UNIFI Capital

THE GREEN FUND

QUARTELY REVIEW - NOVEMBER 2019

UNIFI AIF 2 – The Green Fund

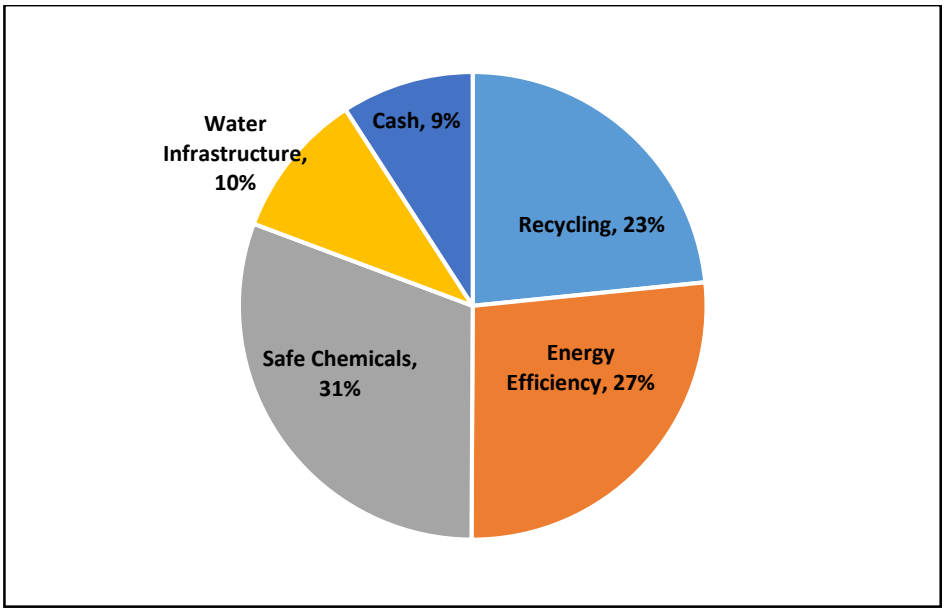
The Green fund targets capital appreciation by investing in the next generation of winners arising from India's evolution towards a more *sustainable economy.* The investment universe would comprise of well managed businesses offering best in class solutions to address challenges in the areas of Energy,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

Quarterly Review

The second quarter ended 30th September for FY-2020 has been a good, with most of the fund's investee companies delivering along expected lines. While consumption trends in the economy are soft on the back of prevailing economic sluggishness, the investee firms are consolidating their position and delivering industry leading growth. At the broader level, the real economy is weak and the new indicative rate of growth is closer to 5.9%. Lower automobile sales, flattening of core sector growth and declining investment in construction & infrastructure sectors continue to indicate the sluggishness in the economy. While various measures have been taken by the Central government to boost domestic economy, the net impact on earnings is likely to be pronounced in the years to come. Historically, valuation of businesses decline disproportionately more than the actual rate of degrowth to account for the uncertainty in near term, which is largely non-economic. While the broader economy awaits a recovery, our investee companies continue to consolidate on their business proposition and deliver earnings growth through cost efficiencies, market share expansion and product diversification.

For the quarter Q2 of FY-20, the weighted average PBT growth for the portfolio was 61% YoY. This growth number was skewed through contribution from Suven Life Science (PBT growth of 319% YoY) and Mahindra EPC (PBT growth of 625% YoY). Excluding the contribution of these two companies which account for 14% of the portfolio holdings, the portfolio earnings growth was 11% YoY.

Sector Exposure



FUND DETAILS

Launch Date:
31 July 2017

Scheme AUM:
INR 0.97 bn

Theme AUM[1]:
INR 3.16 bn

Firm AUM:
INR 41 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.

I Recycling: Recycling constitutes about 23% of the fund's exposure and the various sub-segments within this include: *lead, glass, plastic and refractory recycling.*

a) Lead Recycling: The fund is invested in Exide Industries and Gravita India.

Gravita India's performance showed marked QoQ and YoY improvement led by ramping up of newer capacities in Ghana and Tanzania. Lead volume grew by 31% YoY and 27% QoQ. The lead plant in Ghana with capacity of 12,000 tons is now operating at 85% utilization and the one in Tanzania is operating at 103%. Lead division EBIDTA per kg improved from Rs. 7.8 per kg to Rs. 10.3 per kg QoQ driven by better margin in new plants and positive operational leverage in India plants. We expect H2 would be better as contribution from new plants ramp up.

Key risks would arise from continued loss from plastics division, lower offtake of lead volume and any geo-political disruptions in Africa.

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. In Q2-FY20, Exide's revenue declined by 4% YoY due to sharp drop in auto battery sales. However better growth in the replacement market for auto battery, UPS, solar as well as other infra segment (other than Telecom) absorbed most of this decline. Driven by lower lead prices, raw material to sales declined by 70 bps QoQ and 310 bps YoY. On the back of this, profitability was higher by 23% YoY due to operating margin expansion and lower tax rate. Exide's lithium ion battery assembly unit would begin by end of FY20. While 70% of Exide's revenue come from aftermarket segment, there would definitely be an impact from the slowdown in auto OE sales in the near term. We continue to hold our position in Exide due to (a) growth in auto replacement market, and (b) the company's focus on technology up-gradation to improve market share and profitability.

Key risks include further decline in auto sales, increased competition, faster adoption of electric vehicle and sharp increase in lead price.

b) Glass Recycling: The fund is invested in a Gujarat based container glass manufacturing company, **Haldyn Glass** which reported good performance in Q2-FY20. Led by volume and price increase, in Q2-FY20 revenue grew by 1% YoY and as a result of positive operating leverage, EBIDTA improved by 36% YoY and PAT growth was at 61% YoY. Their JV with Heinz glass for manufacturing glass bottles for perfume industry has broken even at PAT level in Q1-FY20 and continues to improve performance QoQ. While we continue to monitor the business performance of this JV, the overall 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.

Risks: Increase in raw material costs and decline in demand with end user (Alcohol industry).

c) Refractory Recycling: 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. Orient Refractories reported a flattish quarter operationally due to overall slowdown in steel sector. Revenue declined by 5% YoY and PBT declined by 11% YoY due to higher operational costs. Company continues to remain debt free with cash of Rs.102cr on their books. The parent company – RHI Magnesita, 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.

Risks: Slowdown in demand from metal sector and sharp increase in raw material costs.

d) Plastic Recycling: Ganesha Ecosphere reported steady performance in Q2-FY20. Sales volume declined by 8% YoY and realization dropped by 2% YoY. However, operating profit improved by 6% YoY due to higher gross margin. Company has bought down the debt level significantly from Rs. 90cr in March'19 to Rs.60cr in Sep'19. The operating performance is expected to be stable in H2-FY20. Ganesha's business model of giving waste a useful second innings is well-poised for growth on the back of: (1) a widespread channel network for procurement of raw material (PET bottles), (2) capacity expansion in north India in FY19 (20% increase in capacity) and (3) planned greenfield expansion in south India.

Key risks would arise from softer crude prices, disruption in procurement of waste PET scrap, and delay in commencement of new capex activities.

II Energy Efficiency & Emission Savings: The fund has an exposure of 27% 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, e) Hyderabad Industries – a manufacturer of green building products and (f) Tube Investments – a leading manufacturer of cycles and auto & industrial products.

Tube Investments is a new addition to the portfolio. The company is part of Murugappa Group and offers wide range of engineering products such as steel tubes, chains, car door frames, etc. apart from fitness equipment and cycles. Led by significant savings from various cost efficiency initiatives, Tube Investment reported strong PBT growth of 18% YoY despite 16% drop in revenue. The revenue drop was mainly due to decline in sales to its customers in automobile sector. The segments which performed better for the company during Q2-FY20 include industrial chains, fine blanking (door panels) and railway products; each of them have grown over 40% YoY. The company continues its focus on multiple cost savings initiatives like total quality management, using IOT to improve productivity, Toyota production system and rationalisation of power and man power costs. We like Tube Investment due to its diversified product profile, focus on cost savings and initiatives taken to grow both in domestic and export markets.

Severe slowdown in industrial and auto sector would pose a key risk for the investment.

Triveni Turbine achieved its highest ever turnover and net profit for quarter and half year FY20. The company reported 18% growth in turnover and 29% rise in PBT during first half of FY20, led by cost control along with value engineering undertaken in the past years. While the total order booking during the half year is still lower than the corresponding period of last year, the enquiry pipeline is strong in the international market. Many of these enquiries are expected to get finalized during H2-FY20.

As per an international report, the company held the second position globally with 13% market share in terms of number of units sold, for the period Jan–June 2019. Market penetration in new geographies and newer product segment (Oil & Gas) shall mitigate risks of slowdown in economy and we believe FY-2020 will be a better year in terms of the overall performance of the company. Key risks will arise from failure to strengthen the order book in H2-FY20 and a global slowdown in capex that can lead to lower demand.

The fund's investment in **Shreyas Shipping and Logistics** reported a sequential improvement in operations (partly due to Q2 being seasonally better quarter), however on a YoY basis they were weaker. Competitive intensity in the sector continued to be very high and pricing power has been weak. Fuel prices have now moderated, with the average bunker rate for the quarter at Rs. 32,600 per MT compared to Rs. 35,100 per MT in previous quarter. The company reported PBT of Rs.4.8cr vs Rs.1.7cr last year. Seasonally second half of a financial year has higher volumes and with fuel prices having moderated, higher volumes can drive higher profitability. Losses from the associate, Avana Logistek, have narrowed in the second quarter to Rs. 0.8 Cr as compared to Rs. 2.2 Cr. in Q1FY20. Management expects Avana to break even in the 2nd half.

The new regulations mandating use of higher quality expensive fuel are kicking in from Jan 2020. Fuel prices would rise by about 45% for Shreyas. To negate the impact of this rise, Shreyas would have to take a price hike of about 10-15% for its various routes. Management has indicated that these regulations driven fuel price hikes shall be passed on in the form of a surcharge (Bunker Adjustment Factor – BAF). While the hike needed is steep, there is a supportive factor in the form of low bunker prices. There have been renewed efforts by Food & Fertilizer ministries to increase use of coastal shipping and it has the potential to generate significant volumes for the Industry & Shreyas. While the valuation already factors in a weak second half performance, there is scope for positive surprise with company trading at a P/E of 8x for FY20.

Key risks include failure to pass on Bunker Fuel prices; domestic & global slowdown that can lead to lower Volumes

Himadri Speciality Chemical delivered a soft quarter for Q2-20, on account of multiple business headwinds across different segments. Their sales volumes in coal tar pitch (roughly 60% of total vol.) have been largely flattish with a negative bias. The end user- aluminium industry is in a lot of stress, but they are forced to keep their plants running, and as a result supporting Himadri's volumes. However, Graphite volumes (12% of volumes) fell by 50% this quarter as the electric arc furnaces in India are doing poorly; and carbon black (CB) volumes (roughly 25% of volumes) have been forcefully increased in a scenario where carbon black prices have corrected by as much as 21% sequentially. The demand for Carbon Black volumes has shrunk significantly on the back of the sharp slowdown in Auto volumes. As a result, the regular manufacturers of carbon black have moved supplies into the non-tyre categories that Himadri primarily catered to (65% of their volumes). Due to the supply glut, the realizations for CB fell by 21% this Q2, from Rs.14,000 to Rs.11,000. Himadri however maintained its market share given they have a new 5000 ton per month (60,000 p.a.) line coming up in Q3-20. In addition to pressure from domestic suppliers, South Korea has started dumping carbon black in India. The Indian producers have approached the GoI for protection, however a likely resolution may take 2-3 quarters. The Graphite electrode segment is typically a high margin consumer of coal tar pitch, but steel volumes from electric arc are falling, and the consumption of CTP have

fallen. As per our understanding, realizations are unlikely to fall significantly from current levels.

Update on capex: Himadri's new 60,000tpa lines of speciality carbon black segment is expected to commence production by the end of Q3-20, while the 5000tpa capacities in the advanced carbon materials lines are expected to come up by January 2020. We expect the impact of these numbers to only flow in by Q1 of FY21, as demand headwinds for the tyre industry remain and are expected to ease as the auto industry eases in the BS-6 regime by April 2020. On the back of industry developments, we are revising our earnings for the year. With the commissioning of the new product lines over the next few months, the earnings trajectory for H2 of FY-21 and beyond should recover strongly.

Key risks to the investment will emanate from continuous slowdown in the auto industry, slow ramp up in the utilization of new facilities, and fall in aluminium production in India.

Led by the integration of Parador, **Hyderabad Industries** reported robust increase in revenues and earnings at 42% and 164% respectively. With this integration, HIL's revenue mix has moved away from being majorly dependent on roofing sheets, which was 70% of its revenues for Q1-2019, to now constituting 33% of revenues, as of H1-2020. This is an important shift, as it reduces the dependence of the business on a seasonal (Q1 heavy), and cyclical (rural sentiment) product, to a more balanced building materials player. With the complete integration of Parador, an Austrian-German MNC in the wooden flooring space, the company has shifted the profile of its business to that of a home decor player, viz-a-viz a rural economy dependent factory shed maker. As Parador grows in the times to come, the earnings mix is also expected to change significantly away from the asbestos roofing segment.

HIL had a poor Q1-20, led by weak demand for their roofing sheets. However, that is now behind, and the company expects growth to return by Q4 of FY-20. Due to the decline in earnings in Q1, we expect the company to report a moderate increase in earnings from the previous year's base of Rs.102cr., while the expectations for FY-21 are materially ahead of this number.

Key risks will emanate from poor rural sentiment in the summer of 2020 and inability to procure raw materials at favourable prices. Procurement of raw materials has been a challenging affair for the company as their previous source of imports (Brazil) has banned the export of fiber required for the manufacture of roofing sheets.

KPIT Technologies has continued to demonstrate industry leading revenue growth, delivering 17% in constant currency growth (YoY) in Q2-20, on a back of a strong Q1-20 where they grew 19% YoY. Notwithstanding the recent softness in demand of automobiles around the world, global auto majors are accelerating spends on emergent areas of technology across hybrid, electric vehicles and autonomous driving, and KPIT is a global player of scale in each of these automotive technologies.

Notwithstanding revenue growth, operating margins came in weaker sequentially at 13.4% vs 14.6% on the back of a one-time adjustment in industry leading wage hikes. The absolute quantum of the wage hike was roughly Rs.17cr, impacting EBIDTA margins by 3.1%. As a result, EBIDTA came in at Rs.73cr vs 74cr QoQ. Supported by lower tax rates, net earnings at Rs.37cr was sequentially higher by 18% vs Rs.31cr. We expect the margins to accelerate in H2-20 on the back of continuing momentum in revenues. On the back of ramp up in R&D spends committed by their clients, KPIT has string visibility of growth in revenues and margins over the next few years.

Key risks to the investment would emanate from stress in global economic conditions, forcing automobile majors to cut back on their R&D spends, and the inability of KPIT to keep up with the technological requirements of their clients.

IV Water Infrastructure: This segment constitutes about 10% of fund's total investments with exposure to the following segments.

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 with declining raw material (cooking coal and iron) cost, we expect significant improvement in operating performance in coming quarters.

During Q2-FY20, **Srikalahasti Pipes** continued to report sequential improvement in profitability driven by higher volumes, stable operating metrics and higher other income from cash in balance sheet. Revenue growth was flat YoY but operating profit grew by 12% YoY. Some of their orders got postponed from Q2 to Q3 on the back of which we expect better earnings in H2 of FY20.

Tata Metaliks reported a mixed performance for the quarter. While the company's ductile iron division reported strong performance (EBIT growth of 107% YoY), the pig iron division got impacted due to decline in realization (EBIT loss of Rs.16cr). As H2 is typically a strong sales period for the company, we expect the company to report stronger

earnings. Also, the planned capacity expansion in pig iron (from 5 lakh to 7 lakh tonne) and in DI Pipe (from 2 lakh to 4 lakh tonne) is on schedule and should start contributing from Q4FY21.

Key risk include spike in raw material costs.

b) Micro Irrigation: The fund is invested in a Mahindra group company – **Mahindra EPC Irrigation Ltd**, which reported strong P&L performance in Q2-FY20. While the industry growth was in range of flat to negative, the company reported 9% revenue growth in H1-FY20. Favourable raw material costs (lower crude price) has led to higher gross profit margin in H1-FY20 on YoY basis. The reported EBIDTA margin of 11% was significantly higher than Q2-FY19 due to positive operating leverage. We continue to remain positive on the micro irrigation sector as the penetration level in India is just 7%.
Key risks would arise from delay in subsidy release from state governments and spike in raw material price.

V Safe Chemicals: This segment constitutes about 31% of the fund's total investments with 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 gathered momentum in Q2-FY20 as revenue grew 10% YoY and EBITDA margin now 16% vs 13% YoY. The company has guided for Rs. 300-325 Cr of capital expenditure in FY20 and this should lay foundation for growth in FY21 and beyond. The company has launched a yellow high-performance pigment and is only the 2nd company globally to do so. The fact that company developed entire technology in-house and has launched this product in 18 months is a perfect epitome of its technical capabilities. The company has also guided to launch another high performance pigment in the March quarter.
Key risks include disruption of raw material supplies from China, failure of new launches to garner market share, volume impact from dis incentivizing use of plastic or a ban and a general slowdown in consumer spending.

Suven Life Science's financial performance was better than our expectations. Q2-FY20 and H1-FY20 results have been very strong with 200+% and 68% revenue growth respectively due to increased traction in commercial CRAMS. Accordingly, EBIDTA and PAT are also up 110+% YoY in H1-FY20.

Suven's demerger of its loss-making drug discovery business will help the CRAMS entity to be valued on its own merit. The CRAMS business margin profile without drug discovery R&D costs will be about 40+% with a ROE of 30+%. Revenues and PAT are likely to grow at 15% and 20% CAGR over the next 2 years.

Key risks are fall in global R&D spending due to consolidation among top innovator companies and delay or decline in commercial scale CRAMS opportunities due to lower acceptance of the new drug.

Galaxy Surfactant, which is a manufacturer of oleo chemical-based surfactants reported inline performance in Q2-FY20. Post a flattish Q1-FY20 volume growth in performance surfactants, Q2-FY20 volumes were up 11% YoY. Specialty care volumes have gone up 8.4% YoY due to increased business from U.S., Europe and South East Asian countries. EBIDTA grew 5% YoY in H1 and 1% YoY in Q2; The fixed overheads relating to recently commissioned 50000 MT capacity in Jhagadia and higher development expenses in specialty care portfolio led to lower growth in EBIDTA compared to the volume growth. PAT growth for Q2 and H1 was up 45% and 30% yoy due to lower borrowing costs and taxation benefit.
The capacity expansion in Jhagadia would suffice for volume growth over the next 3-4 years. Further capacity expansion for Specialty Care Products (capex of ₹ 1.25bn in FY20) and US Tri-K proteins facility (~US$ 7mn) are on track and are expected to be commissioned in H2.

Key risks would arise from higher raw material prices and inability of the company to scale up its new facilities.

Summary: The earnings performance of three investments that had seen softness in FY2019 - Gravita, Shreyas and Srikalahasti Pipes have improved in Q2-FY20. While they had seen a series of internal and external events that affected them operationally, several measures have been taken by these companies to course correct and emerge stronger. We continue to monitor these investments very closely. For the remainder of our core portfolio, we continue to be comfortable with how their medium term outlook and fundamentals are evolving and we continue to rebalance Green portfolio towards investments with higher conviction of near-term earnings.

Financial Details of Portfolio Companies

(Rs. in Cr)	Exposure As on 31st Oct 2019*	PAT			Debt	Equity	D/E Ratio	ROE
Company		Q2FY20	FY2019	FY2020e	H1 FY2020	H1 FY2020	H1 FY2020	FY2020e
Suven Life Science	11.70%	74	165	216	122	923	0.1	21%
Sudarshan Chemicals	11.20%	43	87	125	412	605	0.7	19%
Triveni Turbine	8.60%	50	100	149	0	511	0.0	33%
Exide Industries	7.80%	237	736	880	56	4,820	0.0	18%
Galaxy Surfactants	7.70%	67	191	227	289	992	0.3	23%
Himadri Chemicals	6.90%	45	324	214	400	1,702	0.2	12%
Orient Refractories	5.50%	26	90	151	0	387	0.0	21%
Haldyn Glass	5.20%	5	6	16	4	138	0.0	12%
KPIT Technologies	5.00%	37	158	150	57	979	0.1	14%
Tata Metaliks	4.30%	24	183	143	83	798	0.1	23%
Sri Kalahasthi Pipes	3.60%	36	118	161	434	1,298	0.3	12%
Gravita India	3.50%	10	21	31	248	213	1.2	14%
HIL	2.20%	32	101	105	580	696	0.8	15%
Shreyas Shipping	2.20%	5	30	21	215	441	0.5	6%
Mahindra Epc	2.20%	4	11	14	26	153	0.2	9%
Ganesha Ecosphere	1.40%	16	62	66	61	445	0.1	15%
Sundram Fasteners	1.40%	71	457	356	996	1950	0.51	18%
Tube Investment of India	0.30%	93	240	347	497	1763	0.28	20%

*As percentage of total AUM; Note: Financials for Suven Life Science are only for CRAMS division.

Portfolio Characteristics

Valuation Parameters	FY2019	FY2020E
P/E Ratio	18	13
P/B Ratio	3.3	2.8
Earnings Growth	8%	27%
Debt Equity Ratio	0.2	0.2
ROE %	15%	17%
PE/ Growth Ratio		0.48

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.*