UNIFI Capital

THE GREEN FUND

QUARTERLY REVIEW - MAY 2019

FY2019 has been a challenging year for the Green fund on the back of multiple headwinds – attributable to the macros and also bottom up business challenges faced by few of our portfolio companies. As each of these one-off variables are dealt with, we expect our portfolio companies to recover significant ground in the coming year. In this note, like our previous newsletter, we highlight the financial and business performance of various portfolio companies in quarter 4 and for full year of financial year 2019.

I Recycling: The various sub-segments within recycling include – lead, glass and refractory recycling.

a) <u>Lead Recycling:</u> The fund is invested in Exide Industries and Gravita India and both the companies have a runway of initiatives that will help them to grow earnings in the coming years.

   Gravita India is India's largest responsible recycler of lead metal. The informal recycling of lead is particularly inefficient in terms of losses and it causes significant environment degradation. Also, lead mining uses large amounts of energy and environmental resources. Responsible lead recycling using appropriate technologies with adequate environmental compliance is the only solution. We continue to stay invested in Gravita as lead is the most critical raw material in a lead acid storage battery and about 90%+ of global lead consumption is out of recycled lead.

   In quarter 4, the overall performance of the company improved sequentially driven by measures taken to improve profit margin of its lead recycling segment. However, there was stress in its plastics recycling plant in Nicaragua due to political unrest in the country and this negatively impacted the plastic scrap collection volume in the country. The company has taken measures to address this issue and we expect profitability to further improve in the coming quarter.

   Incrementally, Gravita has commissioned a new recycling plant in Tanzania and a second plant in Ghana is expected to start soon. This would increase the overall lead recycling capacity by 11% and contribute to volume growth in FY2020.

   The fund's other investment in lead recycling, **Exide Industries**, manufactures batteries by sourcing close to 40% of its lead and lead alloy requirements through recycled lead. The company supplies lead acid batteries to diverse segments like auto OE & aftermarket, telecom, inverter, UPS, e-rickshaw and for various industrial requirements. In Q4FY19, its revenue/profitability grew by 6%/11% YoY respectively due to growth in auto replacement market in spite of slowdown in auto OE sales. In FY19, company grew revenue by 15% and we expect profitability to improve in FY20 driven by a) the growth in auto replacement market, b) benefit of lower lead price in coming quarters and c) the company's focus on technology up-gradation to improve market share and profitability.

b) <u>Glass Recycling:</u> The fund is invested in a Gujarat based container glass manufacturing company, **Haldyn Glass** which reported good performance. 50% of the raw materials used in the manufacturing of container glass is broken glass (called cullet). Glass cullet is a valuable raw material as it saves vast amounts of virgin raw material, in addition to saving a large amount of energy that is otherwise required to manufacture glass. As per experts, glass can be recycled 6-7 times. Led by volume and price increase, in FY19 revenue grew by 34% YoY and as a result of positive operating leverage, profitability improved by 87% YoY. The business environment continues to be good for container glass manufacturers as visible in financial results of peers in industry and we continue to remain invested.

c) <u>Refractory Recycling:</u> Refractories are a consumable in the manufacturing process of iron, steel, aluminium and cement. The fund is invested in India's largest manufacturer of refractories: **Orient Refractories.** The company utilizes used refractories (from plants) in their manufacturing process which accounts to about 25-30% of their raw material mix. RHI AG (2nd largest globally) acquired 69.6% in Orient in April 2013 and as we write this note the parent company is in final stage to consolidate its Indian businesses by merging its unlisted companies in India with the listed entity - Orient Refractories. This is a powerful step in right direction and helps in synergizing for better scale and growth. The company continues to report good volume growth through introduction of new products which is leading to market share gains.

II Alternative Energy: The fund is exiting its investment in Petronet LNG. The trigger for this portfolio transaction was delayed commissioning of Kochi-Mangalore pipeline and an expected slower ramp up of its incremental expansion at their existing facility in Dahej, Gujarat. The cash generated from this sale is being utilised for newer investments into the fund.

III Energy Efficiency & Emission Savings: The fund has an exposure to this segment with investments in (a) India's largest industrial steam turbine manufacturer - Triveni Turbine, (b) India's largest coastal shipping services provider – Shreyas Shipping & Logistics Ltd, c) India's only manufacturer of advanced carbon material for lithium-ion batteries - Himadri Speciality Chemicals, d) KPIT Technologies – provider of auto engineering solutions for electric and hybrid vehicles and e) Hyderabad Industries – a manufacturer of green building products.

Triveni Turbine continues to retain its dominant market share in less than 30 MW industrial turbine segment. These turbines are used for non-conventional sources of generating power by either using a by-product or heat generated in the course of a manufacturing process. In FY19 company grew revenues by 13% while its margins were lower by 3%. The fall in margin was primarily due to new product development charges. Management expects that strong order inflow in FY20 and existing order book would help the company achieve a revenue growth of 12-14% in FY20. With improvement in margins, earnings growth would improve in FY20.

The fund's investment **in Shreyas Shipping and Logistics** continue to benefit from government's push for movement of goods through waterways. However, there was a decline in recent financial performance of company due to rise in bunker fuel cost. To better withstand crude oil price shocks, the company has restructured its business model. As a result, it had chartered out 5 vessels and chartered in 2 vessels. These efforts seemed to have borne fruit as margins improved in the second half of FY19. They have been fully indemnified by the insurance company for the loss of one of their vessel "SSL Kolkata" to an accident. With sanctions on Iran getting effective from November 2018, the company faced decline in cargo volume movement to that country. However, we expect profitability to improve further in the coming quarter due to further decline in fuel cost and revival in domestic economy.

The fund's exposure in **Himadri Speciality Chemical** is driven by (a) its high integrated manufacturing processes of coal tar pitch that make it a cost effective player, and importantly (b) it's ability to use the manufacturing value chain to foray into higher margin derivatives, namely: specialty carbon black, and advanced carbon materials(ACM) used in Lithium Ion batteries. The accelerated demand for smart phones, and electric mobility solutions, are seeing increasing demand for ACM, and Himadri is amongst the handful of manufacturers in the world who have technologically perfected this material. The company has delivered well on all operating parameters for FY-2019, with earnings growth of 31%. We expect growth in excess of 30%+ CAGR over the next 3 years, as they commercialize their new products over the next 3 months.

Hyderabad Industries Ltd (HIL) is a new addition to the fund. HIL has traditionally been a manufacturer of asbestos based roofing sheets. However, it is gradually transforming into a provider of green building products & habitats by supplying environment-friendly products. These include non-asbestos cement roof sheets, fly ash blocks, thermal insulation products and heavy metal free plumbing products. Each of their products are doing well and in FY-2019, the company delivered growth of 26% YoY. Through a German acquisition in 2018, the company has forayed into engineered flooring products, and we expect them to consolidate their growth in this segment in the coming year.

KPIT Technologies is a play on automotive embedded electronics space. This segment focuses mainly on CASE – connected, autonomous, sharing and electric vehicles. There is an increased thrust on CASE not just due aesthetics but also due to various emission regulations. Embedded system is also an important part of power train of an electric or hybrid vehicle.

In Q4-19, KPIT's revenues grew 1.1% QoQ to USD 71mn despite execution delay in couple of large European projects. The company didn't share historical metrics for YoY comparison. However, there is visibility of strong operational performance with constant currency revenue expectation of 16-18% and EBIDTA margins of 14-15%, backed by operational efficiencies. This is vs the Q4-2019 margin of 12.3%. There is visibility of significant margin improvement for the years beyond FY-20 as well.

IV Water Infrastructure: The sub-segments within water infrastructure include – Ductile Iron Pipes and Micro Irrigation.

a) Ductile Iron Pipes: The fund is invested in two of India's largest Ductile Iron (DI) pipe manufacturers– **Tata Metaliks** and **Srikalahasti Pipes**. The demand for DI pipes continues to be robust and this industry is growing at rate of 12% p.a. Both our investments reported strong volume growth in DI pipe sales. The prices of key raw material for these companies – coking coal and iron have been soft recently and we expect the benefit of this lower cost should reflect in coming quarters.

b) Micro Irrigation: The fund is invested in a Mahindra group company – **Mahindra EPC Irrigation Ltd**, which supplies micro irrigation products. The company reported strong Q4FY19 performance with profitability growth of 23% YoY. More importantly, company has substantially reduced its working capital cycle from 185 days in FY18 to 138 days in FY19, which is an important metric to determine the quality of company's performance. We continue to remain positive on the micro irrigation sector as the penetration level in India is just 5%.

V Safe Chemicals: This segment has exposure to a) Sudarshan Chemicals - a manufacturer of organic pigments, b) Galaxy surfactants, a manufacturer of oleo chemical-based surfactants and c) Suven Life Science – a life sciences company.

Sudarshan Chemical's recent financial performance was impacted due to raw material cost inflation and investments made towards new growth drivers. The company has already started passing on the higher raw material costs to its customers and this shall lead to margin improvement in FY20. Further, as a part of their plan to launch new products, they have started manufacturing two new products for the cosmetics industry. Sudarshan chemical aspires to be 3rd largest organic pigment player in the world and towards this endeavour it has already exited its non-core business segments like agrochemicals, master batches and industrial mixing solutions businesses in FY2019. The company is passing through a temporary transition phase and we expect earnings to revive in coming quarters.

Suven Life Science is a new addition to the fund. The company's Q4 as well as FY19 performance was better than expectation driven mainly by the CRAMS division and the prospects continue to look good. The company is also focusing on discovery of new drugs especially in the central nervous system (CNS) space. The intent of this research 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. Suvn-502 is their flagship NCE molecule to treat Alzhemiers and is now in proof of concept phase 2 trials wherein the safety and efficacy of the drug is being tested. The results of these trials are expected in the next two months.

The company has announced a demerger of its CRAMS division into a new listed company division. As an independent CRAMS company (to be named as Suven Pharma), it will not have to absorb the R&D costs of its research division (about Rs.56 crs for FY19) and on account of this Suven Pharma's operating margins will move up from 35% levels to above 40% levels. We believe the demerger will lead to value unlocking in the times to come.

Suven follows a well-defined integrated management system policy to achieve sustainable growth by promoting pollution prevention practices. For its largest revenue generating vertical – contract manufacturing operations, the company adheres to systems and processes that are approved by globally respected and reputed regulatory authorities – this ensures that the consumption of utilities (energy, water) is optimised.

Galaxy Surfactant which is a manufacturer of oleo chemical-based surfactants reported improved performance in Q4FY19. This was due to higher volume growth of 12.5% abetted by increased traction in overseas business. Higher capacity utilisation and product mix led to 36% operating profit growth YoY and PAT growth of 43% YoY. The company's focus on new markets to compensate for the loss of volume in its sales to Egypt was visible in Q4. Over the mid to long term, as urbanisation and premiumisation play out in developing countries like India, specialty surfactants will gradually increase and lead to margin expansion. In the short term, the mass market performance segment will continue to drive the revenue growth.

Financial Details of Portfolio Companies

(Rs. in Cr)	PAT			Debt	Equity	D/E Ratio	ROE
Company	**FY2018**	**FY2019**	**FY2020e**	**FY2019**	**FY2019**	**FY2019**	**FY2019**
Exide Industries	710	736	885	-	5,987	-	18%
Sudarshan Chemicals	85	87	113	303	568	0.53	17%
Suven Life Science	149	165	191	37	461	0.08	36%
Triveni Turbine	96	100	126	-	433	-	23%
Himadri Chemicals	248	324	350	430	1,631	0.26	21%
Gravita India	48	21	31	240	204	1.18	11%
HIL	81	101	135	600	637	0.94	17%
Galaxy Surfactants	159	191	222	253	877	0.29	25%
Haldyn Glass	-0.49	6	13	7	134	0.05	5%
Orient Refractories	86	90	97	-	131	-	26%
Shreyas Shipping	92	31	50	248	444	0.56	14%
Tata Metaliks	160	183	188	209	767	0.27	32%
Sri Kalahasthi Pipes	147	118	141	351	1,262	0.28	10%
KPIT Technologies	NA	158	190	97	960	0.10	16%
Mahindra Epc	5	11	14	3	150	0.02	8%

Portfolio Characteristics

Valuation Parameters	FY2019	FY2020E
P/E Ratio	19	13
P/B Ratio	3.2	2.6
Earnings Growth	7%	25%
Debt Equity Ratio	0.2	0.2
ROE %	17%	18%
PE/ Growth Ratio		0.52