UNIFI AIF

FIRST-PRINCIPLES

UNIFI AIF 2 – GREEN FUND

Q4 FY22

We are approaching the closure of this fund in July of 2022, and keeping that in perspective, we are steadily reducing our exposure to equities. Also, taking into consideration the fact that we are surrounded by inflationary pressure, an uncertain geopolitical situation, and a reversal in liquidity, we have safeguarded the fund position and in accelerating our exits from the fund. This has protected us from the steep fall witnessed in Q1 of FY23TD at a market level. Our intention is to completely exit all our equity positions by the end of June 2022. As of now, we only hold exposure to select names in Banks, Consumer, IT and chemicals.

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FIRST-PRINCIPLES

A fundamental proposition that serves as the foundation for a chain of reasoning.

We count the privilege of managing risk capital seriously. As we round off the financial year and re-group for the next many, it is a good time to emphasize our core principles that define how we think and manage capital.

NON-PRESCRIPTIVE

We invest across a vast range of industries and firms at very different stages of evolution. We appreciate the heterogeneity and uniqueness of India's investment universe and are wary of assigning simplistic rules, boxing our style of investing. Our approach favors the identification of the value and their margin of safety over everything else. This means the dispersion of themes at a portfolio level will likely be high and consistent around a risk and reward equation that is favorable.

MARGIN OF SAFETY

India's lack of complete capital convertibility has resulted in valuations of some of India's finest firms reaching levels that cannot be theoretically justified. As leaders, a few of these companies will continue to consolidate their position of dominance and grow. We are comfortable not aligning with such opportunities and prioritize the discovery of value over the temptation to hold great companies that do not offer a margin of safety in terms of *price and time*. Our strategy of looking thematically at the evolution of India's industries and households enables us to discover opportunities that are beyond consensus.

THE LONG TERM IS A SERIES OF MEDIUM TERMS

We monitor the journey to our investment outcomes very closely and do not feel obligated to stay invested in firms we like without regard to their growth and valuations. While our objective is to generate absolute long-term performance, our instincts are to implement the logical next steps [buy, hold, sell] as our investment journey evolves. This is a corollary to maintaining the margin of safety at a stock and portfolio level.

SUSTAINABILITY

Governance is key to realizing an entity's true value in letter and spirit. We look for companies that have acted consistently on all financial and qualitative facets of governance. Long-term business, and equity value creation, are sustainable when a business checks these boxes. We are uncompromising in the evaluation of this facet and comfortable bypassing opportunities that seem financially attractive but questionable on governance.

PEOPLE

Our strong investment team combined with our working relationships with entrepreneurs, experts, and market intermediaries help navigate the breadth and depth of India's investable universe. We invest in each of these relationships consciously.

ANATOMY OF A PORTFOLIO

In keeping with the first principles, our responses to the market are never static

Cyclicality and evolution of the markets are a reflection of the society they represent and therefore no one answer works forever. A common mistake made at the turn of a cycle is the assumption that the market will revert to how it was immediately before, which is unlikely over time. Maintaining an updated prognosis for the future is critical, especially when the current one is working well. In other words, the portfolio composition must reflect our view of the future and manage the risk of being early appropriately.

A moment of inflection in India's **Banking** system is finally underway. After 10-years, there is a clear divergence today between the systemic growth rate and credit costs. Today, an extended period of provisioning has led to credit costs below normalized levels while a higher nominal-growth environment supports credit growth. Given that India's private consumption expenditure (in real terms based on 2011-12 prices) in FY22 was below FY20 levels, we are yet to witness a complete revival in demand.

Despite the circumstances, the industry is now clocking double-digit credit growth. As policy measures to seed a new cycle of growth fructify and private consumption surpasses pre-pandemic levels, further offtake in credit is anticipated. There is an added angle of the rate-environment. As RBI reverses the low-rate regime, industry margins will gain as interest rates rise*. With this in perspective, our exposure to India's banking sector is the highest ever in recent years, at c.22% vs negligible exposure in the previous sub-cycle.*

Technological change today is exponential. This rapid change lies in the advances of enabling technologies ranging from computing power to data storage to the scale and performance of the Internet. These advances create tipping points — moments when technologies cross a threshold and trigger sudden and significant change, making them a systemically important part of society. And firms that choose to cut back on technology spending will risk long-term competitiveness. **Despite the inflationary environment, this explains the lack of slowdown in the appetite for server and cloud spending**. Productivity gains from technology are eventually a key driver of growth and sustainability. We continue to see opportunities in the technology space and maintain exposure to the sector, driven strictly by the bottom-up, in areas where growth visibility is long tailed.

The rest of our portfolio composition largely continues to draw from the breadth and strength of India's domestic consumption franchisee. India's household consumption expenditure has grown at a CAGR of 8-10% p.a. over the last few years, driven by higher disposable incomes and urbanization. A sharp rise in pent-up disposable incomes over the two pandemic years has resulted in visible betterment across premiumization, non-discretionary consumption, property absorption, and financialization of savings.

The number of households in the upper and high-income brackets increased from 8% in 2005 to 24% in 2018, and this is expected to touch 51% by 2030. This shift in household incomes will accelerate underlying consumption across all cohorts and create newer categories. At a portfolio level, we are aligning with various businesses that would likely benefit from this consumption trend. We have captured this in detail in the later section.

IN CLOSING

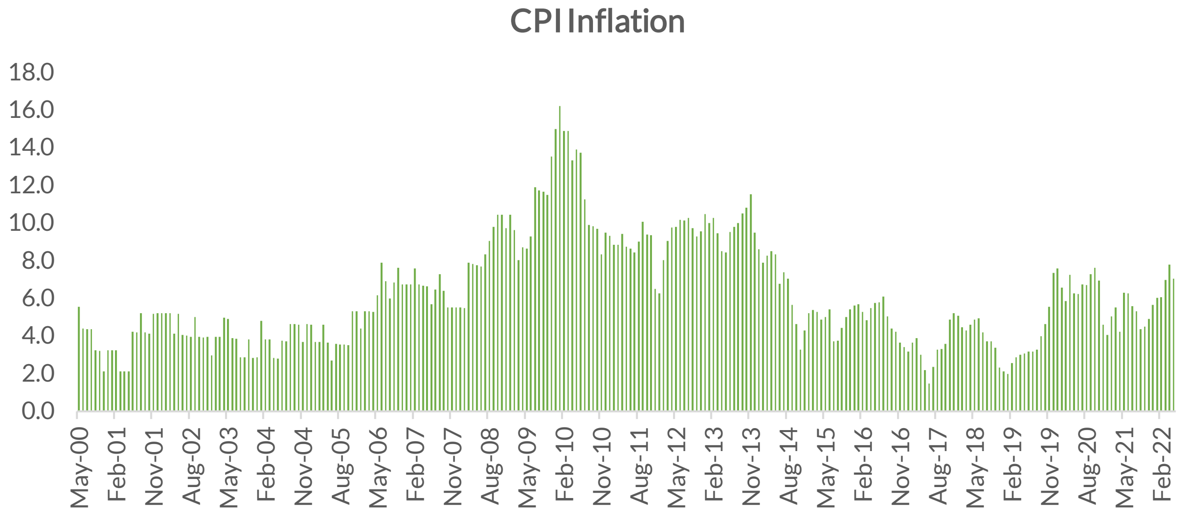
Uncertainty is inherently unmeasurable. In the long run, investment outcomes will continue to be a function of their earnings growth, adjusted for capital efficiency. While in the interim, divergence in how various stakeholders measure and react to risk will affect stock prices.

GROWTH

Contraction in growth rates is as much a logical phase of an economic cycle as is expansion in growth rates. What is difficult is timing the slowdown, especially given the nature of false alarms that are endemic to the industry. Over time, our assessment of the market's cyclical phase will significantly impact our portfolio returns since it determines our stance of either being defensive or investing opportunistically. Let's bear in mind that India's demographic picture fundamentally underpins its growth rates. In a nutshell, the aspirations of 2/3rd of India's consumers aged below 30 and their rising incomes are driving a wave of demand for certain products and services. And there is the added impetus of a manufacturing resurgence. Our job is to identify firms in these sectors available at a reasonable price.

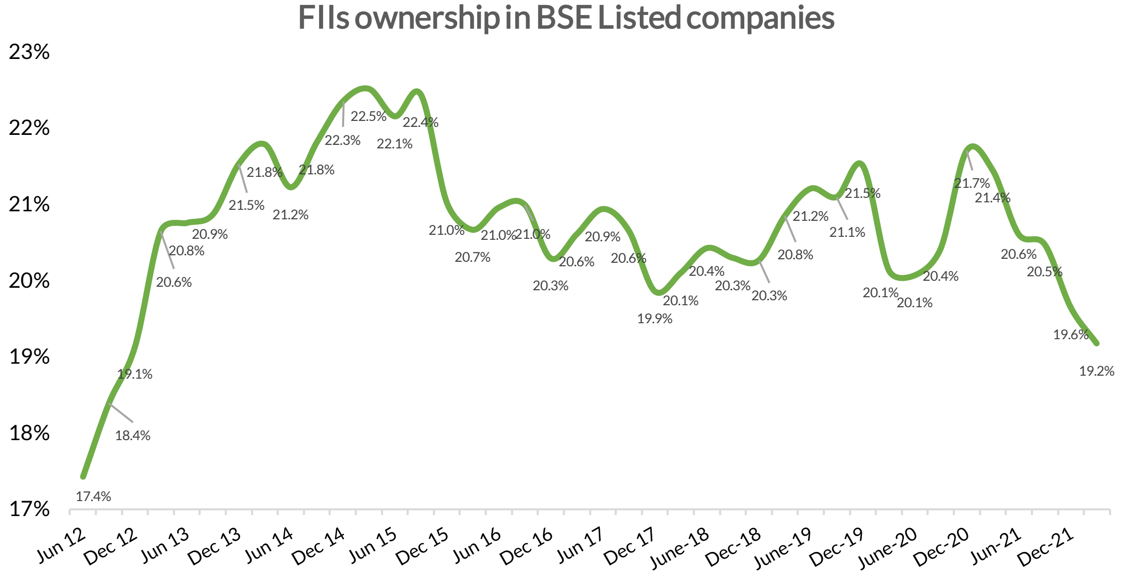
INFLATION

The powerful force of inflation influences demand; low and stable inflation accentuates growth while rising inflation contracts pricing spreads for firms and purchasing power for consumers. The question is, how long will inflationary prices prevail before supply catches up as it always does? Getting this forecast right is essential as it influences interest rates and our choice of asset classes. Today's environment is dominated by jams in container shipping, the war in Ukraine, and the reversal of the benefits of globalization due to geopolitics and rising trade barriers, presenting India with serious challenges and great opportunities. While we face uncertainties, the macroeconomic stability of the country's overall debt and foreign currency flows/balances are foundational to our view as investors.

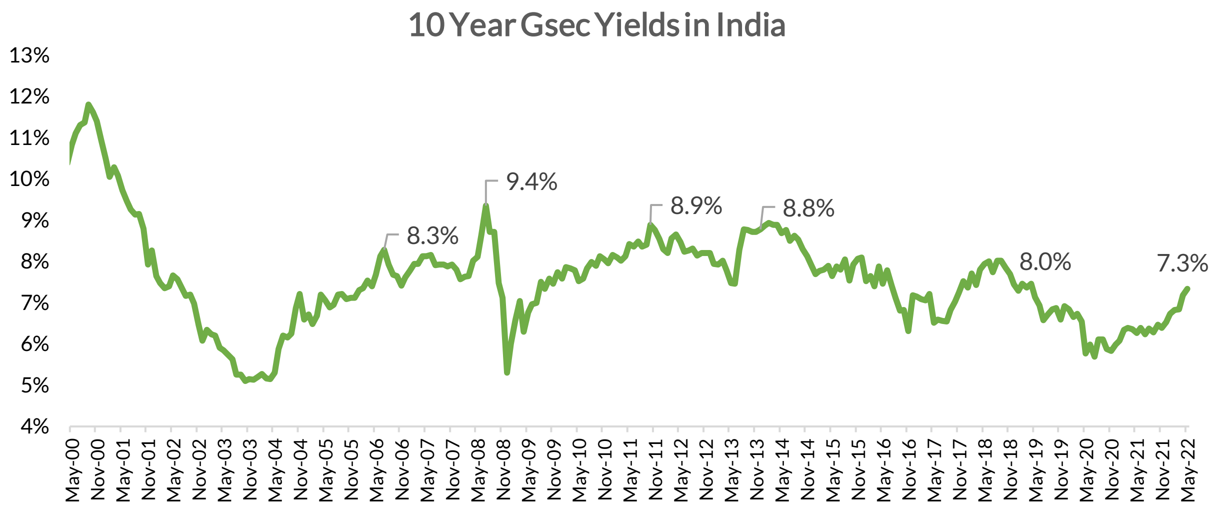


OUR VIEW

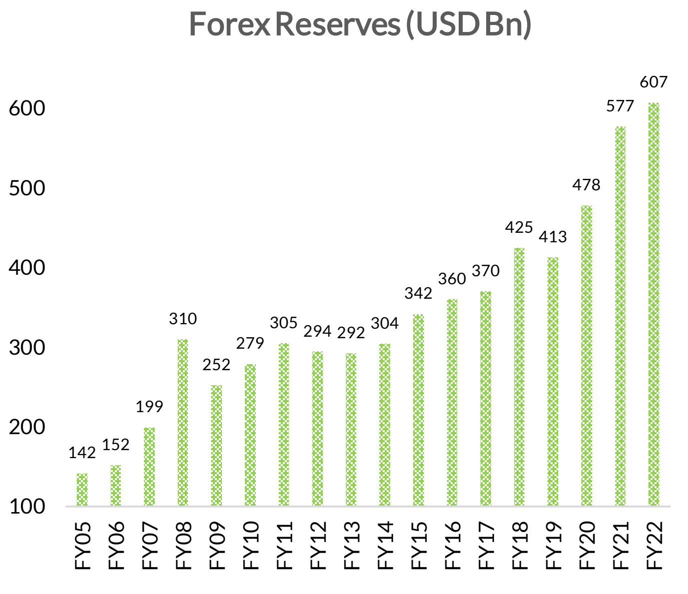
Asset prices are determined by how investors expect growth and inflation to trend. And this is reflected in our current portfolio construction. The demographic picture in the developed world is dominated by high base effects of incomes and consumption and their low and falling birth rates of around 1.5. The selling by foreign investors and the hysteria observed in the western media is a reflection of this. The collateral impact on Indian stock markets has been quite significant, especially on those firms that were over-valued or whose prospects are weak and unclear.



Inflation is impacting firms and consumers, but not equally. It is important to bear in mind that the absolute cost of money is more important than the direction of cost, i.e., interest rates. It is clear that interest rates are still at a reasonable level relative to our past.



And alongside, the probability of a sharp fall in the rupee exchange rate as we suffered in 2014 is low



Different sectors are coping with growth and inflation using the tools at their disposal to optimize their growth and earnings. Certain sectors will do well and others poorly, and we are focused on identifying this accurately and early.

We are approaching the closure of this fund in July of 2022, and keeping that in perspective, we are steadily reducing our exposure to equities. Also, taking into consideration the fact that we are surrounded by inflationary pressure, an uncertain geopolitical situation, and a reversal in liquidity, we have safeguarded the fund position and in accelerating our exits from the fund. This has protected us from the steep fall witnessed in Q1 of FY23TD at a market level. Our intention is to completely exit all our equity positions by the end of June 2022. As of now, we only hold exposure to select names in Banks, Consumer, IT and chemicals.

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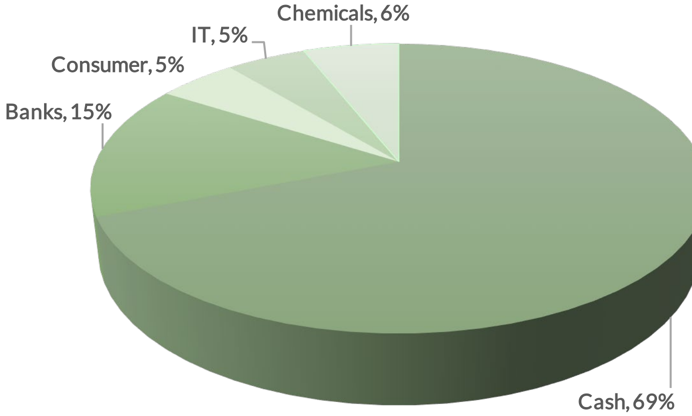
Composition of the Unifi AIF 2 Green fund is as below (As on 4th June):

Unifi AIF 2 Green Fund – Composition



The following annexure presents a brief on our top holdings:

ICICI Bank	ICICI reported earning growth of 59% YoY / 13% QoQ to Rs 7,019cr. This was led by 5.5% QoQ growth in loan book which was driven by growth across business segments. The growth in this quarter was largely driven by Business Banking and SME loans. The bank continues to gain higher incremental lending market share of ~13% compared to its outstanding market share of 7.2%. We believe that the bank will be one of the key beneficiaries of further improvement in system credit growth in FY23 due to higher provision buffers build in balance sheet and comfortable CET-I of 17.6%. The asset quality was further improved in the quarter with net NPA declining to 0.76%. We expect that margins may move northwards in FY23 led by drying up of liquidity in the system leading to better pricing and general improvement in interest rates. We expect credit cost should be contained at <1% given the bank is carrying higher provision coverage on GNPA, restructured book and BB & below book. We expect the bank to report RoA / RoE of 1.9% / 16% in FY23. Key risks would include deterioration of asset quality, higher than expected credit costs, and lower than expected loan growth.
State Bank of India	SBI reported earnings growth of 41% YoY / 8% QoQ to Rs.9,114cr. This was led by higher loan growth of 6% QoQ which was similar to other large private banks. The company is confident about corporate credit growth in FY23 given unutilized credit lines, loans under approval, and improvement in lead economic indicators. As 75% of their loan book is linked to the external benchmark, it will be one of the beneficiaries of the rising interest rate environment. Asset quality has further improved with net NPA improving by ~32bp QoQ to 1.0% The asset quality of SBI is in good shape as it has been reporting benign gross slippages of 40-70bps over the past three quarters now. Net slippages are even better at Nil to negative over the same period. We do not expect any major asset quality challenges flowing into FY23 as the Special Mention Accounts monitored for slippages [SMA I & II] is.

low at 13bps. 50% of the restructured book is being billed now and is performing well. We expect SBI should continue its superior performance on the operational & asset quality side and shall report RoA of 0.9% and RoE of ~17% in FY23.

Key risks would include deterioration of asset quality leading to higher-than-expected credit costs, a decline in NIMs due to falling yields, and lower-than-expected loan growth.

eClerx Services

With tailwinds for the outsourcing industry continuing to be strong, eClerx reported yet another strong set of numbers for Q4FY22. On a constant currency basis, the growth was 5.2% on QoQ and 21% on a YoY basis. It is expected that growth trends will broadly continue in the coming quarters. There is little visibility on near-term roll-offs. Total revenue for Q4FY22 was Rs. 601cr, an increase of 6.7% on QoQ basis and 26% on a YoY basis. EBIDTA came in at Rs. 192cr, an increase of 5.3% QoQ and 21% YoY. EBIDTA margin was 31.9% (down 40bps QoQ and 140bps YoY). PAT increased by 11% QoQ to Rs. 119cr.

Wage hikes and labor shortage in the US are helping eClerx's business model. Overall, the business model has been supported by increased demand, new customers comfortable with offshoring, the slowdown in captive deployment. The company has reiterated EBITDA margin guidance of 28-32%. The deal funnel continues to be strong though not as much as same time last year. There could be, one-off wage related costs in Q1 FY23 as the workforce returns to the workplace but over the course of the year the company is confident of meeting its guidance. Inflation is a headwind though the weaker INR against USD should help sustain margins. On the M&A side the company continues to evaluate opportunities. As funding costs have increased, the management feels that competitive intensity on the acquisition side would reduce in tune benefiting them.

Key risks would be slower than expected growth, global banks routing more work to their captive centers, or a general trend away from offshoring work to India.

CG Consumer

Crompton Greaves Consumer reported revenue growth of 2% YoY to Rs.1,548cr. The lighting segment was down 4% YoY owning to decline in B2G business, while consumer durables delivered 3% YoY growth, on the back of a slow-down in the pumps segment. In each of the key product segments [Fans (19% YoY), Electric Appliances (28% YoY)], the company delivered ahead of industry growth rates, on the back of product innovation, premiumization, and market reach initiatives. The company was able to mitigate commodity inflation through price hikes, product mix improvement, and aggressive cost reduction. As a result, the gross margin was stable sequentially at 30% in spite of material inflation. We expect Crompton to deliver headline growth that is ahead of the industry. The company reported PAT of Rs. 176cr (up 2% YoY) during the quarter.

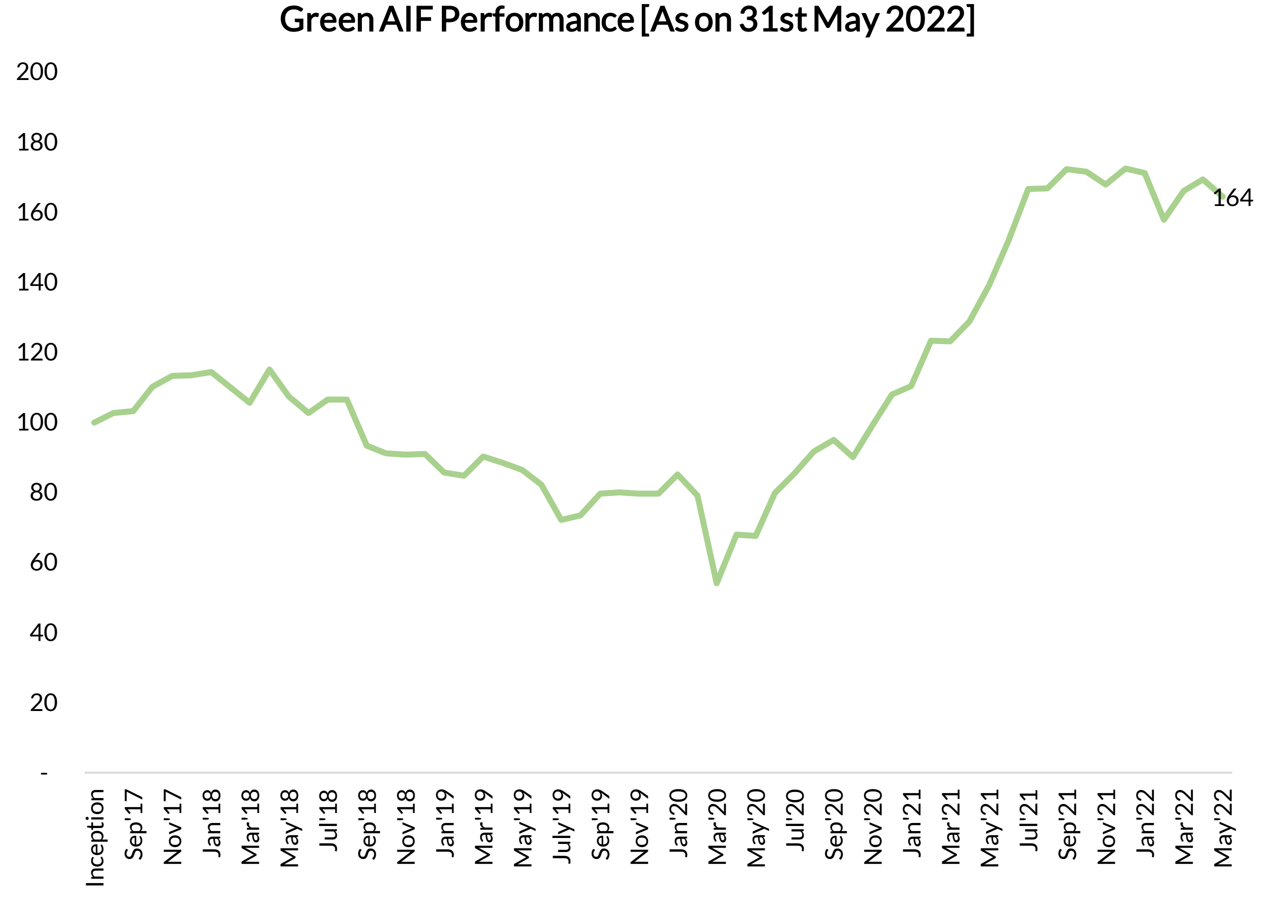
Crompton is amongst India's most profitable players in the consumer durables space with best-in-class growth, margins, and capital efficiency. We continue to like the company given their execution and expect them to benefit from this phase of consolidation and growth in household spending on durables.

Key risks to the investment could emanate from a drop in consumer sentiment, and steep inflation in raw materials.

Axis Bank	Axis bank reported earnings growth of 54% YoY / 14% QoQ to Rs.4,118cr. The bank continues to report an impressive loan growth at 6.4% QoQ which was slightly better compared to its peers., while its incremental market share improved to 9.6% vs 5.9% YoY. The company is witnessing strong traction in the focus areas of retail and SME while it is cautious on wholesale lending due to fierce competition in lending rates. Margins declined slightly by 4bp QoQ. Asset quality has further improved and is among the best in peers given the net NPA at 0.7% and restructuring at ~0.6% of loans. We expect that Bank's margins will improve structurally in FY23 led by a shift from investment to asset book, maturity of RIDF bonds, improvement in CASA book, and a general improvement in interest rates. Opex was elevated as Axis continues to invest in building a front-end team, process, and infrastructure. The bank is likely to report an RoA / RoE of ~1.4/ ~15% in FY23 led by improvement in margins and operating expenses. Key risks would include deterioration of asset quality leading to higher-than-expected credit costs and lower than expected loan growth.
Chemplast Sanmar	Chemplast delivered strong revenue growth of 35%YoY to Rs.1,807cr. EBITDA and PAT at Rs.346cr and 232cr, were up 1% and 37% YoY respectively. The company had built up the inventory in Q3 due to low demand and the same was liquidated in Q4 resulting in volume growth of 28% and 13% YoY for Paste PVC and Suspension PVC respectively. In the first half of the quarter, the spreads were impacted due to the high-cost inventory on the books, impacting the EBITDA growth. The PAT growth was high due to a decline in finance costs post the use of IPO proceeds for debt reduction. The company plans to reinvest a significant portion of its cash flows in scaling up the contract manufacturing business. The multi-purpose plant capacity will commence in phases starting from Q1 FY24. From its IPO proceeds, the company has repaid Rs. 1240cr debt resulting in a net cash balance sheet and is committed to capex of Rs.350cr. The company plans to debottleneck Suspension PVC capacity by 10% in FY23 and expand Paste PVC capacity by 60% in FY24. Chemplast has a prominent leadership in Suspension and Paste PVC in India along with Caustic soda and chlorine derivatives. The profitability growth going forward will be fueled by a favorable able business cycle in key products, technological advantage and operating leverage. The management has turned around the business and has revamped it with a targeted approach. With attractive valuations and clear growth directions along with a more prudent balance sheet, we expect the company to capitalize on its growth in respective segments and consolidate its positions among its peers. Key risks: Decline in PVC prices globally and inability to maintain gross profit spread, Unwarranted expansion in a commodity business.
Coromandel International	Coromandel recorded revenue growth of 50% YoY in Q4 FY22 to Rs.4,227cr. However, the revenue growth number is of less significance as it includes the pass-through of RM cost. EBITDA and PAT grew by 65% and 86% YoY to Rs.280cr and Rs.291cr respectively. Margins were better than expectations due to backward integration in Phosphoric Acid, capacity by 25% in H1 FY23, apart from incurring capex for Sulfuric capacity for backward integration and SSP capacity to capture market share in the category, combining a capex amount of Rs. 700cr. Structurally, the company is well placed to battle cost inflation with good capital allocation and governance, and with a debt-free balance sheet, the company is strongly poised for the next cycle of growth.

Coromandel is India's largest privately held non-urea (Phosphatic) fertilizer company with a diversified revenue mix of regulated and unregulated products. The company has a 15% market share in India's NPK consumption with a better proposition vs peer through differentiated products, focus on specialty grade, strategic sourcing, and international tie-ups for key RM supplies, and backward integration to the extent possible to protect & benefit from integrated chain margins. In Crop Protection, Coromandel has taken a slow and measured step to overhaul its portfolio from older generics to a mix of combination (double or triple molecules) and in-licensed products from global innovators (launched six products). This business forms 25% of consolidated EBITDA.

Key risks to the investment could be significant reduction in RM prices leading to correction in inventory valuation, unexpected regulatory developments, and the erratic monsoon.



KEY PORTFOLIO METRICS

It is important to note that each investment in the fund has been made on its own merit and the portfolio characteristics are merely a by-product of the process. In sync with Unifi's philosophy, the aggregate portfolio has low leverage, demonstrates potential for strong earning's growth, and has reasonable valuations.

Valuation Parameters* (As on 4th June 2022)	FY2022	FY2023E
P/E Ratio	18.9x	15.6x
Earnings Growth	52%	24%
Debt Equity Ratio	0.0	0.0
ROE %	20%	20%
PE/ Growth Ratio	0.65x	

*Adjusted for one-off to make figures representative.

*In closing, we encourage you to write to us, or your relationship manager for a detailed review of the portfolio and understanding of our proposition in greater granularity.

With best wishes,

Baidik Sarkar | Fund Manager & Head-Research

ANNEXURE

FINANCIAL DETAILS OF TOP PORTFOLIO COMPANIES

Unifi AIF 2 GREEN	Market Cap (Rs. cr)	PBT (Rs. cr)		YoY (%)	PAT (Rs. Cr)		P/E	ROE	Portfolio Weight
Company	4th June 2022	Q4 FY21	Q4 FY22		FY 22	FY 23E	FY 23E	FY 23E	4th June 2022
ICICI Bank	5,19,415	5,656	9,224	63%	23,339	29,319	18	16%	5.1%
SBI	4,13,745	8,649	12,479	44%	31,675	44,977	9	17%	5.0%
eClerx	6,961	129	159	23%	418	494	14	27%	5.0%
CG Consumer	23,044	231	213	-8%	577	669	34	27%	4.9%
Axis Bank	2,06,498	3,570	5,479	53%	13,025	17,692	12	14%	4.5%
Chemplast	7,611	225	280	24%	649	725	10	18%	3.5%
Coromandel	28,265	213	389	83%	1,528	1,757	16	25%	3.0%

CLASSIFICATION OF MARKET CAP

Segment	Basis	%
Large Cap	> Rs. 37,750cr	14.6%
Mid Cap	> Rs. 11,800 cr < Rs. 37,750 cr	7.9%
Small Cap	< Rs. 11,800 cr	8.5%
Cash		69%
Total		**100%**

LIQUIDITY ANALYSIS

Segment	% of portfolio
1 day	23%
Between 1 & 3 days	8%
Between 3 & 7 days	
Greater than 7 days	
Total	31%

RISK MANAGEMENT

Risk	Mitigants
Coronavirus Impact	The impact of the ongoing Coronavirus outbreak in India and the rest of the World can be multifold. The lockdown-related slowdown in consumption can affect several sectors. Our investee companies have product & category leadership along the financial wherewithal to withstand temporary phases of demand slowdown and lead consolidation of demand. The BFSI sector could have heightened stressed assets for a certain period of time thereby impacting their profitability.
Geo-political risks	Geopolitical tensions globally can disrupt the supply chain in the region. This might have a non-linear impact on business.
Raw material inflation	India continues to be dependent on the supply of feedstock whose pricing is global in nature. Key categories would be crude, metals, minerals, and natural commodities. Sharp movement in their underlying prices will have a short-term financial impact on the companies. The situation in China [political] has the potential to disrupt the supply chain of a few of our investee companies.

Liquidity risk (in case of NBFCs)	The NBFC led liquidity crisis in India has had a systemic effect on the entire economy. Our investee companies have been able to tap diversified sources of liquidity on the back of their long-term track record of comfortable asset quality and asset-liability management (ALM). However, sustained deterioration of the asset quality can continue to affect our holdings in Banks and NBFCs.
Foreign Exchange risk	The foreign exchange system continues to be guided by global developments. Our investee companies in the IT sector are subject to sharp movements in the USD and GBP. They mitigate the same via hedging, but there remains a portion of revenues that continue to be subject to the vagaries in fx movements. Most of our non-IT exposure is to companies that derive their revenues from the domestic market. The revenue from exports would be minimal for each strategy as a whole, and where relevant, are adequately hedged. A sharp depreciation in the INR will affect the import of feedstock (higher prices) which can lead to a brief moment of earnings-related volatility.
Leverage risk	Except for financial companies, most of the operating companies in the strategies carry nil to moderate debt on their balance sheets with a track record of having managed leverage well in the past. Their leverage is monitored regularly.
Technology Obsolescence	Technological changes can render the products/services of a company obsolete and thereby hurt its profitability and valuation. Such a risk is generally minimized by limiting the aggregate exposure of portfolio to such investments to less than 10% of value.
Governance risk	We avoid investing in companies with a known history of corporate governance issues. If such issue arises in an existing investment, we stop additional purchases and start optimally exiting the investment.
Concentration risk	At the portfolio level, such risks are minimized by limiting the aggregate exposure of portfolio to such investments to less than 10% of value at the time of investment.
Stock Illiquidity risk	High Impact cost, due to thin trading at the time of buying or selling is endemic to small & mid-caps. We plan our investment decisions, size of the investment and trading strategies to minimize the costs due to illiquidity.
Key Man Risk	Small and mid-caps are frequently managed by a key promoter / person on whom the business is completely reliant and without whom the business would be materially inferior. We generally avoid such names and in cases where we make any exceptions, the aggregate exposure of the portfolio to such investments is limited to less than 10% by value.
Slowdown in global consumption	The wallet share of the investee companies in the global manufacturing value chain does not pose a significant risk of loss of business to their vendors. New and high growth areas such as Lithium-Ion batteries, EV vehicles are in the relative infancy stage and have a strong growth curve ahead of them.
Softness in IT product spends	The convergence to digital software solutions is a 'must do' proposition and our investee companies have exhibited significant traction in competing in this space. A combination of their recent deal wins, and current bid pipelines bode well for their future.

CHENNAI:
11, Kakani Towers 15
Khader Nawaz Khan Road
Nungambakkam High Road
Chennai - 600 006. INDIA
Ph: +91-44- 2833 1556

HYDERABAD:
H No. 6-3-346/1, Road No. 1
Banjara Hills Scotia Bank Building
Hyderabad – 500 034.
INDIA Ph: +91-40-4010 2316/17

BANGALORE:
1109, 11th Floor
Barton Centre 84,
M.G. Road
Bangalore - 560 001.
INDIA
Ph: +91-80-255 9418/19

MUMBAI:
Shiv Sagar Estate,
A-Block, 8th Floor,
Dr. Annie Besant Road Worli,
Mumbai - 400 018.
INDIA

DELHI:
No.818, International Trade Tower, Nehru Place.
Delhi - 110 019.
INDIA
Ph: +91-9930112828