UNIFI CAPITAL

REVIEW: Q4-FY 2024

Conscious and Disciplined Approach

In a rapidly changing economic landscape, there is sometimes a temptation to seek simplistic explanations for the environment we navigate. While straightforward narratives are comforting, they are rarely adequate in capturing the moving parts that will determine investment outcomes. India's capital markets today are a prime example of this. The phenomenon of specific segments of the markets experiencing significant gains and rising performance can lead to misleading perceptions about risks.

This drives us to stay true to our investment philosophy of "Growth at a Reasonable Price" [GARP]. Our investment decisions focus on the sustainability and practicality of expectations, balancing capital preservation and growth duality. As a result, we are patient and deliberate in our decision-making. This is crucial in building a resilient portfolio that will perform well across various market environments.

Portfolio, actions

In emerging markets, where high economic and industry-specific growth rates depend on policy, the probability of change in national leadership is a pivotal moment [Mexico, France, India]. As active managers, it is our mandate to assign probabilities to such events and prepare for conceivable outcomes.

Accordingly, over the last 12 months, and getting into a Government-related event, we built exposure to policy-agnostic businesses through IT Services, pharmaceuticals, staples, and discretionary consumption. This provided us with stability to the portfolio and mitigated possible policy risks. We had ~50% of our portfolios in larger capitalization firms available at fair valuations, which provided us with attractive upsides and the added benefit of lower downside and liquidity.

If risk did not materialize, it does not mean it did not exist.

Post-elections, with the assurance of policy continuity towards infrastructure in general, we built exposure to select firms participating in infrastructure development. Domestic-oriented businesses that consume discretionary and non-discretionary continue to find incremental exposure in our portfolio. This includes diversified opportunities across home electricals, healthcare services, and savings financialization. Similarly, we have had a significant allocation to the credit cycle over the past three years. We reallocated capital significantly within the banking sector from the relatively more expensive private banks to more reasonably valued public sector and smaller private banks.

As of date, our investment drivers can broadly be classified into the following.

Driver 1: Capex-oriented businesses that continue to derive benefits from public and private capex (10-15%)

- Infrastructure Development
- Metal and Mining

Driver 2: Domestic-oriented businesses that benefit from the recovery in discretionary consumption and premiumisation (25-30%)

- Consumer Discretionary
- Financialization of Savings
- Healthcare

Driver 3: India Credit Cycle - Sustained growth in the banking sector through select banks that offer deep value (20-30%)

- Strong credit quality and steady credit growth at a reasonable valuation

Driver 4: Globally competitive product and services where India has a deep and sustainable competitive advantage (20-25%)

- IT/ITes Services
- Pharmaceuticals
- Chemicals

Over the past few quarters, we have meticulously adjusted our portfolio positions in response to evolving opportunities. Where our investment thesis has proven successful, we have realized gains, reallocating these funds to opportunities where we perceive attractive outcome. This vigilance allows us to navigate market fluctuations effectively.

Key Sectors	Dec'17	Dec'18	Dec'19	Dec'20	Dec'21	Dec'22	Dec'23	May'24	June'24
Financials	28%	20%	27%	12%	21%	27%	17%	17%	24%
Infra	-	-	-	3%	-	-	-	3%	7%
IT	1%	13%	7%	15%	16%	13%	21%	15%	11%
Healthcare	3%	3%	10%	18%	4%	9%	11%	14%	10%
Chemicals	15%	28%	17%	3%	8%	9%	4%	3%	3%
Consumer	-	1%	15%	16%	15%	19%	25%	25%	24%
Agri	3%	-	-	5%	2%	2%	4%	4%	4%

The above table represents an average of all client folios and is broadly indicative

Earnings Review

Despite expectations of a lower growth rate, the Indian economy delivered better-than-expected numbers, growing 8.2% YoY in Q4. This was primarily driven by an uptick in private and government consumption. A more significant change was seen in exports, up 8.1%, along with easing imports, which supported external balances. As a result, growth for the entire year was 8.2%, above estimates of 7.8%.

Private consumption remained steady in the quarter, with 4% growth, similar to the previous quarter. Private consumption is expected to revive after slowing down to 4% in FY24 vs. 6.8% in FY23. Recent data indicate that rural consumption growth was faster than that of urban. With likely normal monsoon and modest inflation, consumption revival is expected to continue, boding well for consumption-driven sectors.

The macro strength continues to be reflected in India's aggregate earnings. For Q4-2024, across the spectrum of benchmarks, Nifty 50, Nifty 100, and Nifty Midcap grew earnings by 18%, 16%, and 6%, respectively. The sectoral breakup of the broader Nifty 100 is as follows. The earnings growth of the broader sectors spanning banks, NBFCs, automobiles, healthcare, and real estate are in the range of comfortable double digits and run between 1.5x and 2.0x of nominal GDP.

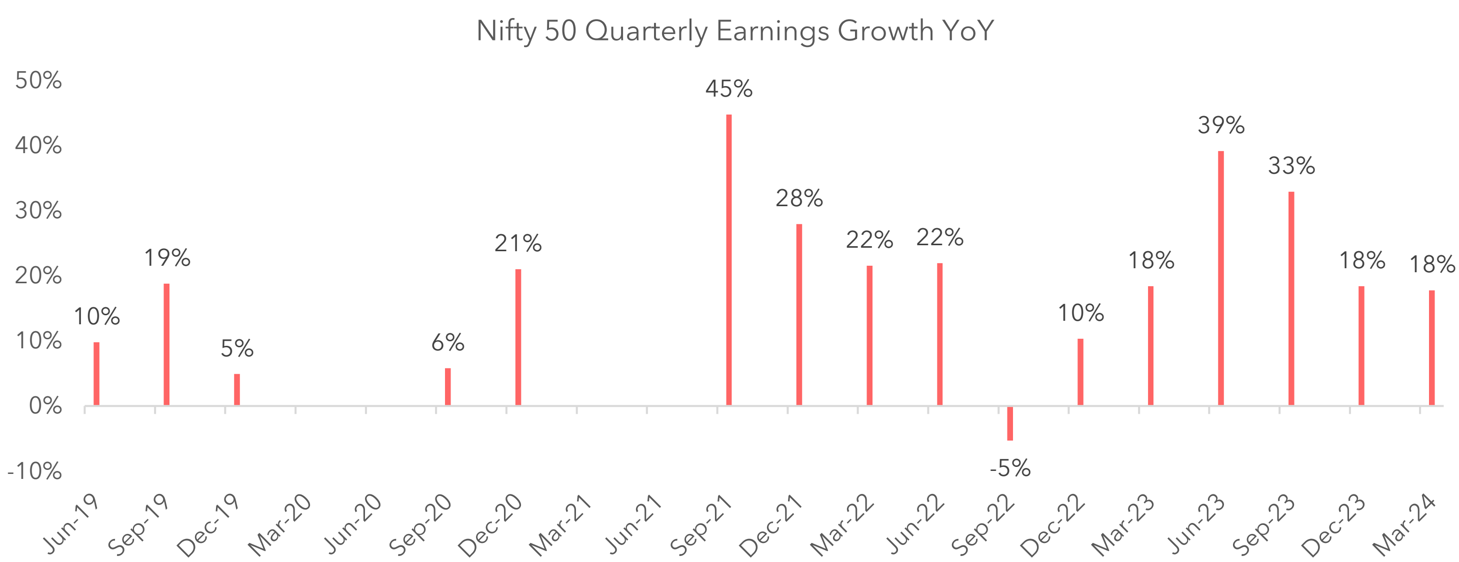
Sector-wise Q4 earnings growth of Nity-top 100 firms

Nifty 100	Adj PAT In Cr		PAT Growth
Sector	March '23	March '24	YoY %
Automobiles	15,176	30,529	101%
Banks-Private	33,967	44,579	31%
Banks-PSU	28,550	33,811	18%
Capital Goods	8,917	11,694	31%
Cement	4,316	5,606	30%
Chemicals & Fertilizers	562	422	-25%
Consumer	12,886	13,589	5%
Consumer Durables	358	447	25%

Healthcare	5,152	7,420	44%
Infrastructure	2,297	2,361	3%
Insurance	15,002	15,697	5%
Metals	10,830	7,653	-29%
Misc*	1,768	3,147	78%
NBFC	18,067	24,127	34%
Oil & Gas	48,476	43,018	-11%
Real Estate	570	921	62%
Retail	1,246	1,592	28%
Technology	26,809	28,985	8%
Telecom	3,006	3,900	30%
Utilities	23,053	23,179	1%
Total	261,007	302,675	16%

[*Zomato, IRCTC, Info Edge, etc]

For Q4 FY 2024, Nifty-100 and Nifty-50 grew reported earnings by c.20%.



Adjusted for the Covid disrupted periods

As we have communicated earlier, index earnings often oversimplify the market, reducing its diverse components to a single investment target. This obscures company-specific risks and investment potential. As absolute return-oriented managers, we evaluate risk and reward at the individual firm level. This approach ensures detailed, firm-specific metrics drive stock selection and investment management.

The structure behind the numbers

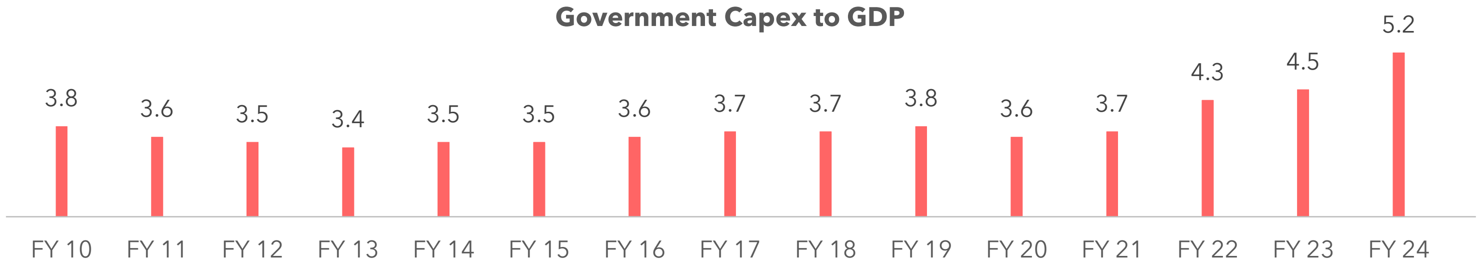
While rising corporate and household incomes address India's generational shift in consumption, the broad contours of India's economic makeup are shifting. As our exposure to firms building India's infrastructure has risen, we evaluate a few of the macros related to this.

Achieving lower fiscal deficit with strong capex growth

The quantum of India's persistent fiscal deficit has historically constrained the ability to deliver significant infrastructure development. However, the past few years, especially post-pandemic, have been very different. Not only has the fiscal deficit come down, but the government's expenditure on capital projects has been the best in history. India's structural infrastructure deficit is now addressed through better execution on the ground and support at the policy level.

India's combined fiscal deficit [Central] rose to its all-time high of 9.2% of GDP in FY21, compared to 4.6% of GDP in FY20 (and 3.4% of GDP in FY19). This narrowed to 6.7% of GDP in FY22, with the promise of bringing it down to 4.5% by FY26. This is budgeted to fall further to 5.1% of GDP in FY25, meeting its target of 4.5% next year.

This discipline in fiscal management has coincided with rising capex, increasing to an all-time high of 5.2% of GDP in FY24, compared to 3.7% in the pre-pandemic years. This was possible as government receipts increased sharply to an all-time high of 17.7% of GDP in FY22, which rose further to 18.3% in FY24.



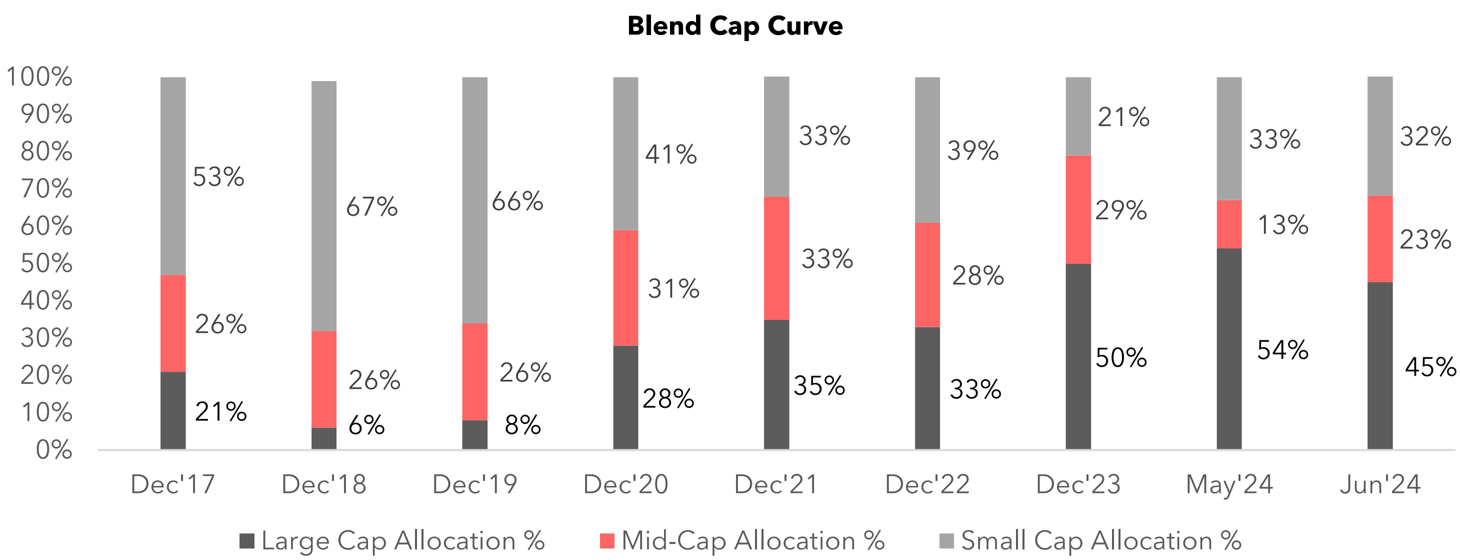
Source: RBI

This has percolated to widespread capital expenditure, driving our interest in the sector. More structurally, total factor productivity (TFP) has significantly contributed to GVA growth. To top this, the softening of inflation provided tailwinds to growth. The next leg of growth prospects will be influenced by (1) the pace of private consumption and capex recovery and (2) global growth and rates cycle.

Portfolio Summary

Our current portfolio demonstrates a balanced approach to market capitalization, backing opportunities rather than a pre-determined preference for small, mid, or large-cap stocks. This approach is a continuation of our commitment to growth at a Reasonable Price (GARP). A fundamental tenet of GARP ensures that our investment strategy remains flexible and responsive to market conditions.

This is a representation of how the cap curve in the portfolios has changed over the past few years:



Across our holdings in Credit, IT, Healthcare, Manufacturing, Capex, and Consumption, the portfolio is adaptive and balanced to the current economy and markets. This approach has positioned us well across cycles to set portfolios up for absolute returns.

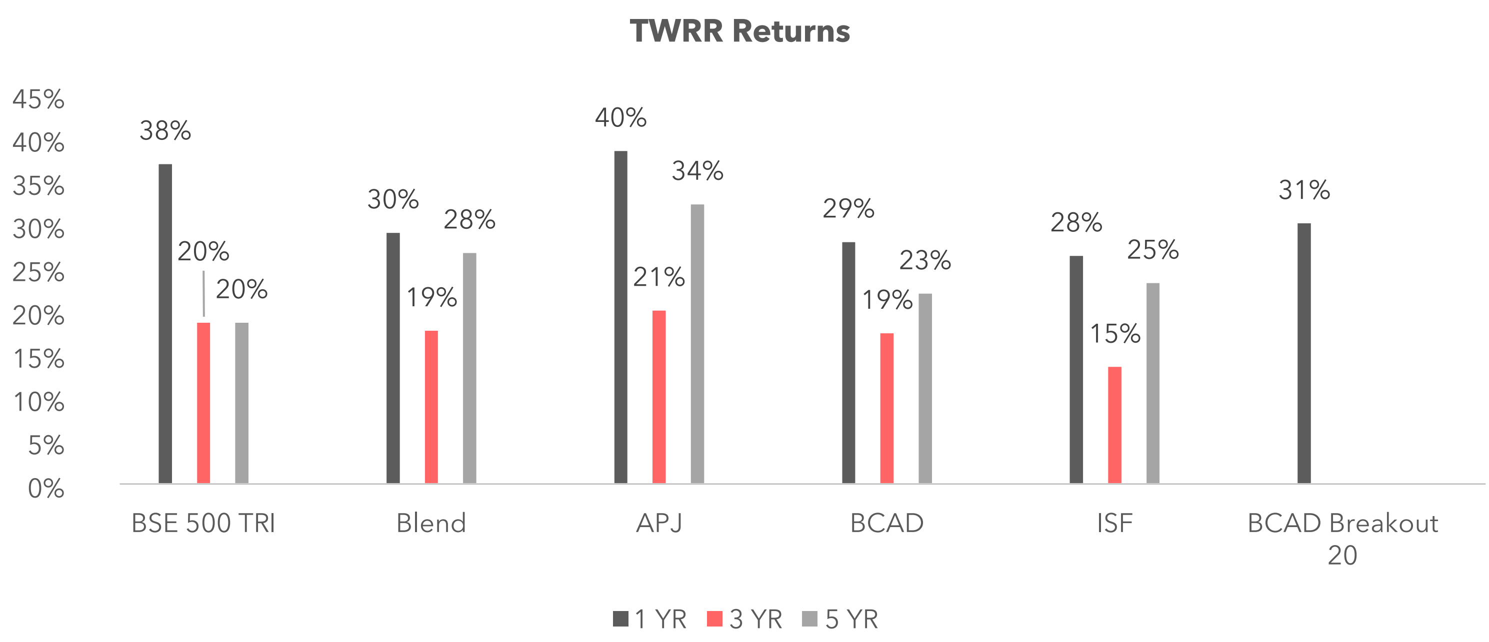
We continue to be optimistic about India's financial industry from a portfolio standpoint. The industry has entered a new cycle of growth led by several factors since FY22 and Q4 24 saw progress for the industry in most of the key parameters. We have increased our exposure in a few firms among mid-sized banks with steady credit growth, strong capital efficiency and reasonable valuations.

Following a few years of stagnation in IT spending, with better macroeconomic circumstances in the West, IT spending has been progressing in the right direction. Over the previous few months, we have reduced our exposure in a few firms where the thesis has played out while we retain investments in those that have a good risk/reward metric.

Within healthcare, we stay aligned with a network chain hospital that focuses on the midmarket and is a cost leader in healthcare, focusing on shifting to higher-margin specialities and improving their case mix. We have also taken exposure to one of India's leading generic manufacturers catering to developed economies. In addition, we have taken exposure to a few mid-sized pharma companies adding market share globally in significant geographies across the value chain – APIs, OTC, and Contract manufacturing.

We have increased our exposure to the Investment and Capex side of the economy to capture the value across the value chain – from Mining to Capital goods to Developers.

Our other holdings are from across industries drawn from the bottom up and experiencing fundamental strength in their performance. Where necessary, we have right-sized our positions based on the changes in their risk and reward over the past few quarters. We have taken the gains where our thesis has played out and reallocated them to positions where we believe the risk/reward is more favourable.



Returns as of 30th June 2024. BCAD breakout tenure <3years

The following sections outline our investment strategies and provide a performance summary for Q4 FY24. Individual portfolios will vary in holdings and proportions based on the timing of your investments. Please do not hesitate to contact your relationship manager for a detailed review of your portfolios.

Review of Strategies

We have captured an outline of each of our investment strategies in the following sections with a summary of how the fundamentals of our key holdings have played out in Q4 FY24. Tail positions which are on their way out of the portfolios have not been discussed. Individual portfolios will vary in holdings and proportion based on the timing of your investment with Unifi. For a detailed review of your portfolios, please do not hesitate to contact your relationship manager.

Blend

The Blend strategy continues to cherry pick ideas from across the six distinct themes managed by Unifi, thereby investing in "the best of our best" and participating in opportunities across the breadth of the market. The ideas represent a mix of emergent themes, corporate actions, and fundamentally attractive bottom-up opportunities. We continue to focus on delivering superior risk adjusted returns from an absolute perspective.

As on July 19th, 2024	FY 25E
Wt. Avg PE	23.1x
Wt. Avg PB	4.6x
Wt. Avg ROE	21.8%
Wt. Avg Mcap^	Rs. 144,492cr

^ex- BFSI

BCAD

The strategy continues to invest in sectors that are currently witnessing a shift in market share from the unorganized to organized players. While the lockdown related disruption can impact the near-term demand for consumption-based themes, as market leaders with strong net-debt free balance sheets, a majority of our investee companies are likely to see an increase in their market share, as marginal players find it difficult to operate in the new environment.

As on July 19th, 2024	FY 25E
Wt. Avg PE	21.4x
Wt. Avg PB	4.0x
Wt. Avg ROE	21.6%
Wt. Avg Mcap^	Rs. 102,851cr

^ex- BFSI

BCAD2: Breakout 20

The BCAD 2 Breakout 20 strategy seeks to invest in sectors that are witnessing structurally high growth rates driven by demographic led consumption and larger stream of disposable incomes. The fund continues to focus on large operators with competitive advantage at scale, consolidating position in their respective categories.

As on July 19th, 2024	FY 25E
Wt. Avg PE^	21.5x
Wt. Avg PB	4.0x
Wt. Avg ROE	21.0%
Wt. Avg Mcap^	Rs. 102,407cr

^ex- BFSI

APJ

The strategy seeks to deliver absolute returns over a five-year horizon through investments in sectors that will benefit from the next stage of India's growth on the back of improvement in India's infrastructure, and policy climate. The APJ strategy continues to focus on firms delivering manufacturing excellence broadly across technology, chemicals, pharmaceuticals, materials, and infrastructure in general.

As on July 19th, 2024	FY 25E
Wt. Avg PE	26.3x
Wt. Avg PB	4.6x
Wt. Avg ROE	21.1%
Wt. Avg Mcap^	Rs.72,430cr

^ex- BFSI

ISS

The Insider Shadow Strategy invests in fundamentally sound companies where there has been an increase in the promoter holding. Typically, such an action by the controlling shareholder demonstrates their conviction that the company's growth prospects, or inherent value is not captured in the stock price at that moment. Unifi's proposition is to gain from the eventual balancing of the value-price mismatch in the market by identifying and investing in such companies after a detailed review of their fundamentals and corporate governance standards.

As on July 19th, 2024	FY 25E
Wt. Avg PE	20.7x
Wt. Avg PB	3.5x
Wt. Avg ROE	19.1%
Wt. Avg Mcap	Rs.61,975cr

^ex- BFSI

Risk

Risk	Mitigants
Coronavirus Impact	The impact from the ongoing Coronavirus outbreak in India and 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	Any geopolitical tensions between India and neighboring countries can disrupt 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 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 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.

Thank you for placing your trust in Unifi.

Sincerely

Baidik Sarkar
Head - Research