UNIFI Capital

THE GREEN FUND

QUARTERLY REVIEW - AUGUST 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.

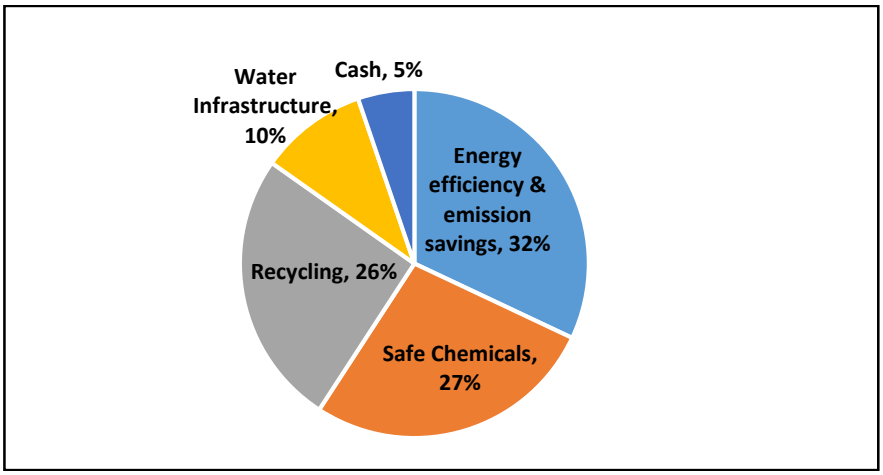
Quarterly Review

The slowdown in domestic economy is real.

In the first quarter of 2019, GDP growth came in at 5.8%, materially below the +7% rhythm of the previous four years. Importantly, slowdown in manufacturing which accounts for 75% of deceleration in headline growth fell to a 2-year low of 0.6%. The auto sector, which accounts for a large share in manufacturing, has been undergoing a crisis in the past several months, de growing by anywhere between 5-20%, while private consumption, the mainstay of domestic demand, grew by just 3.1% in the quarter gone by. In a nutshell, the real economy as well as business sentiment is weak. 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.

In the Q1-FY20 the weighted average earnings growth for green portfolio was 12% YoY. While majority of portfolio positions reported inline results, few investments are yet to recover from the earnings decline witnessed in FY2019, notably Gravita India and Shreyas Shipping Ltd. In this note, like our previous newsletters, we highlight the financial and business performance of various portfolio companies during quarter ending June 2019. The decline in green portfolio is partly attributed to decline in earnings of few portfolio investments and rest due to fall in overall market valuation.

Sector Exposure



I Recycling: Recycling constitutes about 26% 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.

During the June quarter, **Gravita** commissioned its new plants in Ghana and Tanzania. With the new capacities, Gravita's overall lead capacity has increased by 11% and the contribution from these would start flowing from Q2-FY20. As the cost of scrap

FUND DETAILS

Launch Date:
31 July 2017

Scheme AUM:
INR 0.88 bn

Theme AUM[1]:
INR 3.21 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.

procurement is lower in these new countries, the operating profit per kg would be significantly better than existing operations. Meanwhile, starting Q1-FY20, the company has completely hedged its lead inventory. While there was a slight dip of 5% YoY in lead sales volume (some sales volume got deferred to Q2-FY20), there was a noticeable improvement in EBIDTA margin from 4.8% in Q4-FY19 to 5.7% in Q1-FY20. The company reported net profit of Rs. 2.5cr VS Rs. 12cr YoY. We continue to stay invested in Gravita as we anticipate sequential improvement in operating performance of the company as the new facilities ramp up.

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 Q1-FY20, company's profitability grew by 7% YoY due to growth in auto replacement and inverter battery market in spite of slowdown in auto OE sales. Incrementally, company stated in its annual report that its 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. 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.

b) Glass Recycling: 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). Led by volume and price increase, in Q1-FY20 revenue grew by 20% YoY and as a result of positive operating leverage, EBIDTA improved by 108% YoY. PAT growth was lower at 16% YoY due to higher tax rate. Their JV with Heinz glass for manufacturing glass bottles for perfume industry has broken even at PAT level in Q1-FY20 for the very first time. 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.

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. During Q1-FY20, the company reported stable performance with revenue/ebitda/PAT growth of 9%/22%/19% respectively.

d) Plastic Recycling: **Ganesha Ecosphere** is a new addition to the fund. Founded in 1987, the company has emerged as one of the leading Polyethylene Terephthalate (PET) recycler in India. They collect PET waste through their collection centres across India and use it to manufacture RPSF (recycled polyester staple fibre), dyed texturized yarn and spun yarn. The company's products find applications in manufacturing of textiles (T-Shirts, body warmers etc), functional textiles (non-woven air filter fabric, carpets, car upholstery) and fillings (for pillows, duvets, toys). Ganesha's business model of giving waste an 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. In Q1-FY20, the company reported 53% YoY earnings growth. This was driven by volume growth and operating margin expansion by 350 bps YoY.

II Energy Efficiency & Emission Savings: The fund has an exposure of 32% 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. The company had a good start to the year as preponement of orders in domestic market and lower raw materials cost lead to robust earnings growth of 41% in Q1-FY20. However, the overall inquiry generation and order finalization has been lower during the quarter, primarily due to the slowdown in the domestic market during the election season. Order book, which is a lead indicator of the potential revenue growth, is currently lower by 6.8% as compared to last year. However, management is confident that the new orders would pick-up in the coming quarters and the company is positioned for a 30% improvement in earnings in FY20.

The fund's investment **in Shreyas Shipping and Logistics** slipped into losses as EBITDA margin fell to 5.3%, weakest in last 22 quarters i.e., since Dec 2013 (when it was 4.2%). Sequential decline in realization (about 10% QoQ) and increase in bunker fuel has led to fuel expenses rising to 38.3% of revenues from 29.5% in Q4-FY19. The impact was further magnified due to lower volumes as there were operational hiccups due to switching of operations from Mundra to Kandla and then back to Mundra. While

realisation per TEU is back to earlier level in Q4FY19 and fuel cost have come down, we continue to monitor this investment closely.

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. In spite of the weak macros, Himadri delivered a flattish quarter YoY (Rs.74cr vs Rs.77cr YoY) on the back of improving quality of earnings mix. The company's total volumes were down 10% sequentially, however, reported earnings per unit improved 6% YoY for their core carbons materials business demonstrated sequentially stronger pricing power, resulting in better earnings mix. For H1 of FY20 we expect their earnings to be largely flattish, followed by a gradual ramp up towards the end of H2-FY20.

Hyderabad Industries Ltd (HIL) performance was weaker than expected, reporting earnings of Rs.41cr vs Rs.52cr YoY. On the back of the long electoral season, and weak availability of labour, coupled with weak rural sentiment per se, roofing volumes were down sharply. In another development, there has been a disruption in the sourcing of fibre (which is a key raw material) from Brazil as a result of which alternative arrangements may lead to cost escalations in the quarter to come. The other parts of their business, namely building solutions are doing well, but are at full capacity and debottlenecking is likely to happen this year. Parador, their German acquisition is doing well and is expected to continue doing well in the times to come. We have begun to trim our exposure in this investment.

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.

In Q1-FY20, KPIT's revenue grew by 5% QoQ to USD 72mn. There continues to be visibility of strong operational performance in FY20, with constant currency revenue growth expectation of 16-18% and EBIDTA margins of 14-15%, backed by operational efficiencies. Due to a change in accounting standard, there has been a charge that is non-operating in nature to the P/L, and thereby reducing reported earnings. We do not view this as a material event.

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 Q1-FY20, Srikalahasti Pipes reported strong improvement of 340 bps in operating margin. Profitability jumped by 93% YoY due to low base of last year. Tata Metaliks reported strong performance in DI segment but the pig iron manufacturing segment got impacted due to lower spread between raw material price and realisation.

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 Q1-FY20 performance with profitability growth of 45% YoY. We continue to remain positive on the micro irrigation sector as the penetration level in India is just 7%.

V Safe Chemicals: This segment constitutes about 27% 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's recent financial performance reflected price hike taken by the company in lieu of increased raw material prices in FY19. This resulted in gross margin improvement by 2.2% QoQ and management expects this to improve further by 1% in coming quarters. Driven by 13% YoY growth in speciality pigments and 4% in non-speciality portfolio, revenue grew by 10% YoY in Q1-FY20 while profitability grew by 14% YoY. Company is introducing about 20-25 products every year and two major products would be launched in FY20. Growth in a year is driven by product launched 2 years back. While the management has hinted a strong second half, given the weak macros we remain cautiously optimistic.

Suven Life Science's recent financial performance was better than our expectations due to good performance of the commercial CRAMS division. Due to better product mix (more Phase 2, Phase 3 and commercial billing than Phase 1 projects), CRAMS division EBIDTA grew by 41% YoY and PAT

grew 28% YoY. In the drug discovery division, where there are only R&D expenses incurred, the spending has been high due to the ongoing phase 2A trials of Suvn 502 molecule as well as pre-clinical spends for 12 other molecules. Hence, on a consolidated basis, reported profitability was lower and appears flattish. The results of the clinical trials relating to Suvn 502 is expected in early October.

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.

Galaxy Surfactant which is a manufacturer of oleo chemical-based surfactants reported inline performance in Q1-FY20. While the volume growth in performance surfactants was flattish, speciality care surfactants grew by 12% YoY. Overall operating margin improved by 200 bps YoY and profitability grew by 15% YoY. Incrementally, Galaxy has expanded its performance surfactants capacity at Jhagadia by 50,000MT during the quarter which would suffice for volume growth over the next 3-4 years. 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.

Summary: Near term macro-economic developments have come down heavily on the Indian economy. However, there are several niche and interesting pockets of growth that are not dependent on the direct macroeconomic environment and the fund stays aligned with them. The recent correction in the markets have given us an opportunity to add to our exposure in a few names with high conviction. The two positions that have seen material draw downs, Gravita and Shreyas are continued to be monitored very closely. Both these companies have seen a series of internal and external events that have affected them operationally. For the remainder of our core portfolio, we continue to be comfortable with how their medium term outlook and fundamentals are evolving.

Financial Details of Portfolio Companies

(Rs. in Cr)	Exposure As on 31st July 2019*	PAT			Debt	Equity	D/E Ratio	ROE
Company		Q1FY20	FY2019	FY2020e	FY2019	FY2019	FY2019	FY2019
Exide Industries	11.64%	224	736	784	-	5,987	-	18%
Sudarshan Chemicals	11.00%	30	87	113	303	568	0.53	17%
Suven Life Science	9.44%	61	165	191	37	461	0.08	36%
Triveni Turbine	9.66%	31	100	130	-	433	-	23%
Himadri Chemicals	8.23%	74	324	350	430	1,631	0.26	21%
Gravita India	3.65%	2	21	31	240	204	1.18	11%
HIL	5.16%	41	101	105	600	637	0.94	17%
Galaxy Surfactants	6.74%	53	191	218	253	877	0.29	25%
Haldyn Glass	4.40%	3	6	12	7	134	0.05	5%
Orient Refractories	4.98%	22	90	97	-	131	-	26%
Shreyas Shipping	3.51%	-3	30	33	248	444	0.56	14%
Tata Metaliks	4.11%	20	183	188	209	767	0.27	32%
Sri Kalahasthi Pipes	3.77%	33	118	148	351	1,262	0.28	10%
KPIT Technologies	5.45%	31	158	155	97	960	0.10	16%
Mahindra Epc	2.11%	2	11	16	3	150	0.02	8%
Ganesha Ecosphere	0.92%	16	62	70	96	419	0.2	18%

*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	17	13
P/B Ratio	2.9	2.4
Earnings Growth	8%	19%
Debt Equity Ratio	0.2	0.2
ROE %	15%	17%
PE/ Growth Ratio		0.68

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.*