THE BLENDED AIF

2^{nd} Quarterly Review - Sep 2019

Executive Summary

Unifi Capital actively manages six bottom up equity strategies that sift through opportunities across the breadth of the market. The mandate is to participate in opportunities that arise from: *a mix of emergent themes, corporate actions and attractiveness of core fundamentals*. Our objective is to deliver superior risk adjusted returns from an absolute perspective. Investments under the Blend fund have accordingly been cherry picked from across 6 distinct funds. In effect, the endeavor has been to identify *"the best of our best".*

The Blend AIF went live on 15th Feb, 2019 and over the last 6 and a half months we have deployed about 89% of the capital. Each of our investments are a function of rigorous bottom up evaluation, and a common thread that runs across each of them may be characterized as follows:

I. Leader in its industry
II. Privy to fundamental tailwinds
III. Strong leadership teams with track record of execution
IV. Good Corporate Governance and financial discipline
V. Insulated from disruption for foreseeable future

In the course of our primary diligence and investment, we have engaged with the managements of all our investee companies (ex-Coal India) in addition to secondary channel checks to triangulate our thesis.

Just as in our first communique to you, we shall be briefly touching upon the rationale behind three of our large holdings and our thoughts on their future.

Suven Life Sciences

Established in 1989, Suven is based out of Hyderabad and operates in five segments.

- **Contract Research & Manufacturing Services (CRAMS)** develops and supplies cost-effective pharmaceutical and agrochemical intermediates for New Chemical Entities (NCE's) to global majors including the likes of AstraZeneca, Perrigo, Sanofi, Pfizer, Bristol-Myers, Lilly, Bayer and Merck.

- **Drug Discovery Research Services (DDRS)** to global pharma and biotech companies in physicochemical properties, screening (receptors/enzymes), and the entire development value chain.

- **Formulation Development Centre** supports drug discovery and product delivery through customized and dedicated formulation development laboratories, which is highly technical and infrastructure intensive in nature.

- **Specialty Chemicals** undertakes commercial scale manufacturing and supply of intermediates to Specialty chemicals companies that have engaged Suven's contract research services.

- **New Drug Discovery –** Suven is also focusing on discovery of new drugs especially in the Central nervous system (CNS) space. The intent of this division is to develop new chemical entities (NCE) and prove its safety and efficacy at a trial scale and then out-license / partner with a bigger innovator company for a commercial launch. At the out-licensing stage, there is normally a huge monetisation opportunity.

Suven has 13 molecules in its NCE pipeline under various stages of trials, of these Suvn 502 is their flagship NCE molecule which is now in proof of concept phase 2 trials wherein the safety and efficacy of the drug is being tested. Suvn 502 is a CNS drug to treat Alzheimer's. Over the years, Suven has spent Rs. 450cr+ in new drug discovery R&D and has completely expensed it.

Demerger & Value unlocking - New Drug Discovery will be the only division of Suven Life Sciences as all the other divisions are to be demerged into a separate company which shall be named Suven Pharma. The notified date of this de-merger is 01-October-2018. The NCLT led demerger process is likely to be completed in the next 9 to 12 months.

Suven Life will have Rs. 300 Crs cash to undertake R&D for few more years by which it expects an integration with a larger partner. This division will have only costs in the P&L till such time monetisation of R&D pipeline happens.

Suven Pharma, the demerged company, will not have to absorb the R&D costs of Suven Life (about Rs. 56cr for FY19) and on account of this Suven Pharma's operating margins will move up from 35% levels to above 40% levels.

Laying foundation for sustained growth through Rising Pharma - Recently, Suven announced a JV with Shore Pharma of USA to acquire Rising Pharma's IP assets from Aceto corporation. Rising Pharma is a bankrupt company with 89 commercialised ANDAs and 26 ANDAs approved but yet to be launched and 13 ANDAs filed and awaiting approval. The revenues associated with these assets is about $220 Mn per annum. Suven and the JV partner (former director of Aceto corporation) have jointly bid for these IP assets at $140 Mn. Suven will take a 25% stake to start with and it has invested USD 35 Mn. Rising Pharma has been a client of Suven in the CRO business and that's how the interactions started. The strategic intent is to get formulations CRAMS orders from this JV. Contribution from Rising pharma is expected only in FY22 and beyond.

The CRAMS business is expected to perform steadily over the next 18 months and the unlocking of value through demerger shall act as a strong tailwind. In due course, Rising Pharma should start yielding results. Suven Pharma is poised to generate RoE of 19% and earnings growth of 15% over next two years. The stock currently trades at a P/E of 13.3x FY 21e.

Intellect Design Arena

Globally, there are about 50 technology firms of scale that have the capability provide a full-service CBS (core banking software) to financial institutions of scale. The complex nature of the industry, strict regulations, and the high cost associated with failure are the biggest entry barriers for this industry. Intellect is an emergent and fast growing digital and cloud enabled players in the CBS space that has built strong credentials over the past decade in the global banking industry, as demonstrated in their license wins across several tier-1 and tier-2 financial institutions in both developed and emerging economies.

Intellect today caters to 200+ global financial institutions of scale with 47% of its revenue comes from advanced economies, demonstrating its technical competence. Advanced-market contracts have high gross margins (55-60%) and a total contract value of a large client can reach to US$ 20-25mn in revenue over the years. Over the past few quarters, the company has booked license revenues > Rs. 500cr., expanding on its relevance and building a strong stream of annuity revenues for the future. As the management continues to focus on expanding its reach in advanced markets, we believe a material ramp up in operating leverage, and earnings will follow.

We like Intellect for its demonstrated ability of building a relevant digital, cloud enabled product practice that is seeing increased adoption around the world. Their deal wins from the Reserve Bank of India (RBI) for central bank software, Life Insurance Corporation of India for insurance software, GeM (Government of India e-market place) and a string of licence wins from North America, Middle East to Singapore demonstrate their technical relevance and reference-ability for the future. We expect them to continue to grow earnings at 50% CAGR over next two years, which in turn shall boost the RoE to 15%. The stock currently trades at 1.7x revenues, which is at a steep discount to its global peers.

Equitas

Incorporated in June 2007, 'Equitas Holdings Ltd' is a Chennai based financial services provider focused on individuals and micro and small enterprises (MSEs). It is a 100% holding company of Equitas Small Finance Bank. Equitas offers financial services to low income groups and economically weaker individuals operating small businesses and MSEs with limited access to formal financing channels. Set up in Sep 2016, Equitas SFB was one of the 8 microfinance institutions to receive the license from RBI to set up a small finance bank. It was the first listed small finance bank when it went public in April 2016. Led by Mr. Vasudevan who has an experience of about two decades in Cholamandalam Investment and Finance Co Limited, the bank has scaled up its operations over the past 3 years and is now present in 15 states, serving 27 lakh customers with a balance sheet size of almost Rs 17,000 Cr.

The loan book is well diversified as the management steered away from the unsecured MFI loans to secured loans in the form of MSE loans and vehicle finance loans. MFI now constitutes 25% of the AUM with the rest coming from small business loans (41% share) and vehicle finance loans (25% share). AUM growth continues to be strong at 38% YoY to reach Rs 12,355 Cr at June 2019. Asset quality was good with GNPA at 2.75% and NNPA at 1.69%. The bank recorded a strong traction in growing its deposit franchise with term deposits growing by 65% YoY in Q1 FY20 to reach Rs 6,435 Cr. CASA ratio is respectable 26% at the end of Q1-FY20.

Customer deposits (CASA + fixed deposits) as a percentage of total borrowings is now at 63% which decreases the dependence on external borrowings. Given this growth, the management has now cut the deposit rates post Q1 FY20. This should bring down the cost of funds going forward. We are expecting the bank to record a PAT of Rs 310-320 Cr in FY 20 with ROE of 12%; At P/B of 1.43x. and a P/E of 12.4x FY 20e, there is margin of safety in the valuation.

Listing of SFB: Equitas Holdings being the holdco of SFB was expected to list the SFB separately by Sep 2019. The management had applied to the exchanges in Feb 2019 for the same. The application was forwarded by the exchanges for SEBI clearance. This might take another month's time thus missing the Sep 2019 deadline. The bank has already been in touch with RBI for extension of the deadline given the delay in the statutory approvals. We expect RBI to extend the same.

Q1 FY20 | Results summary

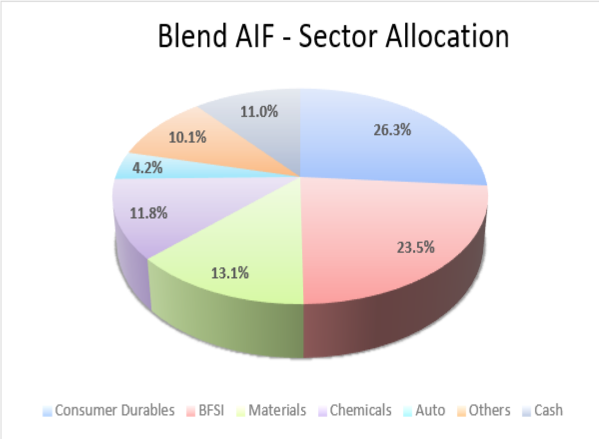
Of the BFSI holdings, Equitas & Can Fin Homes have reported Q1 in line with our expectations. Bank of Baroda reported its first quarterly results post its merger with Vijaya Bank and Dena Bank, with asset quality metrics better than expectations. Loan growth should pick up from the levels of 6.4% seen in Q1 as Dena bank was under PCA prior to the merger. IIFL Finance saw a 19% growth in AUM with a stable asset quality and now 85% of its loan book is retail in nature.

All three of our investments in consumer durables space (VIP, Crompton Consumer & Sheela Foam) had a steady start to the year and same was the case for our two investments in pharma (Suven & Aarti Drugs). Intellect, our sole investment in IT, reported mixed results with decent momentum in revenue growth but lower than expected margins, partly due to higher depreciation, leading to flat YoY PAT. However, as a product company, the trajectory in their revenue and margin growth is expected to be lumpy, but directionally positive.

Despite a very weak environment, TVS Srichakra reported a 2% sequential improvement in margins, which can improve further in the 2nd half as rubber prices have corrected by ~30%. Garware reported softer than expected performance, which was primarily due to weak institutional business in the run up to elections. Garware shall recoup the lost business in the second half. In case of Coal India, the improvement in operational performance has been weaker than our expectations. Additionally, there has been a softening of International Coal prices. As there could be an impact on FY20 earnings, we are acting to mitigate it.

Key Portfolio Metrics

The following schema illustrates the broad sectoral and thematic allocation for the Blend Fund.



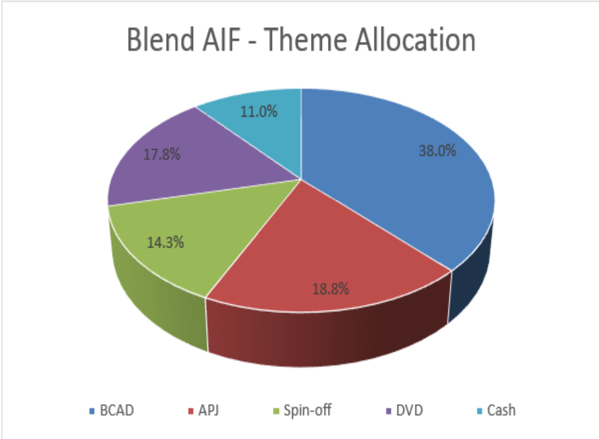


Exhibit 2: BLEND AIF allocation as on 31st August 2019

It is imperative to highlight here 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 31st Aug 2019)	FY2019	FY2020E
P/E Ratio *	24.5	18.5
Earnings Growth *	14.6%	21.8%
Debt Equity Ratio	0.25	0.16
ROE %	21%	22%
PE/ Growth Ratio	1.67	0.85

**Adjusted for one-off to make figures representative*

We are continually monitoring the environment for opportunity to profitably deploy and our cash position is an outcome of our investment process and not a call on cash per se. We will be writing to you again in November with updates on the fund and delving deeper into our other holdings.

In closing, we encourage you to write to us, or your relationship manger for a detail portfolio review and understanding our proposition at greater granularity.

With best wishes,

K Sarath Reddy
Founder and CIO

Annexures:

Financial Details of Portfolio Companies

(Rs. in Cr)	Sales*		Operating Profit #		PAT		D/E Ratio	ROE	Portfolio Weight
Company	Q1 FY'20	FY'19	Q1 FY'20	FY'19	Q1 FY'20	FY'19	FY'19	FY'19	
CROMPTON GREAVES CONSUMER	1,347	4,479	192	584	122	401	0.55	43%	11.4%
GARWARE WALLROPES	232	1,018	43	192	30	126	0.17	21%	9.3%
VIP INDUSTRIES	564	1,785	126	225	68	145	0.15	25%	8.2%
EQUITAS	344	1185	126	433	62	219	-	11%	7.9%
BANK OF BARODA^	6,928	20,401	4,393	15,518	834	1,100	-	2%	7.5%
HIMADRI SPECIALITY CHEMICALS	524	2,377	122	537	74	307	0.26	18%	6.9%
SHEELA FOAM	436	2,141	53	209	39	134	0.04	18%	6.3%
SUVEN LIFE SCIENCES	201	664	62	224	26	150	0.04	15%	5.8%
AARTI DRUGS	405	1,561	55	207	22	90	0.87	17%	4.4%
INTELLECT DESIGN ARENA	343	1,450	12	128	3	131	0.10	13%	4.3%
TVS SRICHAKRA	606	2,382	73	259	26	103	0.57	14%	4.2%
CAN FIN HOMES	148	531	134	474	81	297	-	18%	3.9%
COAL INDIA	24,939	1,00,051	6,612	24,649	4,630	17,464	-	74%	3.8%
IIFL Wealth Management	361	1,577	100	559	62	374	-	15%	1.6%
IIFL Finance	542	2,151	291	1,432	174	644	-	16%	1.5%
IIFL Securities	185	876	52	300	24	171	-	23%	1.2%
NAVIN FLUORINE INTL	252	955	61	218	43	149	-	14%	0.5%
POLYCAB INDIA	1,933	7,956	205	1,014	135	500	0.10	18%	0.4%

* In case of financials (Bank of Baroda, IIFL Finance, Can Fin & Equitas) instead of Sales, Net Interest Income (NII) has been reported
# In case of financials (Bank of Baroda, IIFL Finance, Can Fin & Equitas) Pre-provision Operating Profit (PPOP) has been reported
^ FY19 Figures are for consolidated BOB pre- amalgamation, hence not comparable with post amalgamation financials for Q1-FY20

Information on Fund Risk Management

Price Risk: *Stock markets are volatile and may decline significantly in response to adverse issuer, political, regulatory, market or economic developments. Different parts of the market and different types of equity securities may react differently to these developments. For example, small cap stocks may react differently than large cap stocks. Issuer, political or economic developments may affect a single issuer, issuers within an industry, sector or geographic region, or the market as a whole. Unifi AIF 3 – BLEND Fund adopts a bottom up approach towards investing. Also, various macro events and its implications are considered to reduce the overall negative impact on portfolio.*
Loss of Capital: *All investments in securities present a risk of loss of capital which is an outcome of various events like macro events or something internal to the company. The Fund would seek to moderate this risk of loss of capital through a careful selection of investments.*
Liquidity Risk: *This represents the possibility of not honoring redemptions upon closure of fund due to illiquidity of the portfolio. Also, it is possible that the realized price from selling the security might be lesser than the valuation price as a result of illiquid market. The Fund would ensure that at a significant portion of its investments can be liquidated at prevailing market prices.*
Risk of Key Personnel: *This represents loss of one or more key personnel of the Fund Management team who are responsible for managing the Fund's portfolio. The process of investment and fund management is institutionalized and hence procedure driven. This reduces the risk of loss of key personnel.*
Concentration Risk: *This represents risk of concentration of investments in few opportunities. This risk is minimalized as individual position weightage isn't allowed to go beyond 10% of the Investible Funds.*
Leverage Risk: *This represents risk of leverage risk at the investee company level. This risk is minimalized through prudent selection of investments.*