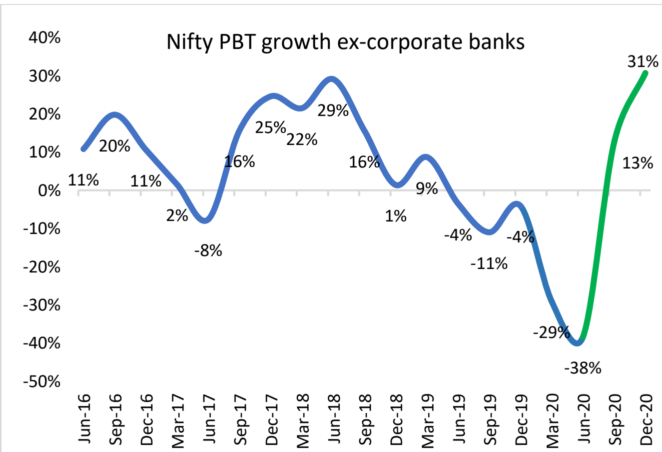
"Crises and deadlocks when they occur have at least this advantage, that they force us to think." - Jawaharlal Nehru

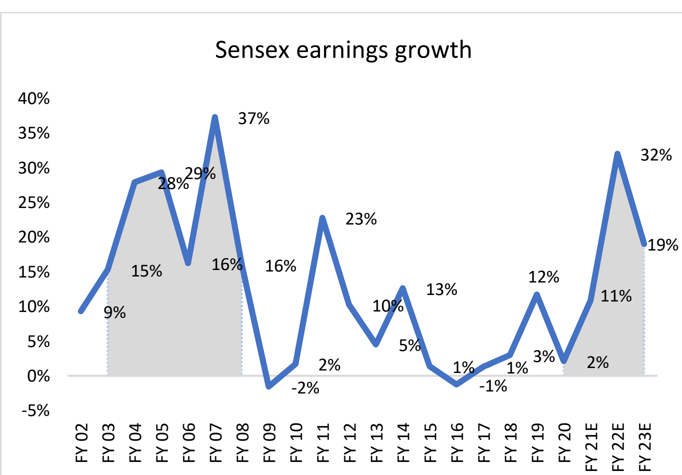
CY 2020 – Putting Roller Coasters to Shame

2020 was emblematic of the flaws in most financial and economic theories and did a remarkable job of exposing the complex systems we inhabit. While the markets discount deterioration sooner than one thinks it does, it is also much more forward looking than we give it credit for. In other words, the sharp recovery in prices we are witnessing today, is now almost perfectly explained by the sheer weight of earnings growth that is coming in by the day. With the benefit of hindsight, it adds up perfectly.

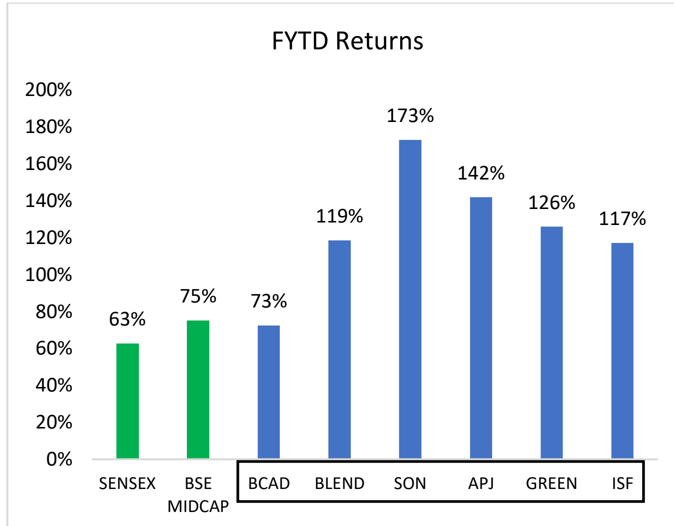


As the numbers indicate, India has come out of the pandemic much faster than <u>*anyone*</u> *anticipated.*

The environment supporting this pace of earnings growth requires us to contemplate the direction of change underway. <u>Ergo, prices have moved from discounting a margin of safety, to chasing the margin of upside</u>, given the sheer quantum of earnings growth. As the next chart indicates, India has not witnessed this direction of expected earnings growth in more than a decade; almost 60% across FY21-23e.



The simple observation is that the prevailing circumstances have not only lowered the cost of capital, resulting in drastic repricing of equities (upside), but improved the prospects of most of our investee companies. Although it is early to call the likelihood of permanent change, the signs of (a) inflection among sector leaders, and (b) consolidation are clear, and these form the bedrock of Unifi's approach to investing. The numbers reflect that.



TWRR returns as on 31st Jan 2021

Unifi's Investment Strategies
BCAD- BCAD Fund; BLN- Blend Fund; SON – Spin Off Fund; APJ- APJ Fund; GRN- Green Fund; ISF- Insider Shadow Fund

An Encore

FY03-FY08 was among corporate India's finest years with the Sensex recording an earnings growth of 25% CAGR. This was a result of the various reforms implemented in the previous years across the core of India's economy. In the following years, as India reverted to the classical school of fiscal prudence, the imperative of creating growth took second seat to managing the fiscal, and inflation. This crisis forced the Government to revisit its policy template and push for tangible expansion in the real economy.

Breaking out of the IMF framework, the Union Budget of 2021 set clear its emphasis on capex-led growth at the cost of near-term fiscal pressures. This will augur well for corporate India in the times to come as (a) the groundwork for multiplier effect is laid on higher government spending and (b) push on rightly incentivized domestic manufacturing, will ultimately abet the transmission of money supply across the economy. The focused push for domestic manufacturing by way of PLI schemes in Electronics, Pharmaceuticals, and several other sectors will catalyze India's capex push for the next several years. Coupled with India's rapid GST led formalization, and turning of India's credit cycle, this presents the perfect platform to deliver growth on for multiple years ahead. From a micro economic level, pentup demand is not a two-quarter phenomenon. The uncertainties at the macro level have hindered investment decisions over the past several years and the coming years promise to make up for them. To sum it up, we are set for interesting times.

In closing, when facts change, investment opinions follow. As you may have noticed from your portfolios, the stocks that have performed in the 2020 cycle have largely made way for newer investments that are likely to benefit from the new normal.

At Unifi, we are aligned with each of the above trends, but at the same time stay true to our core principles of seeking the right mix of risk and reward in each of our investments.

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 FY21. 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.

DVD / Blend

The DVD / Blend fund 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 Feb 22, 2021	FY 21E
Wt. Avg PE^	23.2x
Wt. Avg PB	4.9x
Wt. Avg ROE	28%
Wt. Avg Mcap	Rs. 54,359cr

^ex- BFSI

BC AD

The fund 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 Feb 22, 2021	FY 21E
Wt. Avg PE^	30.0x
Wt. Avg PB	11.3x
Wt. Avg ROE	29%
Wt. Avg Mcap	Rs. 40,914cr

^ex- BFSI

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, chemicals, pharmaceuticals, materials, and infrastructure in general.

As on Feb 22, 2021	FY 21E
Wt. Avg PE^	17.7x
Wt. Avg PB	5.0x
Wt. Avg ROE	22%
Wt. Avg Mcap	Rs. 56,476cr

^ex - BFSI

Spin Off

The spin off fund seeks to generate superior risk adjusted returns relative to market indices by investing in stocks of companies that are undergoing a corporate demerger. Typically, in a transaction such as this, the sum of the parts of valuation of the different companies that are undergoing a separation is higher than the market cap of the de-merged entity. The fund's proposition is to gain from the fundamental asymmetry linked value-price mismatch, by closely tracking the entire Spin-Off process and investing in such companies, subject to a comfort from bottom-up fundamentals.

As on Feb 22, 2021	FY 21E
Wt. Avg PE^	22.2x
Wt. Avg PB	5.6x
Wt. Avg ROE	19%
Wt. Avg Mcap	Rs. 23,046cr

^ex- BFSI

ISF

The Insider Shadow Fund 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 Feb 22, 2021	FY 21E
Wt. Avg PE^	15.1x
Wt. Avg PB	2.8x
Wt. Avg ROE	16%
Wt. Avg Mcap	Rs. 12,654cr

^ex – BFSI

Green

The fund continues to invest in sectors that will benefit from India's evolution towards a more "sustainable economy". The investment universe would comprise of well managed businesses offering best in class solutions to address challenges in the areas of Energy, Emissions, Waste and Water.

As on Feb 22, 2021	FY 21E
Wt. Avg PE	20.9x
Wt. Avg PB	4.2x
Wt. Avg ROE	20%
Wt. Avg Mcap	Rs. 21,992cr

^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. How long it takes for sentiment to return in consumption remains to be seen. 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	The Galwan incident at the Sino-Indian border has increased tensions on both side of the LAC. Even though talks are continuing though the diplomatic channels, both the countries have mobilized troops close to the border. Any flare up can escalate into a full-scale military action between two of the biggest armies of the world and disrupt supply chain in the region.
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 (Corona Virus, and 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 spanning Brexit, US-China trade war, OPEC related developments, and other geo-political issues. 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. Further, in case 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

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