IT SERVICES — NEUTRAL

RHH Weight: 11%

Nifty Weight: 12.2%

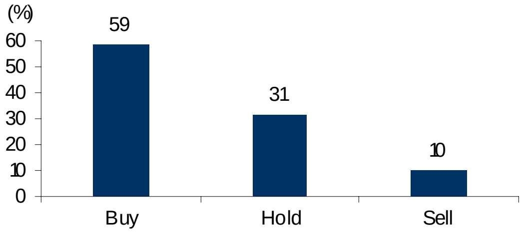
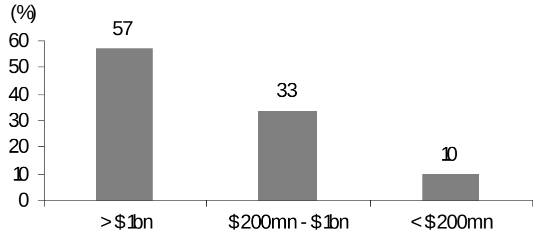
Chg: (120bps)

- Economic stability in the US and Europe is sufficient to ensure offshoring growth – a strong recovery would be an added bonus. 'New Normal' theories of long but slow macro-economic recovery in developed countries would mean that sales growth for corporates would be low but cost pressures would continue – this is a positive for IT offshoring.
- Leading indicators for technology spending in developed countries continue to get stronger. Though revenue growth in FY10 would remain below the trend, macro-economic stability is pointing towards strong growth for Indian IT companies in FY11.
- Deal flows and project renewals for Indian IT vendors have improved in the last quarter and are expected to increase further in the coming months. Further, discussions on large deals too have picked up; these deals are expected to materialise in the November '09–February '10 period, providing crucial visibility to growth prospects in FY11 and FY12.
- Valuations of tier-1 IT service companies have improved considerably, after factoring in the Q1FY10 surprise and expectations of an earlier recovery; there is still room for a further re-rating as earnings upgrade are expected to continue.

OIL & GAS	NEUTRAL
RHH Weight: 13.4% **Nifty Weight: 16.4%** **Chg: (340bps)**	❖ The government's recent decision to lift the subsidy burden on upstream oil companies for LPG and kerosene provides significant relief to players like ONGC, Oil India and GAIL. ❖ Expected allocation of RIL's KG-D6 gas beyond 40mmscmd and expansion plans for domestic LNG capacities, primarily from Petronet LNG (50% increase to 15mmtpa by FY12), Ratnagiri Gas and Shell, bode well for gas utility companies like Gujarat State Petronet, Indraprastha Gas and GAIL. ❖ After hitting a low of ~US$ 2.7/bbl in July '09, the benchmark Singapore complex GRM has risen to US$ 3.6/bbl in August '09. However, we expect GRMs to remain under pressure in the near term due to upcoming refining capacities of ~2mnbpd in China and the Middle East, and narrowing of light-heavy differentials. ❖ We expect the long-awaited reforms in the oil and gas sector to be enforced. These reforms include further clarity on the subsidy sharing mechanism (positive for the sector), an upward revision in APM gas price (positive for ONGC and Oil India), a fixed pricing formula for future gas production, and a change in pipeline tariff that would provide earning visibility for PSU companies like IOC, BPCL, HPCL, ONGC, and GAIL.

PHARMACEUTICALS	POSITIVE
RHH Weight: 4% **Nifty Weight: 2%** **Chg: 200bps**	❖ We have a positive view on the pharmaceuticals sector based on: ❖ a) The partial defensive nature of the sector – demand is largely inelastic to economic downturns. Specifically, revenue growth in the domestic market and RoW (emerging markets) is unlikely to surprise negatively. ❖ b) Over FY09-FY11, we estimate an earnings CAGR of 16% in the base business of our pharma universe, driven by growth in the domestic and US markets and the lower base effect of the CRAMS space. In addition to base business earnings, companies like Sun Pharmaceuticals and Dr Reddy's Labs are expected to report non-recurring Para-IV earnings. ❖ c) Sector valuations remain attractive at a P/E of 16.9x FY10E and 15.3x FY11E base business earnings. ❖ Increasing regulatory issues remain a key risk to our earnings estimates.

Coverage Profile

By recommendation	By market cap (US$)
	

Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and –5%
Sell	Less than –5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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