UNIFI CAPITAL

REVIEW: Q3-FY 2025

Acknowledging Context

Price discovery, primarily a micro-pursuit, is now subject to multiple risk perceptions.

Unifi has traditionally focused on businesses' bottom-up, sifting for risk and reward at the right price. The past few months have witnessed significant global macro shifts, and near-term asset prices reflect the changes in risk perception. The broad causation of the current environment is an uncertain international trade environment and its consequent impact on key G20 economies. If implemented in its entirety, this has the potential to impact multiple avenues of global spending and change international supply chain equations, opening up risks to economic growth in general.

Indian equities, while structurally strong and not yet in the line of international trade developments, are not immune to these emerging variables. Until the uncertainties around the macros are nearly fully discounted, the global risk appetite will influence (a) foreign capital inflows into India, (b) liquidity pressure, (c) INR currency stability, and (d) cost of capital, all of which affect valuation multiples. Over the last many months, portfolio adjustments at Unifi have taken cognizance of this and other firm-related developments.

Q3 FY 2025 Earnings Update

In the third quarter of the fiscal year 2024-25, Corporate India experienced moderate growth. Nifty reported a single-digit PAT growth for the third successive quarter since the pandemic (Jun' 20). Sales/EBITDA/PAT growth for Nifty constituents was at +6%/+8%/+5% YoY in 3QFY25. Excluding Metals and Oil & Gas, profits for Nifty constituents were up 7% YoY (vs. est. of +7% YoY).

NSE 500	Adjusted PAT growth		
Sector	**Dec 2023**	**Dec 2024**	**YoY**
Banks-Private	47,829	49,725	4%
Banks-PSU	38,094	47,142	24%
Oil & Gas	50,408	41,486	-18%
NBFC	34,543	36,466	6%
Technology	30,666	33,156	8%
Utilities	26,041	24,608	-6%
Automobiles	23,847	23,370	-2%
Metals	16,265	18,306	13%
Healthcare	13,618	15,916	17%
Consumer	16,013	15,494	-3%
Insurance	13,458	15,445	15%
Capital Goods	9,396	11,323	21%
Misc	11,884	10,373	-13%
Cement	6,237	5,876	-6%
Retail	2,434	2,600	7%
Consumer Durables	1,440	1,977	37%

This softness was driven by weakness in Private Banks, Auto, and lower-than-expected sentiment in IT Services, Consumption, etc. This reflects the broader economic landscape, which has pockets of challenges. Auto volumes remained weak from a domestic consumption perspective, particularly in passenger cars and commercial vehicles, both of which are closely tied to lower overall economic activity and consumer confidence. Low credit growth and pricing pressure resulted in muted earnings growth for the financial sector. Weak consumption trends and raw material inflationary pressure weighed on consumer companies, limiting their growth and profitability. Technology services companies reported modest growth,

driven by weak demand from their end-user base, reflecting a slowdown in client spending. At the same time, the healthcare sector remained resilient, supported by sustained demand from export markets and stable pricing, which helped to maintain growth.

Despite these headwinds, the Indian economy grew at 6.2% during the October-December period, up from 5.6% in the previous quarter, with full-year growth projections adjusted upwards to 6.5%. This is expected to sustain the times to come, setting the base for a broader recovery. We elaborate on the strength of the Macro's below.

India, Macro

Key aspects of India's macroeconomic indicators remain reasonably strong, laying the foundations for sustainable growth in the times to come.

Core Growth | Real GDP grew 6.2% YoY in Q3-FY25, in line with the expectations and better than 5.8% (revised up from 5.6%) in Q2-FY25. This needs to be seen in the context of the base quarter's growth of 9.5% in the previous year (i.e., FY24). After growing 9.2% in FY24, India's real GDP growth is expected at 6.5% in FY25 (and at a similar level in FY26), implying an average growth of 7.5% during the three years ending FY26. Not only is this the fastest growth compared to any other major nation in the world, but also very strong vis-à-vis the state of the global economy. This is led by a recovering rural economy, a stable political environment, a robust banking sector, a good external position (CAD at just ~1% of GDP), and a continued focus on social and real infrastructure.

Inflation remains contained; c.4% in FY26e. | While core economic growth is expected to be robust, inflationary pressures continue to remain at bay. India's headline inflation averaged 4.9% in 2024 before easing sharply to 3.9% in the first two months of 2025. Similarly, the core inflation (all items excluding food & fuel items) averaged only 3.4% in 2024 and stood at 4% in Feb '25. This combination of strong growth and low inflation gives enough firepower and room to the RBI to ease monetary policy in the times to come.

Fiscal position continues to improve; deficit budgeted at 4.4% of GDP in FY26 | India over-achieved its fiscal deficit targets in FY24 and FY25 (based on its revised estimate) and also budgeted a fiscal deficit in FY26 at 4.4% of GDP. Notably, the Government has consolidated its deficit without resorting to sharp spending contraction, hurting GDP growth. Further, the Government has shifted its focus from deficit to debt-to-GDP ratio from FY27 onwards, a more comprehensive and credible indicator of fiscal position. It intends to bring down its debt-to-GDP ratio from 57% in FY25 to 49-50% over the next five years, laying firm foundations for India's nominal growth expectations of c.11% for many years.

Despite near-term weakness in corporate earnings, India's macroeconomic foundation is strengthening. A combination of healthy GDP growth, easing inflation, and fiscal discipline is setting the stage for sustainable economic expansion. This environment fosters business prospects, improves capital flows, and enhances consumption trends. As inflation remains under control, purchasing power improves, benefiting sectors across the board. A lower fiscal deficit ensures stability, supporting infrastructure and policy-driven growth initiatives. These factors create fertile ground for well-run companies to thrive. Firms with strong execution capabilities and sound financials stand to gain the most. As economic momentum builds, earnings will follow. This interplay of macroeconomic tailwinds and corporate adaptability will define wealth creation in the coming years.

Review of FYTD2025

In FYTD 2025, Indian markets have moved through two exact phases of excess and correction. Unifi's returns, at an FYTD 2025 level, have moved at a median of +2%/-2% around the headline benchmark of BSE 500.

The First Half: A Test of Discipline | Our strategies underperformed relative to the benchmark in the first half of FY 2025. The portfolio consciously avoided firms without fundamental backing yet performing with momentum. This trend was spread across the breadth of the market, driving valuations to unsustainable levels. In the first half, we aligned with value over impulse, led by house discipline of risk and reward-led investing, and the firm belief that capital preservation and long-term compounding matter more than chasing transient gains. While this phase led to short-term underperformance, it also allowed us to avoid the risks accompanying euphoric rallies.

The Second Half: Strength in Concentration | The latter half of the year saw a more deliberate and strategic stance, recognizing several micro and macroeconomic factors. We took more concerted steps in refining and correcting our investment strategy, and rebalancing exposures to mitigate risks. This phase was characterized by a heightened focus on capitalizing on emerging trends, reinforcing our commitment to long-term value creation.

It is essential to acknowledge that asset prices tend to move in a parabolic manner rather than in a predictable, linear line in periods of market turbulence. Current pricing does not necessarily reflect fair value, as external uncertainties have induced stress-driven biases in valuation, and external shocks amplify price movements beyond what underlying fundamentals would typically justify.

Portfolio Update

FY 2025 was a year of sharp sectoral divergences, and this is how we responded.

Credit | India's credit growth has experienced a modest deceleration, easing from mid-teen levels to a range of approximately 11-13%. Despite this slowdown, overall asset quality remains robust across the financial system, while specific segments across credit cards and microfinance have exhibited some signs of stress. We anticipate the current credit cycle will persist for the next few years, supported by a relatively stable macroeconomic environment and prudent lending practices. In line with our GARP investment approach, we have actively adjusted our portfolio allocation throughout the year. We have reduced our exposure to re-rated stocks, such as a leading PSU Bank and two South Indian Private banks, and reallocated capital to opportunities where we see further potential for valuation expansion. This includes India's second-largest PSU Bank and a smaller South Indian private bank, which is more attractively valued.

IT Services | Twelve months ago, the IT sector was poised for growth, supported by expectations of interest rate cuts and the ability for higher spending. The outlook for digital transformation remained strong, and enterprises were expected to accelerate their investments in cloud, cybersecurity, and next-generation software solutions. In alignment, we positioned our portfolios to capture the opportunities within the IT services sector. However, rising trade-related uncertainties and the context of India's services trade surplus have introduced complexities that could influence industry trends. While AI-driven automation presents opportunities, it also brings challenges in terms of revenue visibility, pricing pressure, and the evolving role of human capital within the sector. Given these uncertainties, we have taken a more cautious stance on the IT services sector in recent months.

Hospitals | India's private hospital sector is experiencing a structural shift towards premiumization, with leading hospital chains focusing on high-margin specialties and international patient care, resulting in higher realizations and profitability. The increased adoption of technology is improving operational efficiency and patient outcomes. Given these tailwinds, the hospital sector remains an investment opportunity with long-term growth potential.

We have maintained our exposure to one of India's most prominent chains in the private and affordable care segment while adding new positions in a leading premium care chain and a minor exposure to a standalone multispecialty asset in South India. ARPOB (Average Revenue Per Occupied Bed) continues to rise for each of them, driven by higher patient footfalls, a favorable case mix, and good capital efficiency. Given high earnings growth and reasonable valuations, these holdings remain resilient even in challenging market conditions.

Pharmaceuticals | We have exited a large generics player as the business continues facing headwinds in the export market. During the year, we have added exposure to specialized API players that emphasize building an extensive product portfolio of low-volume and high-value APIs while maintaining high compliance standards. We tend to be cautious with the uncertainty in exports for the Pharma sector and are very selective with portfolio construction in this space.

Infrastructure | We have increased our exposure in this sector over the year; however, the outlook turned challenging due to delayed government spending following the elections. However, the overall space is expected to recover as investments pick up. With structural growth in place, we remain optimistic about its long-term potential. Within infrastructure, we also have a favorable view of the Water Infra segment, which is poised for steady growth. We expect select companies in this space to benefit from increased investments and policy support, driving their long-term performance.

Financialization of Savings | The financialization of savings in India presents a significant growth opportunity driven by rising household incomes and the under-penetration of financial products. We remain optimistic about this space, given its long-term potential. Adhering to our valuation discipline, we have trimmed our exposure in this segment during the initial months of this financial year as valuations saw a sharp re-rating in a few of our holdings [wealth advisor and a KRA] while we took exposure to an asset management company (AMC) to our portfolio on the grounds of value.

Agrochemicals & Fertilizers | The agriculture sector has delivered a mixed performance. Our investments in the phosphatic fertilizer investment did well, benefiting from strong fertilizer demand, improved product mix, and operational efficiencies, leading to resilient earnings growth. The company's strategic focus on backward integration and new product launches further strengthened its position. On the other hand, the domestic crop protection-focused company faced headwinds due to adverse climatic conditions and internal restructuring issues despite a strong product portfolio. We expect this to reverse in the coming financial year.

Summary

Financial markets do not always reflect intrinsic value linearly. In times of heightened uncertainty, asset prices react disproportionately to short-term macroeconomic fluctuations and liquidity shifts. This is an integral characteristic of market cycles when pricing can deviate significantly from fair value in the face of external stressors. And India's current environment is no exception. While there is the issue of froth in several sections of the market, volatility driven by external adjustments amplifies reactions. While such distortions may create near-term challenges, they also present opportunities to engage with high-quality businesses at attractive valuations. We continue to evaluate/engage closely with our investee companies to check for resilience in the face of external headwinds while maintaining their ability to deliver medium-term growth.

As we continue to navigate evolving macroeconomic conditions, we reaffirm our conviction in the long-term growth trajectory of our investee companies. These businesses are structurally sound, well-capitalized, and positioned to capitalize on emerging opportunities across their respective sectors. Their strong fundamentals, innovation-driven strategies, and operational efficiencies underpin our confidence in their ability to deliver sustained value over time.

The following sections outline our investment strategies and provide a performance summary for Q3 FY25. 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 Q3 FY25. 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 four 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 of March 2025	FY 25E
Wt. Avg PE	23.9x
Wt. Avg PB	5.1x
Wt. Avg ROE	20%
Wt. Avg Mcap	Rs.136,106cr

BC AD

The strategy continues to invest in sectors that are currently witnessing a shift in market share from the unorganized to organized players. As India's economy rapidly grows in scale and sophistication, several sectors are poised to undergo significant changes over the next decade. Most of our invested companies are likely to experience an increase in their market share, as marginal players find it difficult to operate in the new environment.

As of March 2025	FY 25E
Wt. Avg PE	23.8x
Wt. Avg PB	4.7x
Wt. Avg ROE	20.0%
Wt. Avg Mcap	Rs.135,999cr

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 of March 2025	FY 25E
Wt. Avg PE	24.2x
Wt. Avg PB	5.0x
Wt. Avg ROE	21%
Wt. Avg Mcap	Rs.134,050cr

APJ

The fund 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 fund continues to focus on firms delivering manufacturing excellence broadly across technology, pharmaceuticals, materials, and infrastructure in general.

As of March 2025	FY 25E
Wt. Avg PE	22.2x
Wt. Avg PB	3.6x
Wt. Avg ROE	19%
Wt. Avg Mcap	Rs.122,348cr

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 of March 2025	FY 25E
Wt. Avg PE	20.4x
Wt. Avg PB	4.1x
Wt. Avg ROE	18%
Wt. Avg Mcap	Rs.105,463cr

Risk

Risk	Mitigants
Geo-political risks	Any geo political 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

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