UNIFI Capital


# THE GREEN FUND

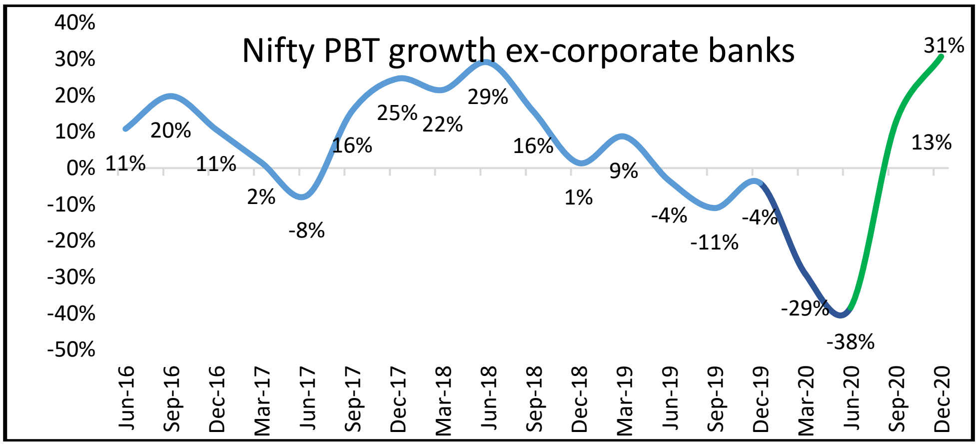
QUARTERLY REVIEW - MARCH 2021

## UNIFI AIF 2 – The Green Fund

The Green fund targets capital appreciation by investing in the next generation of winners arising from India's evolution towards a more *sustainable economy.* The investment universe comprises of well managed businesses offering best in class solutions to address challenges in the areas of Energy, Emissions, Waste and Water.

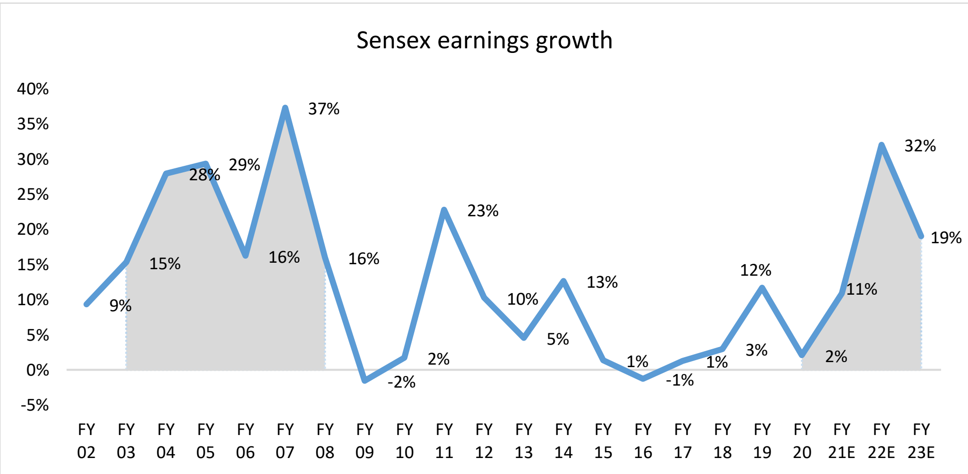
### CY 2020 – Putting Roller Coasters to Shame

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 anyone anticipated.

The environment supporting this pace of earnings growth requires us to contemplate the direction of change underway. Ergo, prices have moved from discounting a margin of safety, to chasing the margin of upside, 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.2




### FUND DETAILS

**Launch Date:**
31 July 2017

**Scheme AUM:**
INR 1.51 bn

**Theme AUM[1]:**
INR 2.85 bn

**Firm AUM:**
INR 64 bn

**No. of Investors:**
71

**Investment Manager:**
Unifi Capital Pvt Ltd.

**Tenure:**
5 Years or 200% absolute return whichever is earlier

**Custodian**
BNP Paribas

**Reporting:**
Quarterly Review

**Hurdle Rate:**
12% Per annum compounded

**Fees:**
1% per annum of AUM payable monthly and 20% of profits earned above the hurdle rate. The management fee would be offset from our share of Profits.

*[1]AUM under Green Fund in PMS as well as AIF.*

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.

## An Encore

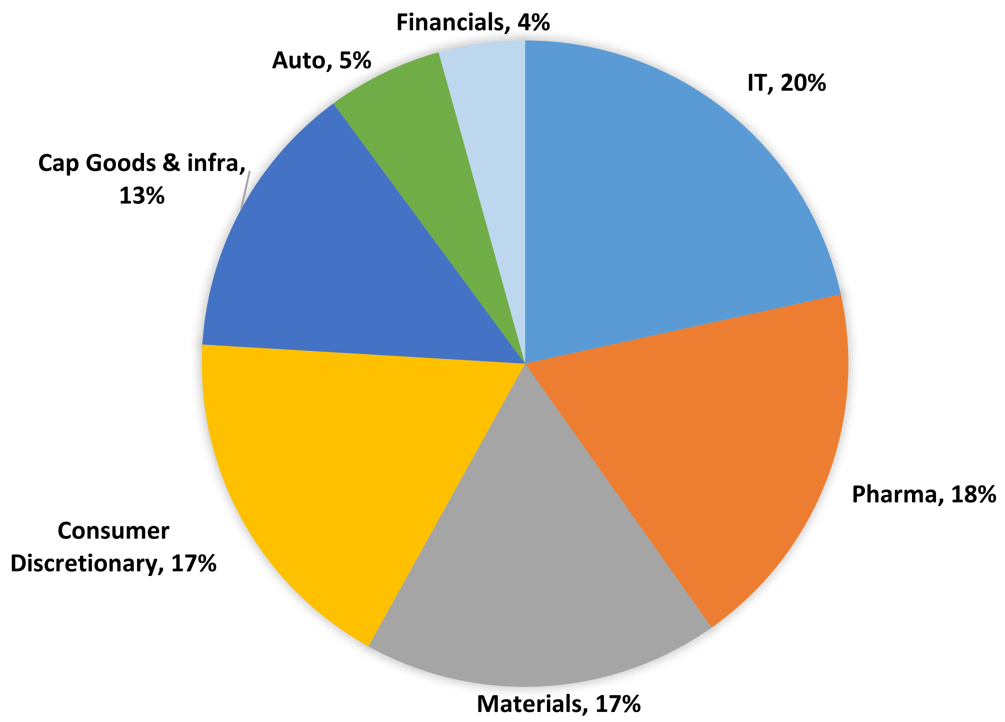
FY03-FY08 was among corporate India's finest years with the Sensex recording an earnings growth of 25% CAGR. This was a result of the various reforms implemented in the previous years across the core of India's economy. In the following years, as India reverted to the classical school of fiscal prudence, 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 catalyse 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, pent-up 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, 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.

## Sector Exposure



## Summary of results from the quarter Q3-FY 2021

**I Information Technology (IT):** This segment constitutes about 20% of the fund's total investments with major exposure to the following companies.

**Sonata** delivered Sales growth of 13% YoY driven by both their seasonal products sale in Q3 FY21 which almost doubling sequentially to Rs.1100cr (21% YoY) and IT services sales of Rs.300cr with 4.5% QoQ growth. Their IT services EBIDTA margin improved 450 bps QoQ to 28.9% thereby showing 110bps YoY improvement. This has propelled their overall EBITDA margins to improve 150bps YoY and 250bps QoQ to 11% (Products have modest 2.5% EBIDTA Margins). The adjusted earnings post the Vivaad se Viswas tax provision was flattish YoY, despite the weakness in their top account from the travel vertical. However, PAT improved 72% sequentially from Q2-FY21 on the back of a recovery in the stressed travel segment and recovery is expected to continue with stable macro conditions.

Sonata is a key partner to Microsoft in their global product development initiatives and has a strong domestic products re-selling business. With the worse of the pandemic induced stress in their travel business behind them, we expect the traction in earnings to return sequentially over the next few quarters. There is a trend of better off-shoring that is being witnessed on the back of industry wide work-from-home initiatives, and this is likely to be margin accretive in the times to come.

Risks: Slower than expected economic recovery in Europe and cuts in discretionary IT spends by enterprise clients.

**Tech M** delivered good sequential revenue growth of 3.5% YoY to $1,309 mn for Q3 FY21 but -3.3% YoY decline. In INR terms, EBIDTA and PAT delivered growth of 21% and 13% YoY respectively. This growth was driven by steep increase in margins [by 360 bps] to 19.6%, driven by better off shore and lowering sub-contracting costs along with margin uptick in their portfolio companies. Segmentally, major growth driven was by the Technology, Media & BFSI which were up 20% YoY along with recovery in retail (6% YoY) and represent 34% of their revenues, and looking ahead, incremental growth is expected to be driven by Telecom and Manufacturing segments (10% YoY decline and represent 57% of revenue). Demand induces by 5G technology expected to dive further enterprise growth in FY22. They will continue to strive for margin sustenance at these levels and demand growth in telecom and other segments, accelerating in the forthcoming year.

Risks: Slower than expected economic recovery in USA and Europe and cuts in discretionary IT spends by enterprise clients.

**Wipro** delivered revenue growth of 3.9% sequentially to $ 2,071mn and margin expansion [EBIT] to 21.7% against 18.4% YoY. On the back of this, PAT at INR 2,967cr, was up 20.8% YoY. EBIT margin increase (+350bps) was led by mix shift towards offshore and largely stable utilisations. Some of this operating efficiency is expected to continue, but as business / travel return to usual, the sustainability, margins will moderate a little. Manufacturing grew 4.0% QoQ CC, Healthcare 5% QoQ CC & Consumer 5.1% QoQ CC while BFSI growth was restricted at 1.2% QoQ CC. Even after the second quarter of recovery, revenue run-rate across verticals and geographies (barring Health BU, Europe, and Technology) is still lower than pre-COVID levels, hinting at another potential quarter of revenue recovery. In order to consolidate their position in the global BFSI industry, the has recently acquired leading technology consultancy firm, do drive the needed scale for synergy and growth in the vertical.

Risks: Slower than expected economic recovery in USA and Europe and cuts in discretionary IT spends by enterprise clients.

**II Pharma and Chemicals:** The Green fund has an exposure of 18% to this segment with major investments detailed below.

**Suven Pharma** reported good in-line results w.r.t Q3FY21. Sales and EBIDTA were up 52% and 70% on a YoY basis & 18% and 45% on a QoQ basis respectively. PAT grew by 95% YoY and 53% QoQ. The impressive results were due to the product mix and profit-share eligibility from the U.S. formulations business. The nature of Suven's research services segment and campaign based commercial supplies necessitates tracking its annual progress rather than quarter-wise. From that standpoint, the 9MFY21 numbers indicate a growth of 15% YoY both in terms of revenues and profits which is as per our expectations.

Suven currently has six commercially launched intermediates and specialty chemicals and is looking to add two more in FY-2022. SPL has also diversified into formulations by building appropriate capacities and obtained USFDA approvals. Company has launched 3 ANDAs (formulation drugs) in 9MFY21 and looks to launch 1 more in Q4. It also targets to launch 3-4 ANDAs every year over the next 5 years. The pace of additions to research projects have increased post the lull in H1 and this bodes well for billings in the coming quarters. The sequence of the proposed Rs.600cr multi-year capex would be discussed in the ensuing quarterly call. The performance of Suven's associate Rising Pharma (USA) is progressing better than expectations and opportunities for commercial contracts could arise in the future from them.

Key risks - Management bandwidth (COO hiring delayed) and low traction in research activities due to covid are the key concerns.

**JB Chemicals** reported revenue growth of 28% YoY to Rs.548cr. EBITDA and Operating PBT registered growth of 91% YoY and 112% YoY to Rs.171cr and Rs.153cr, respectively. Domestic business delivered growth of 26% YoY driven by key chronic segments - cardiovascular/anti-hypertensive. MR Productivity had improved from Rs. 3.6 Lakh in FY20 to Rs. 4.4 Lakh in 9M FY21. Exports grew by 31% YoY. Exports for Q3 FY21 had been incrementally strong as it also included revenue deferred from Q2 FY21. The company registered 31.2% EBITDA margin as against 20.9% last year on the account of operating leverage and cost optimization initiatives by the new management.

We like the company due to the strength of its 4 key brands (Cilacar | Nicardia | Rantac | Metrogyl) and the potential for KKR to accelerate its growth momentum.

Key risks: Supply chain disruptions, Pricing pressure in Domestic Business and unexpected regulatory developments.

**III Materials:** The Green fund has an exposure of 17% to this segment with various investments detailed below.

**Hyderabad Industries** delivered Sales, EBIDTA and PAT growth of 38% / 136% and 508% growth on YoY basis with strong recovery in all business segments. Roofing, Parador and Polymer segments have delivered 30%, 80% and 40% YoY. A buoyant rural economy has led to strong demand for their roofing business, while the flooring business in Europe continues to deliver ahead of the market and sustain the demand. Cost optimization, a better pricing environment and de-leveraging, has led to margin expansion of 520bps YoY. We expect the company to significantly deleverage over the next 12-18 months and continue to deliver ahead of the market in each of its segment of operations. The company has displayed high growth environment and the management's vision is aligned in similar lines going forward.

Key risks may emanate from poor rural sentiment for the year ahead, higher competitive intensity, and inability to procure raw materials at favourable prices.

**JK paper** reported revenue decline of 9% YoY to Rs. 745cr. EBIDTA and PBT declined by 33% YoY and 51% YoY to Rs. 155cr and Rs.103cr, respectively. While YoY numbers reflect that the company is still below pre-covid profitability, there was sharp PBT improvement of 69% QoQ.

JK paper is play on revival on domestic paper consumption driven by reopening of offices and educational institutions. Further the company is increasing its capacity from 4.36 lakh tonne to 7.42 lakh tonne driven by green field packaging board expansion in Gujarat with capacity of 1.7 lakh tonne and addition of 1.36 lakh tonne from inorganic acquisition of Sirpur paper mills. The medium-term earnings growth would be driven by volume increase, cost optimisation and better realisation.

Key risks would be delay in capacity addition, decline in realisations and extended impact of COVID-19.

**Mahindra EPC** reported Sales/EBIDTA and PBT YoY decline of 2% / 11% and 7% respectively. The numbers need to be seen in the context of the fact that in the micro irrigation sector, 60% of business flows in H2. The company is now operating at 90% utilization, and on the back of strong demand from the agri sector, the outlook continues to remain robust. The collapse of market leader in the micro irrigation industry, favourable government support towards irrigation and low penetration levels in India, makes the company well poised to capture incremental demand in the sector.

Key risks would arise from delay in subsidy release from the government, higher raw material prices and extended impact of COVID-19.

**IV Consumer Discretionary:** The Green fund has an exposure of 17% to this segment with major investments detailed below.

**Stovekraft's** revenue increased by 47% YoY and 24% QoQ to Rs. 295cr. Company continues to benefit from higher in-house consumption and sift from unorganized to organized in the Kitchen appliances sector. They continued to increase their manufacturing presence and reduced the dependence of imports. This led to gross margin expansion to 35.7% from 35% in Q3FY20. Operating leverage benefit due to steep increase in sales resulted in EBITDA margin of 14.5% in Q3FY21 vs 8.2% in Q3FY20. Given the historical losses, company isn't required to pay any tax and hence the PAT came at Rs. 33cr in Q3FY21 vs Rs. 9cr in Q3FY20.

Kitchen appliances is an under penetrated category and has large unorganized market. Piegon is a value brand, which offers products at 20-30% cheaper to the larger competitors. Stovekraft is able to offer products at lower price given high backward integration. Unlike many other players who depends on outsourcing/importing from China, Stovekraft manufactures most of the products in-house. So, customers who are upgrading from unorganized to organized will find Pigeon as more attractive. Also, company is increasing its distribution reach and adding more SKUs. We believe Stovekraft would continue to benefit from the tailwinds of the sector and company led execution.

Key risks: sharp increase in the raw material prices and increasing competition.

**Symphony's** revenue declined by 26% YoY to Rs.216cr as the trade channel continued to have higher levels of inventory, due to lockdown in the peak summer seasons of April and May. Given lower recovery of fixed costs, the company reported an EBITDA of Rs.33cr which was a decline of 52% YoY. The reported PAT declined by 47% YoY to Rs.27cr. Summer is the key season for air cooler sales and the impact of lockdown has been very material for the current year. We look forward to normal operating conditions in the next year and expect the company to come back well, given the scope for consolidation in this space, given the higher share of unorganized players.

Risk: Increasing competition leading to pressure on margins and erratic weather pattern, leading to a poor summer season in general.

**Crompton Greaves Consumer** delivered Sales, EBIDTA and adjusted PAT growth of 26% / 46% and 45% growth on YoY basis, and reported sharp improvement on all parameters, led by their structural efficiency initiatives. Both their segments, Lighting (up 10% YoY) and Consumer durables (up 32% YoY), did well. In each of their key product segments across Fans, Lighting, Pumps and other Electric Appliances, the company delivered ahead of industry growth rates, on the back of product innovation, premiumization and their market reach initiatives. Constant product re-engineering with an intent of improving functionality and optimizing input costs has been a continues feature in their execution, leading to continuous margin improvement. We expect this trend to continue, along with headline growth that is ahead of the industry. 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 them as we expect them to benefit from this phase of consolidation.
Key risks to the investment could emanate from drop in consumer purchasing power, translating to lower sales of consumer durables.

**V Cap Goods and Infrastructure:** The Green fund has an exposure of 13% to this segment with various investments detailed below.

**KEC International** reported revenue growth of 7% YoY to Rs. 3289cr as the covid impact in Brazil continued to be severe. Ex- Brazil, revenue growth is 15% YoY. During the quarter, company also reduced the pace of execution for few of the projects as there had been a steep increase in the raw material prices. The EBITDA declined by 6% YoY to Rs. 299cr given the elevated metal prices. PAT had been flat on YoY basis at Rs. 145cr given the lower interest expense.

The revenue growth is expected to bounce back from Q4 as the raw material prices are on declining trend and Brazil is coming back to normal operations. During H1 of the year, the order intake had been muted as many government agencies could not operate fully given the circumstances. Project tendering and awarding has now gained traction from October. KEC has an order book and L1 position for Rs.24,000cr., which gives revenue visibility for several more quarters. The higher infra expenditure in the budget (especially for Power and Railways) augurs well for KEC and we expect company to be a good proxy play for the infra.

Key risks include entail higher receivable cycles and unforeseen project delays.

**Triveni Turbine** reported revenue decline of 15% YoY to Rs. 174cr. EBIDTA and Operating PBT declined by 16% and 17% respectively to Rs. 35cr and Rs. 29cr respectively. The decline in revenue was due to delay in project execution in the international market. Gross margin improved by 230 bps despite steep rise in commodity prices as contracts are structured in a manner where raw material price inflation can be passed on to the customers.

Order inflows continue to remain sluggish because of slower finalization of orders and deferment in the exports market especially in the South-East Asian market & Europe. As and when, travel restrictions eases, exports business will come back to growth path. Cement, Steel and Distillery are driving the Domestic market with increase in focus towards wastage heat recovery and new capital expenditure. We continue to hold Triveni Turbine given the strong balance with cash of Rs. 350 cr and its ability to grow market share in small scale steam turbines.
Key risks include failure to strengthen order book in FY22 and slowdown in the private capex.

**VI Auto:** The Green fund has an exposure of 6% to this segment with various investments detailed below.

**Honda India** reported revenue growth of 20% YoY to Rs.285cr, however the gross margin declined from 39.4% in Q3 FY20 to 36.1% in Q3 FY21 due to higher raw material prices. EBITDA margin at 10.5% was flattish YoY due to positive operating leverage on the backdrop of higher sales.

PAT increased by 22% YoY to Rs. 21cr. We expect further improvement in company's profitability in subsequent quarters on the back of strong traction that is under way in agricultural spends and also the key export markets like North America and Middle East doing well.

Key risks would arise from delay in subsidy release from the government and extended impact of COVID-19.

**Mayur Uniquoters** delivered 22% YoY revenue growth, on the back of strong volume growth in the auto segment. Gross margins improved by 210 bps YoY to 45.7% on account of price hikes and a richer product mix. EBITDA was up 46% YoY to Rs.45cr, aided by margin expansion and operating leverage. Overall, PAT was up 50% YoY to Rs.35cr. The company started servicing orders of Mercedes through exports and saw some traction for their production at the new PU plant. Mayur also added new clients like Volkswagen and BMW and is looking to tie-up with a Korean company to increase global footprint. This augurs well for revenue growth through exports, which is a higher margin business. The volume recovery in the footwear segment, ramp up of PU plant and business from new clients provides good visibility for earnings growth going forward.

Key risks would be sharp increase in PVC prices, delay in ramp up of the PU plant and logistic issues for exports.

**VII Finance:** The Green fund has an exposure of 4% to this segment through Karur Vysa bank (KVB) detailed below.

**KVB** reported AUM growth of 5% YoY and 3% QoQ to Rs.52,113cr, however NII growth was lower at 1% YoY due to reversal in interest income. The bank made a one-time provision of Rs176cr for employee wage revision agreement, which bumped up the cost income ratio leading to a lower PPOP of Rs256cr. Bulk of restructured accounts were in the retail segment comprising of homeloan / LAP, where the loans are secured. On the commercial banking side, the bank recognised the stress as NPA with slippages of Rs.891cr in the quarter. Collection efficiency was improving with December ratios at 90% and 94% for Term loans & Working capital loans respectively. Overall, the PAT was Rs35cr in Q3 FY21.

KVB is a play on the upcoming recovery in the credit cycle within the economy. The bank's deposit franchise is strong with total deposits of Rs.62,089cr and CASA of 35%, which have been improving every year. KVB has an AUM of Rs 52,113 Cr spread across Corporate segment (24.3%), Commercial segment (32%), Retail (22%) and Agriculture (21%). Gold loans forms 23% of the entire book and is spread between Retail and Agri loans. With much of the provisioning done for the past stress and credit cycle being at the cusp of a strong recovery, the bank would be able to get back to its earlier return ratios, thanks to its long-standing market position and 780 strong branch network.

Key risks would include deterioration of asset quality, higher than expected credit cost and decline in NIMs due to falling yields.

**Investment Exits:** The fund exited its investment in Petronet, Tata metaliks, Gravita India, Mahindra CIE, Hind Oil Exploration and Shreyas Shipping. Most of the exits were carried out for better incremental risk reward opportunities. Few exits were considered in lieu of performance not being up to the expected levels or due to unfavourable macro conditions for growth in coming quarters.

## Financial Details of Portfolio Companies

| Green | Exposure 5th March 2021* | Market Cap (Rs.cr) | PBT (Rs.cr) | | YoY (%) | PAT (Rs.cr) | | P / E | RoE |
|---|---|---|---|---|---|---|---|---|---|
| | | | Q3 FY20 | Q3 FY21 | | FY 20 | FY 21e | FY 21e | FY 21e |
| **Suven Pharma** | 10.41% | 12,342 | 78 | 148 | 90% | 316 | 365 | 34 | 31% |
| **Sonata Software** | 9.84% | 5,039 | 105 | 100 | -5% | 275 | 253 | 20 | 30% |
| **HIL Ltd** | 9.37% | 2,358 | 13 | 73 | 462% | 106 | 179 | 13 | 22% |
| **Stove kraft** | 7.97% | 1,734 | 9 | 33 | 279% | 3 | 87 | 20 | 36% |
| **JB Chemicals** | 7.24% | 9,268 | 88 | 208 | 136% | 273 | 451 | 21 | 28% |
| **KEC International** | 7.11% | 12,092 | 203 | 199 | -2% | 566 | 575 | 21 | 19% |
| **Triveni Turbine** | 6.10% | 3,553 | 37 | 36 | -3% | 122 | 127 | 28 | 27% |
| **Tech Mahindra** | 5.60% | 94,722 | 1,474 | 1,716 | 16% | 4,033 | 4,646 | 20 | 20% |
| **Symphony** | 5.02% | 9,561 | 73 | 34 | -53% | 186 | 99 | 97 | 15% |
| **Wipro** | 4.97% | 235,526 | 3,079 | 3,850 | 25% | 9,722 | 10,524 | 22 | 16% |
| **JK Paper** | 4.21% | 2,773 | 188 | 103 | -45% | 475 | 222 | 13 | 9% |
| **KVB** | 4.08% | 4,796 | 20 | 56 | 280% | 235 | 352 | 14 | 5% |
| **Mah EPC** | 3.31% | 428 | 10 | 10 | -9% | 23 | 21 | 20 | 14% |
| **Honda Power** | 2.82% | 1,101 | 23 | 29 | 26% | 66 | 58 | 19 | 10% |
| **CG Consumer** | 2.76% | 25,221 | 139 | 203 | 46% | 443 | 472 | 53 | 28% |
| **Mayur** | 2.66% | 1,862 | 24 | 46 | 92% | 66 | 70 | 22 | 11% |
| **Haldyn Glass** | 1.18% | 163 | 4 | 7 | 197% | 12 | 13 | 12 | 9% |

*As percentage of total AUM.

## Portfolio Characteristics

| Valuation Parameters (as of Mar 5th 2021) | FY21e |
|---|---|
| P/E Ratio | 21.2 |
| P/B Ratio | 4.9 |
| Earnings Growth | 19% |
| Debt Equity Ratio | 0.2 |
| ROE % | 21% |
| Wt. Avg Mcap | Rs.22,715cr |

# Annexure:

## Information on Fund Risk Management

i) *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 2 – The Green 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.*

ii) *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.*

iii) *Liquidity Risk: This represents the possibility of not honouring redemptions upon closure of fund due to illiquidity of the portfolio. Also, it is possible that the realised 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.*

iv) *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 institutionalised and hence procedure driven. This reduces the risk of loss of key personnel.*

v) *Concentration Risk: This represents risk of concentration of investments in few opportunities. This risk is minimalised as individual position weightage isn't allowed to go beyond 10% of the Investible Funds.*

vi) *Leverage Risk: This represents risk of leverage risk at the investee company level. This risk is minimalized through prudent selection of investments.*