Dear Investor,

For the seventeenth edition of our fortnightly communiqué, **Asset Insider**, we introduce Carnelian Mutual Fund, a new entrant in India's mutual fund industry with a distinctive approach to identifying businesses and managing investment risk. In this edition, we explore Carnelian's investment philosophy, its proprietary research frameworks and its focus on quality growth at a reasonable price. We also examine the rationale behind its ₹5,000 crore capacity limit and take a closer look at the newly launched Carnelian Small Cap Fund, understanding how the fund house plans to translate its investment philosophy into portfolio construction.

1. Carnelian Mutual Fund: More Than a New Fund House

A new mutual fund house is usually introduced through its first scheme, its fund manager or its investment category. With Carnelian, however, the more interesting starting point is its **investment philosophy and the process it intends to follow across market cycles.**

Carnelian Mutual Fund is a newly licensed fund house sponsored by Carnelian Asset Management & Advisors Private Limited. The sponsor brings together complementary experience across investment research, business building and asset management. Its leadership includes Vikas Khemani, with prior experience as CEO of Edelweiss Securities; Manoj Bahety, formerly Head of Research at Edelweiss Securities; and Swati Khemani, who has played a role in building and managing the Carnelian business. The investor presentation cites 28 years of experience for Vikas Khemani and Manoj Bahety, and 24 years for Swati Khemani.

The distinction worth understanding is that **the mutual fund house is new, but its sponsoring organisation and investment professionals bring prior industry experience**. That experience is reflected in the emphasis on research, governance checks, valuation discipline and portfolio construction. It should not, however, be confused with an established performance track record for the new mutual fund schemes.

The Core Philosophy: Quality Growth at a Reasonable Price

Carnelian describes its investment philosophy as **QGARP — Quality Growth at a Reasonable Price**.

The philosophy combines three questions:

- **Quality**: Is the business fundamentally strong, and does its management demonstrate integrity?
- **Growth**: Is there potential for sustainable or accelerated earnings growth?
- **Valuation**: Is the price reasonable relative to the business's prospects?

This approach attempts to avoid two common investment pitfalls: buying a business simply because it is cheap, and paying an excessive price for a good business without considering the potential downside.

Carnelian's philosophy rests on two pillars: Risk and Growth, with valuation connecting the two. Risk is not treated merely as short-term price volatility; the process also considers permanent capital loss and opportunity cost. The aim is to identify opportunities where the potential reward justifies the risk being taken.

How does Carnelian assess risk?

One of the more distinctive aspects of its stated approach is the use of two proprietary frameworks: **CLEAR and CONNECT.**

CLEAR: A forensic examination of the numbers

- **C — Cash flow**: Do reported profits translate into actual cash generation?
- **L — Liabilities**: Is the company carrying excessive or potentially hidden debt?
- **E — Earnings quality**: Are earnings sustainable and supported by the underlying business?
- **A — Asset quality**: Does the balance sheet reflect sound assets?
- **R — Related parties**: Are promoter conduct and related-party transactions satisfactory?

CONNECT: Validate the business beyond financial statements

The second stage involves validating the business through a wider set of interactions and checks, including management, customers, suppliers, distributors, employees and plant visits.

The underlying idea is straightforward: financial statements can help identify warning signs, but understanding the quality of a business also requires examining how it operates in the real world.

For a small-cap investor, this process is particularly relevant because smaller companies can differ significantly in governance standards, balance-sheet strength, liquidity and the maturity of their business models.

Finding Growth Before It Becomes Obvious

Carnelian's growth framework separates opportunities into two primary categories.

MAGIC — Businesses about to change gear

This basket focuses on companies where a structural shift or identifiable trigger could accelerate earnings growth and potentially lead to a valuation re-rating. Possible triggers include new leadership, a new product, an industry shift or the completion of a major capital expenditure phase.

Compounders — Businesses built for sustained growth

These are businesses with durable competitive advantages, growing markets and the potential for consistent earnings growth and cash generation. Since quality compounders can command premium valuations, the discipline is to avoid overpaying.

Carnelian also provides for a smaller opportunistic allocation to special situations and mispriced opportunities.

For its Small Cap Fund, indicates an intended portfolio design of:

Investment basket	Indicative allocation
MAGIC — accelerated growth and potential re-rating	50–60%
Compounders — durable, sustained growth	30–40%
Opportunistic — special situations and mispricing	0–10%

Why the ₹5,000 Crore AUM Cap Matters

A notable feature of Carnelian Small Cap Fund is its stated **₹5,000 crore capacity limit**.

In small-cap investing, fund size can influence how easily a portfolio can enter or exit positions. Smaller companies may have limited trading volumes, so a large order can affect the price at which a fund transacts. As assets grow, a fund may also face pressure to spread capital across more stocks, potentially diluting its highest-conviction ideas.

Carnelian's stated rationale for the cap is to preserve three things:

- **Agility**: The ability to build or exit positions without materially moving stock prices.
- **Portfolio conviction**: Avoiding the need to invest in progressively weaker ideas simply to deploy additional capital.
- **Access to emerging opportunities**: Retaining flexibility to invest in businesses before they become widely recognised.

The restriction is designed to apply when the scheme reaches the prescribed threshold, subject to its offer documents. Under the disclosed terms, fresh lump-sum subscriptions, switch-ins and STPs are to be suspended after the specified trigger and applicable notice period, while SIPs can continue. The AMC may reopen subscriptions subject to the stated conditions.

This is a meaningful capacity-management decision, although it does not guarantee alpha or superior returns

2. Carnelian Small Cap Fund:

The Carnelian Small Cap Fund is the fund house's first small-cap equity offering. Its stated objective is long-term capital appreciation through predominantly investing in equity and equity-related instruments of small-cap companies.

The NFO is open from 16 October to 30 October 2026, with the scheme scheduled to reopen for ongoing transactions on 13 November 2026. Its benchmark is the Nifty Small cap 250 TRI, and the scheme is labelled Very High Risk. □cite□turn1file0□turn945417search0□

The more useful way to understand this fund is through its portfolio-building process:

1. Start with a broad universe of more than **1,000 companies**.
2. Narrow the universe through sector, thematic, fundamental and quantitative screens.
3. Apply forensic checks through **CLEAR and CONNECT**.
4. Evaluate companies using the **MAGIC and Compounder frameworks**.
5. Build a focused portfolio of approximately **30–50 stocks**, subject to the scheme's investment mandate and the fund manager's decisions.

The presentation describes this as a structured, high-conviction approach rather than an attempt to own a large number of small-cap companies.

The fund's asset-allocation framework requires at least 65% in small-cap equity and equity-related instruments, with the permitted allocation to other instruments governed by the scheme documents. Investors should review the full Scheme Information Document for the precise limits and risks.

Why Small Caps — and Why Now?

The small-cap opportunity is rooted in the possibility that today's smaller businesses may become tomorrow's established companies. However, identifying those businesses requires more than assuming that smaller companies will automatically deliver higher returns.

These figures are historical index illustrations, not the performance of Carnelian Small Cap Fund. They do not predict future returns, and small-cap investments can experience sharp drawdowns and extended periods of underperformance.

The case for examining small caps today should therefore rest on a long-term investment horizon and the opportunity to identify businesses with improving earnings, competitive advantages and room to scale—not on a claim that the current market level is necessarily the ideal entry point.

For Carnelian, the more relevant question is how it intends to select companies within this broad universe. Its emphasis on forensic research, quality growth, valuation discipline and capacity management provides the framework through which it plans to pursue that opportunity.

The Bigger Picture

Carnelian's introduction is ultimately about a particular way of investing: **identify quality businesses**, **understand the source of risk, look for sustainable or accelerating growth, and remain disciplined about valuation and fund size.**

The Small Cap Fund provides an initial example of how this philosophy may be implemented through a focused portfolio and a stated capacity limit. As with any new scheme, the investment process will need to be assessed over time through portfolio disclosures, consistency of execution, risk management and performance across different market conditions.

For investors, the key question is not simply whether small caps offer potential. It is whether the fund house has a clearly articulated, repeatable process for distinguishing promising businesses from companies whose risks may outweigh their growth prospects.

Carnelian's proposition is captured in its stated principle: "Alpha, not AUM." The long-term test will be whether its research discipline and portfolio decisions can translate that philosophy into consistent, risk-aware investment outcomes.

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