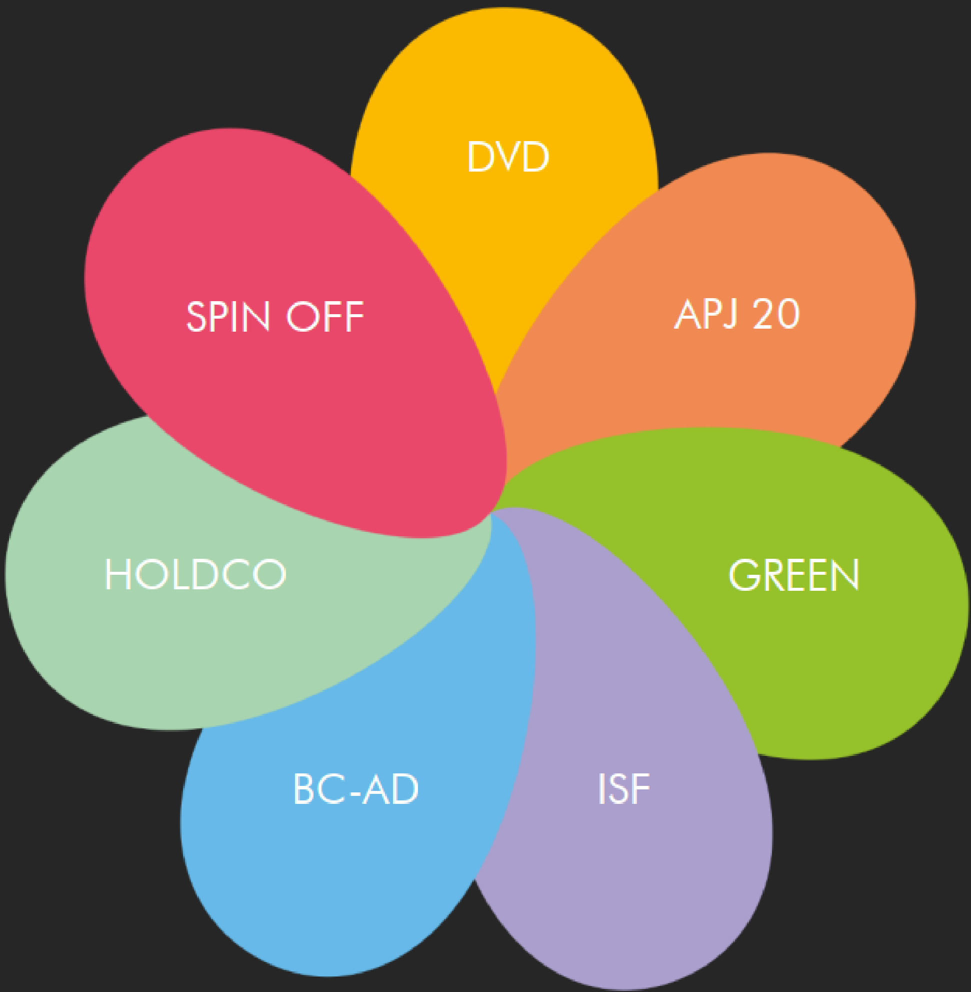
UNIFI Capital



THE BLEND FUND

7th Quarterly Review – Dec, 2020

The year so far

In March this year when markets (and cities) emptied out, we made the decision to go against the then prevailing conventional line of thought, and aggressively added to our positions in select equities. We grounded that decision in a rigorous analysis of the *variety of perceptions*, and combined that with our core principle of seeking the most favorable balance of risk and reward in an investment. In the process, we have delivered one of our best years ever as fund managers.

[For those inclined, in the field of decision theory, there is such a thing as the Ellsberg Paradox. It suggests that most people hesitate to act in a circumstance where the odds of a situation have a guaranteed positive outcome, with the magnitude being unknown. They prefer taking risks in situations where the odds of the situation are known, but have lower outcomes. Investing in times of stress is a very similar proposition].

Never waste a good crisis

Corporate results from Q2-2021 have dispelled lingering concerns, if any, on the economic linkage between the core of the Indian economy and larger listed firms. As GDP for Q2-FY2021 *shrank by -7.5%*, the trend of consolidation sharply accentuated across sector leaders, and our portfolio companies. In a sense, survival instincts seem to have come to the fore as *sector leaders* seized the opportunity to consolidate market share [from weaker peers], and strengthened several aspects of their operating metrics, and in the process delivered significant corporate and shareholder value. Under normal circumstances, such endeavours and the resultant outcomes may have been difficult to practice, and execute.

While the universe of BSE-500 delivered EBIDTA growth of 12% [in the backdrop of a -7.5% decline in GDP], the core holdings of our portfolios delivered significantly ahead of their peers, as they capitalized on the crisis, and strengthened their proposition, as well as their operations.

Make no mistake, this does not mean the recovery is all pervasive. Frontline indices only cover the formal industry, with an overwhelming weight on those who are significant market leaders, while India's industries are overwhelmingly unorganized. What we are witnessing today is a strong phase of consolidation from the informal to the formal sector. While we anticipated this cycle of consolidation post the implementation of demonetization and GST, it has taken a social pandemic to enable this shift. While a significant part of this performance is attributable to the normalization of supply-chains, a deeper examination suggests signs of a new structural normal among the sector leaders, which will see them deliver materially ahead of the pre-Covid era.

Beneath the surface

As a parallel to this phase of consolidation among the leaders, there is a sharp improvement in the macro-environment underway.

- GST collections crossed the Rs.1 lakh crore mark in October & November, and is now marginally higher YoY, indicating a return activity across the breadth of the economy
- India's power consumption [YoY] registered growth of 4%, 12% & 5% during September, October & November respectively, indicating a firm bounce back in the industrial activity while energy consumption [petrol & diesel] has registered growth of 5% & 7% for the month of October, indicating normalization of industrial activity, in spite of the continued momentum on WFH in select industries
- Total number of E-way bills generated in October at 64.1 mn., is the highest tally recorded since the system was introduced more than two years ago, indicating strong mercantile traction across the economy
- Manufacturing PMI rose to 58.9 on Oct-19 [the highest since 2008] implying strong expansion in manufacturing activity ahead

India's recovery is on a self-sustaining path

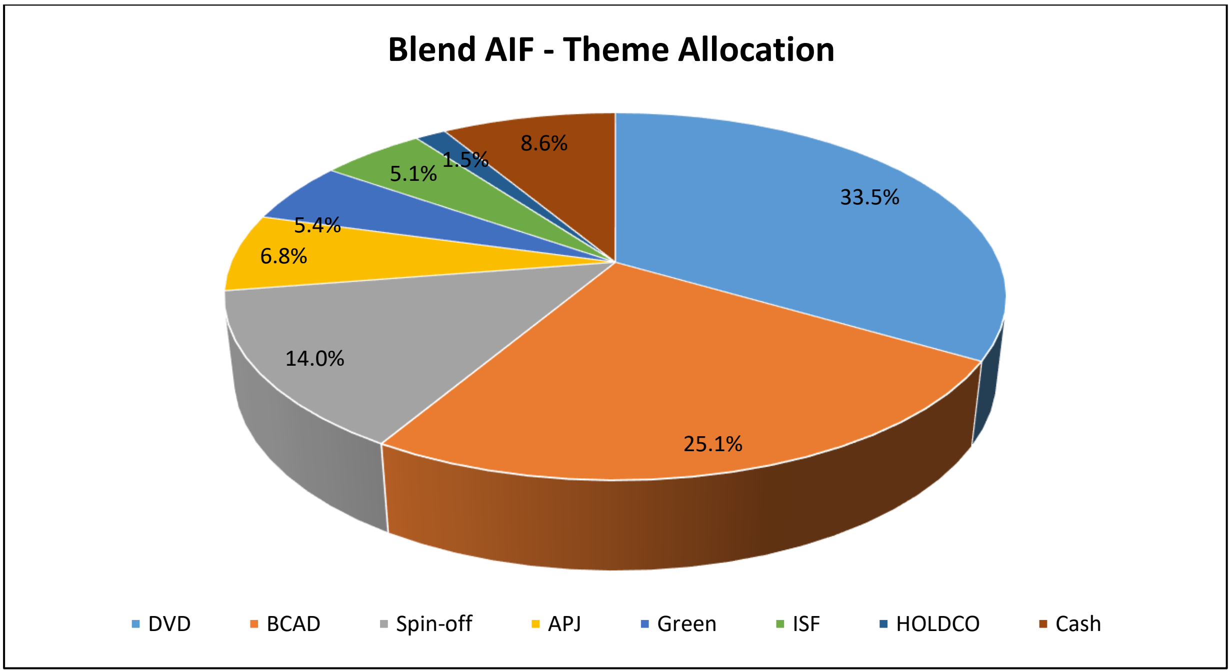
As the macroeconomic data indicate, India's industrial risk appetite has not only remained healthy, but has come back strongly. The point to note here is, while liquidity has significantly entered certain asset classes, and the markets, it is yet to fully permeate all parts of the economy [read brick and mortar, physical retail, leisure travel, F&B, and others that have a significant multiplier effect on the economy]. In the post-vaccine world [c.2-3 quarters from today], we expect these untouched parts of the economy to significantly increase their economic participation, and in the process, significantly strengthen the pace of economic recovery. As the markets discounted these developments, India recorded its highest ever monthly inflows of USD7bn [November-20], and in the process delivered a broad-based rally across the breadth of the markets. Given the stated objective of all global central banks to keep the *system* flush with liquidity, the intensity of flows is expected to sustain over the medium term.

Given the resilient private sector where the leaders have emerged stronger, and a flourishing rural economy that will abet domestic consumption, we believe India Inc is set to deliver a positive earnings surprise for FY2021 and the forthcoming fiscal FY-2022.

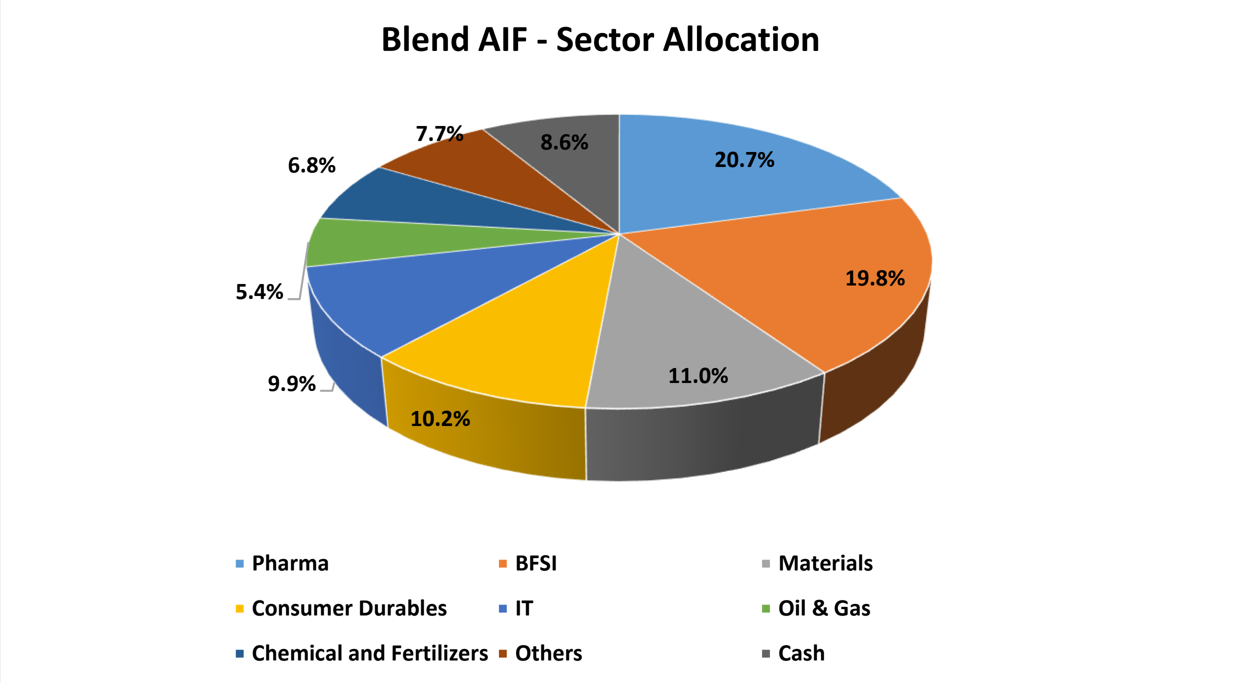
We have navigated this period of an uncertain environment with success, by staying true to our core principles of seeking the right mix of risk and reward in each of our bottom-up investments. Our approach for the times ahead remains similar, and steadfast.

Thank you for your trust in Unifi, and we look forward to touching base with you in the new year. Stay safe, and our best wishes for a healthy and prosperous 2021!

The strategy wise composition of the Blend AIF fund is as below



The sector wise composition of the Blend AIF fund is as below



Q2 FY21 | Result summary

The Blend AIF continues to draw from the best opportunities across all of Unifi's investment themes. The fund's holdings are well diversified and poised to benefit from the normalization of the economy, with the investee firms consolidating their position and delivering industry leading growth.

Both our investments in Pharmaceuticals, which together form 21% of portfolio, continue to benefit from various bottom-up initiatives undertaken by them. Suven Pharma shall benefit from growth in its core CRAMS business and commercial launch of new molecules in speciality side of business. JB Chemical continues to experience strong momentum in exports with Covid acting as a tailwind, while the domestic formulations business has started normalizing.

At 20%, Financials constitute the second largest segmental exposure. The retail focussed institutions, ICICI and Axis Bank seem to be having lower than anticipated asset quality challenges and are poised to emerge stronger. ICICI Securities has successfully capitalized on the increase in market activity, delivering higher than expected profits.

Other major sector exposure include Textile materials (11%), Consumer Durables (10%) and Information Technology (10%). The underlying investments in each of these sectors have reported good results. In the infrastructure space, we have increased exposure to KEC, which has a good track record in EPC and is in position to gain from increased capex spends. We have taken a 5% exposure to Mahindra Holidays, which is a play on the increasing consolidation in the domestic tourism industry. While the hospitality sector is one of the worst hit by the pandemic, Mahindra Holidays stands to benefit due to its strong balance sheet and unique business model. We also initiated exposure to Chambal Fertilizer, which is India's largest private sector manufacturer of urea, with a 5% allocation.

As our thesis played out, we exited Aarti Drugs. Further, with a stock price rally in VIP Industries ahead of its fundamentals, the unfavourable risk-reward equation prompted us to exit the investment.

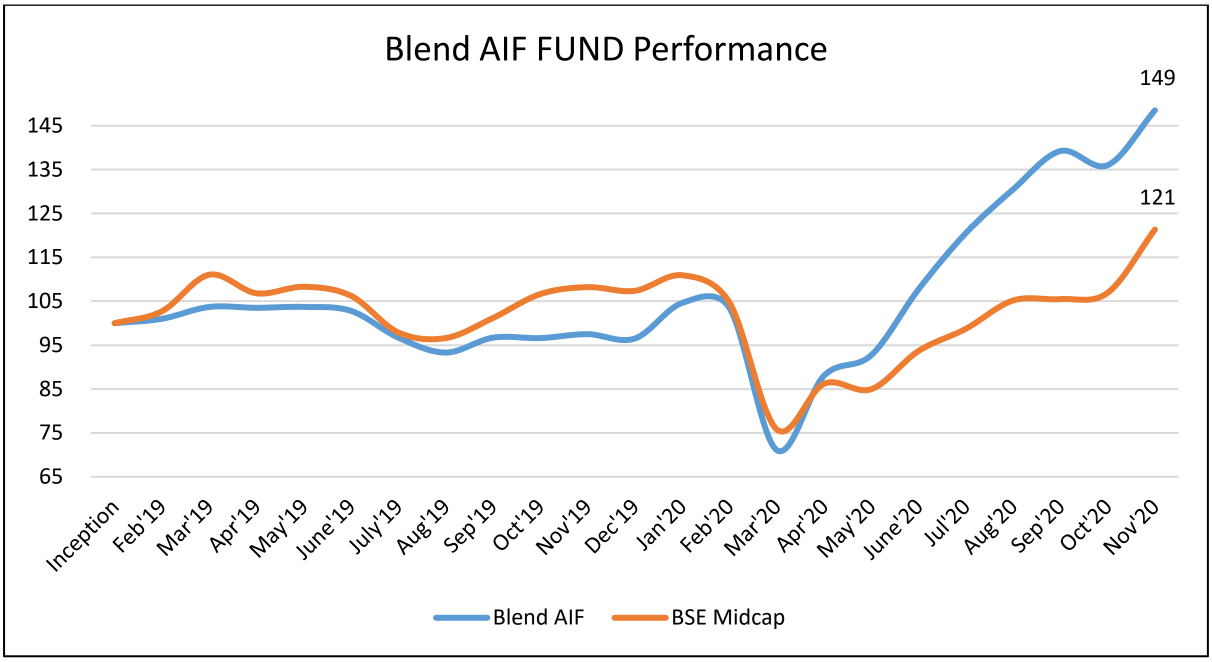
The following annexure presents a brief on our top holdings

Garware Technical Fibres	Garware delivered revenue, EBITDA and PBT growth of 15% YoY, 39% YoY and 32% YoY respectively. Gross margin expanded 5.1% YoY on the account of better product mix and new products launches. EBITDA grew by 39% on the back of operating leverage and gross margin expansion. PBT excluding other income grew nearly 46% while there was a 16% decline in the other income. Both the segments of Synthetic Cordage as well as the Fibre and Industrial products have recovered well and the core business segment [Synthetic cordage] has seen significant expansion in margins. The company was granted three patents in this quarter and this augurs well for topline growth and gross margin expansion in the times to come. The company has Rs. 530cr surplus cash on books as on 30th Sept'20 with core FY21E RoE of 26%. Key risks: Fall in the price of Salmon, sharp rise in Crude Oil and failure of newer innovative products to garner market share.
Suven Pharma	Suven reported decline in revenues of 13% YoY while EBIDTA and PAT declined by 25% and 20% YoY, respectively. The second quarter of last year had high margin campaign launches from its commercial CRAMS segment which we are aware is uneven. [Once a customer buys a batch of material, the next order comes after a lag of 12-18 months depending on how the new drug is received and accepted by the market]. Suven currently has six commercially launched intermediates and specialty chemicals and is looking to add two more in FY-2022. Suven's business model necessitates looking at the annual progress rather than quarter-wise developments. Despite a flattish H1, we are expecting revenue and PAT growth of 10% and 15% for the full year given the prospects in H2 especially due to the profit-share kicking in from formulation supplies to USA. Suven's revenues arise from contract research services, commercial scale intermediate and specialty chemicals and they have now diversified into formulations by building appropriate capacities and obtained USFDA approvals. The company has launched 2 ANDAs (formulation drugs) in H1, and is scheduled to launch one more in H2 and 3-4 ANDAs every year over the next 5 years. The company is planning a capex of Rs.600cr over the next 3 years towards refurbishment and expansion of its R&D as well as manufacturing capacities to be able to sustain their high margins and lay foundation for the next stage of growth. Key risks - Management bandwidth (COO hiring underway) and slowdown in new research orders due to COVID are the key concerns.
JB Chemicals	JB Chemicals reported flat revenue, EBITDA and PBT growth. Revenue growth would have been higher, but for the company deferred Rs.57cr of exports dispatches planned in Q2 FY21 to October due to constrained availability of ships/containers. Adding Rs.57cr to the top line for the quarter, revenues would have been up 10% YoY to Rs. 501cr; and absolute EBITDA would have been up 35% and PBT (excluding other income) would have been up 40%. The export order book continues to be healthy, up 39% YoY in H1. As communicated earlier, the ownership of JB has changed in the prior quarter, and PE firm KKR now owns 54% of the company. 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 and add to their efficient operations. Key risks: prolonged economic weakness and supply chain disruptions that can impact the supply and demand for drugs and unexpected regulatory developments.
Tech Mahindra	Tech M delivered revenues of $1,265.6mn for Q2 FY21, reporting a growth of 4.7% QoQ but 1.7% YoY decline. In INR terms, EBIDTA and PAT delivered growth of 31% and 10% respectively. The company witnessed steep increase in margins [by 390 bps] to 18.2%,

	driven by better off shore and lowering sub-contracting costs along with margin uptick in their portfolio companies. Segmentally, major growth was driven by the Technology, Media & BFSI which were up 20% YoY and represent 26% of their revenues, and looking ahead, incremental growth is expected to be driven by Telecom and Manufacturing segments (10% YoY decline and represent 55% of revenue). Demand induces by 5G technology expected to drive further enterprise growth in FY22. We continue to like Tech Mahindra on the back of their pursuit of margins, that is expected to accelerate from here on as well, 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.
Axis Bank	Axis Bank reported NII growth of 20% YoY and 5% QoQ to Rs.7,326cr on the back of healthy expansion in NIMs. Advances grew by 11% YoY to Rs.5.76Tn with retail advances forming 53% of the same. The cost to income ratio continues to be in control at 38% in Q2 FY21. PPOP increased 48% YoY and 18% on QoQ basis to Rs.6,900cr. The provisions were flat on a sequential basis at around Rs 4,600cr. Overall, PAT was up by 51% QoQ at Rs.1,683cr. The asset quality improved, with GNPA & NNPA coming down to 4.18% and 0.98% respectively. The BB & below book is about 2.4% of the book and the bank estimates that about 1% of loans might come for restructuring by Dec-20. Overall, the incremental covid related stress pool is estimated at 3.5% of the book for which the bank already has made provisions of 2.2%. Axis Bank is well placed to get back to normalcy from FY-2022 onwards. Given the low cost of deposits and access to capital, the bank is expected to deliver on all parameters from the forthcoming year, and eventually migrate to higher double-digit ROEs. Any announcement of a one-time restructuring from RBI will also allow lending institutions like Axis Bank to restructure eligible loans and help the customers move from the NPA buckets back to the standard bucket. That would help lower the stress and the associated provisions lower. Key risks would include deterioration of asset quality leading to higher-than-expected credit costs and decline in NIMs due to falling yields.
ICICI Securities	ICICI Securities delivered a good quarter, with the broking segment growing by 82% YoY to Rs.392cr. ISec increased its market share in Equity trading volumes to 11.1% from 10.7% in Q1 FY21, adding about 113,000 clients in the quarter, taking the total count of clients to 4.96mn. The distribution revenue was almost flat on a YoY basis but recovered from the low Rs.80cr in Q1FY21. The focus for the times ahead would continue to be on rationalization of human resources and push to digital initiatives. On the back of robust revenue growth and measured operating expenses, PBT was up 102% YoY at Rs.372cr., and PAT was higher by 137% YoY at Rs.193cr. I-Sec is a leading tech-based securities player offering a range of financial services including brokerage, financial products distribution and investment banking, with a focus on both retail and institutional clients. As of Sep 2020, the proprietary electronic brokerage platform ICICI Direct had approx. 4.96 Mn operational accounts of whom about 1.2Mn had traded on NSE in last 12 months. I-Sec is also the second largest non-bank MF distributor with an AUM of Rs.352bn. We like the business due to its absolute technology leadership, continuing consolidation of user base, high RoE of more than 50%+ and access to ICICI Bank's franchise for customer acquisition. Key risks would arise from a prolonged downcycle in equity markets leading to lower turnover, and heightened competition leading to loss of market share.

ICICI Bank	ICICI Bank reported NII growth of 16% YoY and 1% QoQ at Rs.9,366cr, while their non-interest income dropped 10% YoY due to lower business volumes. Their cost to income ratio fell to 40% from 45% in FY20, on the back of lower operating expenses. Overall, operating profit was higher by 18% YoY at Rs.7,719cr. Advances were up 6.5% YoY & 3% QoQ at 6.5Tn with retail forming 66% of the same. The bank continues to enjoy a strong consumer franchise with a CASA ratio of 41%, one of the highest within the banking industry. The stress in the corporate book has already been adequately provided by the management. The listed status of subsidiaries has provided good liquidity window to the bank enabling higher provisions. The management is confident of being able to manage the overdue and restructured book, given the good collections history of the underlying clients. Key risks would include deterioration of asset quality, higher than expected credit costs and decline in NIMs due to falling yields.
Petronet LNG	Petronet registered growth of 1% YoY in their regassification volumes for Q2-21. The utilization of both Dahej and Kochi terminals were back to the pre-Covid levels as the demand for natural gas picked up across India. EBITDA increased 17% YoY on the back of one-off inventory gain and positive impact of rupee appreciation due to Ind AS 116 accounting. Adjusting for this, EBITDA increased by 7% YoY. Reported PAT declined by 15% YoY as there was a tax write back in the base quarter. The concerns on capital allocations have cleared to a greater extent with the announcement that the company would not invest in any new international LNG project that would require significant capex. The dividend payout would continue to remain high till it starts any new major capex (yield of >5%). The long-delayed Kochi-Mangalore pipeline was completed in the month of November and now the utilization from Kochi is expected to pick up gradually. Petronet is a play on India's increasing consumption of natural gas. Domestic production of gas is not on par with demand growth, leading to a spike in imports. Petronet is the largest player in the re-gasification space and has back-back long-term contracts to meet their end user requirements. Key risks will be a slowdown in economic activity, leading to lower demand for fuel and aggressive capital allocation to new projects.
CG Consumer	Crompton Greaves Consumer delivered Sales, EBIDTA and PAT growth of 13% / 48% and 28% growth on YoY basis, and reported sharp improvement on all parameters, led by their structural efficiency initiatives. 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 continuous 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.
KEC International	KEC reported revenue growth of 16% YoY on the backdrop of strong execution. Company focused on improving employee productivity and also mechanized few of the processes to execute seamlessly. Despite 16% growth in revenue, the EBITDA remained flat on YoY

	basis due to change in the business mix. During the quarter, company executed more of railways and civil projects, where the margins are relatively lower. This will get corrected in the later part of the year as the execution of power T&D projects picks up. Lower interest expense resulted in a PAT growth of 4% YoY. Construction work has now resumed at almost all its sites and company is back to pre-Covid levels of execution across the board. KEC has an outstanding order book (plus L1) of more than Rs.24,000cr resulting in revenue visibility over the next 7-8 quarters. The company has not seen any delays in its payment cycles from key customers namely Power Grid and Indian Railways. KEC is a proxy play for rising infrastructure spends in India and we like the company for its ability to navigate the environment cautiously, but profitably. Key risks include higher receivable cycles and unforeseen project delays.
Sheela foam	Sheela Foam delivered 3% growth in domestic revenues, recovering strongly from drop in sales in Q1FY21. Gross margin was back to 48% levels given the increase in volumes and lower prices of TDI. EBITDA was up 8% YoY to 63cr, aided by better cost control. The Spanish & Australian subsidiary continued their good run and contributed Rs.23cr to earnings. Overall, consolidated PAT was up 19% YoY to Rs.70cr. Incorporated in 1971, Sheela Foam is one of the leading manufacturers of mattresses in India marketed under its flagship brand ‘Sleepwell’. The company also manufactures other foam-based home comfort products as well as technical grades of polyurethane foam (PU Foam) for use in a wide range of industries. The Indian mattress market is about Rs.10,000cr in size of which 65% is unorganized. It is expected that pure branded mattresses as a portion of consolidated revenues will go up from 36% in FY18 to 41% by 2023. We like the company due to its net debt free status with a RoE of 20% and an industry leading market share of 23%. The company has also launched low-priced brands ‘Starlite’ and ‘Featherfoam’ to take on unorganized players. Key risks for the business would arise from higher raw material costs, intensive competitive pressure leading to loss of market share and slump in discretionary consumption spends.
Intellect Design Arena	Intellect delivered significant improvement in key areas of (a) recurring revenues and (b) operating margins, with revenues of USD50mn [up 8% YoY], while in INR terms, revenues and earnings grew 14%, and >100%. The improvement in earnings was driven by a sharp improvement in margins [by 400bps] as AMC revenues grew 19% YoY and costs around R&D and SGA were rationalized. In the quarter gone by, the company delivered on several license wins to marquee banks around the world and given the pace of digitization and modernization of financial systems around the world, Intellect is expected to do well in the times to come. Key risks: Long sales cycles, and delays in discretionary expenditure by financial institutions. It is important to note that product sales cycles are binary in nature and conventional metrics of earnings over the short term is not the right measure of performance.



Key Portfolio Metrics

It is important to note 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 8th Dec 2020)	FY2020	FY2021E
P/E Ratio *	22.1	24.4
Earnings Growth *	28.6%	13.4%
Debt Equity Ratio	0.24	0.16
ROE %	23.3%	23.8%
PE/ Growth Ratio	0.8	1.82

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

We are continually monitoring the environment for any opportunities that have potential to materially improve the portfolio composition. We will be writing to you again post the 3rd quarter results.

In closing, we encourage you to write to us, or your relationship manager for a detailed review of the portfolio and understanding of our proposition in greater granularity.

With best wishes,

K. Sarath Reddy | Founder & CIO

Annexures:

Financial Details of Portfolio Companies

BLEND AIF	Market Cap (Rs. cr)	PBT (Rs.cr)		YoY (%)	PAT (Rs. Cr)		P/E	ROE	Portfolio Weight
Company	(Dec 8th)	Q2 FY20	Q2 FY 21		FY 19	FY 20	FY 20	FY 20	
Suven Pharma	10,170	125	97	-22%	167	316	32	37%	11.00%
Garware Tech	4,565	44	58	32%	126	129	35	18%	10.97%
JB Chem	7,731	102	99	-2%	193	273	28	18%	9.67%
Tech Mahindra	90,054	1337	1409	5%	4298	4033	22	19%	6.89%
Axis Bank	1,89,361	2433	2317	-5%	4976	1627	-	2%	6.12%
ICICI Sec	15,040	184	372	102%	491	542	28	48%	6.12%
ICICI Bank	3,50,368	4367	5266	21%	3400	7930	-	7%	5.92%
Petronet LNG	39,420	949	1244	31%	2154	2698	15	25%	5.40%
CG Consumer	20,552	126	189	50%	401	443	46	35%	5.26%
KEC Int	9,520	180	196	9%	496	566	17	22%	5.14%
Sheela Foam	8,202	60	63	5%	134	194	42	20%	4.89%
Chambal Fert	8,588	394	663	68%	590	1226	7	38%	4.65%

CLASSIFICATION OF MARKET CAP

Segment	Basis	%
Large Cap	> Rs. 29,350cr	24.33%
Mid Cap	> Rs. 7,250 cr < Rs. 29,350 cr	46.73%
Small Cap	< Rs. 7,250cr	20.33%
Cash		8.61%
Total		**100%**

LIQUIDITY ANALYSIS

Segment	% of portfolio
1 day	31.22%
Between 1 & 3 days	20.92%
Between 3 & 7 days	23.63%
Greater than 7 days	15.62%
Total	**91.39%**

Risk Management

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. A second wave of infections cannot be ruled out. 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 long 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	Indian 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 cycle 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 the 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 sub-10% levels.
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 it
Key Man Risk	Small and mid-caps are frequently managed by a single 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.