UNIFI Capital

THE GREEN FUND

QUARTERLY REVIEW - JULY 2020

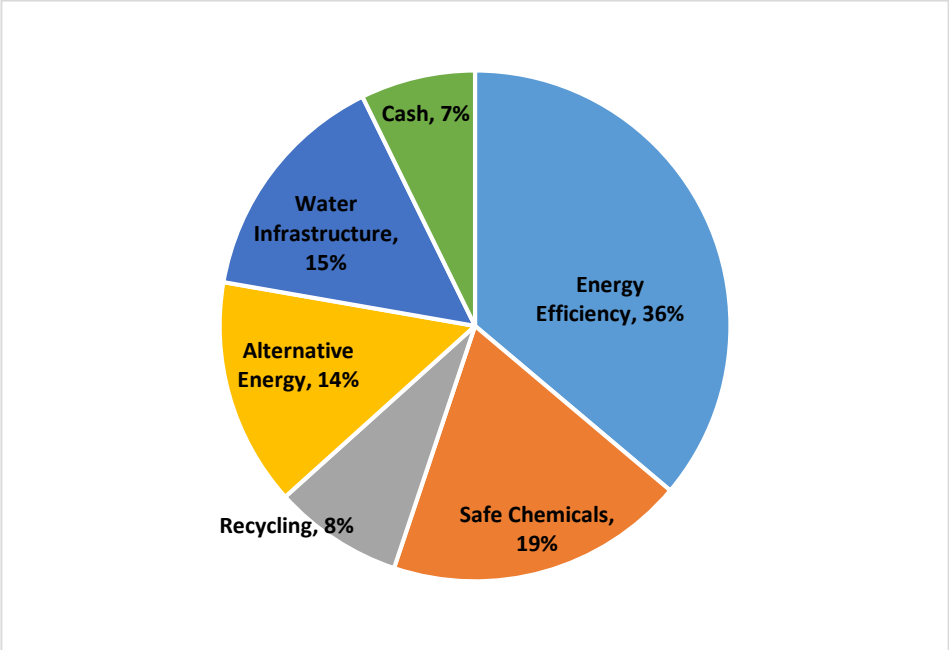
UNIFI AIF 2 – The Green Fund

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.

We started 2020 with one of the biggest crisis mankind has ever faced post World War-II. As we write this note, the total number of COVID-19 cases across the globe has already crossed 13 million with 5.7 lakh deaths. Between the 12th Feb and 23rd Mar, the NIFTY gave up 38% [12,201 to 7,610] as panic turned de rigor. With policy actions, the recovery was equally swift as the NIFTY climbed back 35% from the lows [10,300 by 22nd June]. In an environment where participants are emotionally shaken, it is easy to lose sight of the fact that the markets price the future. Depending on how the variables change, it is difficult to say if the markets are pricing in 6 or 24 months into the future, but it can be said that right now, it is looking past the near-term economic decline.

We made significant changes to the Green portfolio during this phase of market volatility and this is detailed in this note. We have taken higher exposure to companies where near-term recovery looks faster than the general economy, and reduced exposure towards names which trade at rich valuation relative to growth. All the portfolio companies have delivered resilient performance in Q4 of FY-20 and are poised to consolidate their position and do well in the times to come.

Sector Exposure



FUND DETAILS

Launch Date:
31 July 2017

Scheme AUM:
INR 0.97 bn

Theme AUM[1]:
INR 2.15 bn

Firm AUM:
INR 42 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.

Summary of results from the quarter Q4-FY 2020

I Energy Efficiency & Emission Savings: The Green fund has an exposure of 36% to this segment with various investments detailed below.

Hyderabad Industries, under the circumstances that prevailed in Europe, and the 15-day lockdown imposed in India (Telangana closed ahead), delivered a good quarter with just a 3% YoY decline to Rs.645cr in revenues for Q4-FY20 with EBIDTA and PAT declining 9% and 12% to Rs.56cr and Rs.23cr respectively. With the integration of Parador, HIL's revenue mix has moved away from being majorly dependent on roofing sheets, which was 80% of its revenues for FY 2019, to now constituting 55% of revenues, as of FY-20. This is an important shift, as it reduces the dependence of the business on a seasonal (Q1 heavy), and cyclical (rural sentiment) product, to being 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 roofing sheets maker. As Parador grows in the times to come, the earnings mix is also expected to change significantly away from the asbestos roofing segment. At a revenue and EBIDTA level, Parador is almost 50% of the revenues and operating earnings. However, on account of revaluation of their assets, their depreciation is elevated. As a result, at an EBIT level, Parador contributes to 34% of EBIT (post depreciation). Over all, the Parador acquisition made in 2018 has been a good one, shielding them from the volatility of the Indian market, while growing in the international markets.

The company continues to have levers for growth and improvement in earnings towards the end of FY-21 and FY-22. With a run rate of almost Rs.100cr of annual depreciation (led by asset revaluation), the company is generating strong cash flows, which will support its intent to almost entirely deleverage by the end of FY-22.

Key risks will emanate from poor rural sentiment, high competitive intensity and inability to procure raw materials at favourable prices.

Tube investment reported stable operating performance in Q4FY20. In spite of a 24% decline in top line, company reported flat PBT growth (with highest ever margin of 11.5%). This was mainly due to significant savings from various cost efficiency initiatives. The drop in revenues were visible across segments: Cycles (-49% YoY), Engineering (-17% YoY), Metal formed product (-16% YoY) and Gears (-30% YoY). TI is in the midst of an efficiency drive to improve margins, and they are just 50% through this initiative. While management has not offered any guidance on growth for FY-21, we expect FY-22 to see a sharp rebound in financial performance. We continue to 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 and extended impact of COVID-19 would pose a key risk for the investment.

Symphony's India business had a very strong quarter, despite the lockdown in March-20 which resulted in a revenue loss of 15-17%. The revenues for Q4-20 are higher than Q4-FY19 and Q4-FY18 on the back of better sales mix and subsequent improvement in gross margin to 48% from 43% YoY. Subsequently, PAT has doubled to Rs. 44cr vs Rs. 22cr last year.

Summer is the key season for air cooler sales and the impact of lockdown will be high on Symphony this year. But, the heatwave during May has resulted in strong secondary sales in the outlets that were open. As a result, the channel inventory had reduced to an extent in May and June post which off-take is expected to resume as per normal levels in Q2 of FY-21.

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

KEC international is a new addition to the fund. The company is a global EPC player with presence in various verticals like power transmission & distribution, cables, railway electrification, smart city infrastructure and solar power transmission. KEC is likely to benefit from a) Indian railway infrastructure projects which has a deadline of 100% electrification by 2023 (as of now only 57% is electrified), b) Green energy corridor - which is a comprehensive scheme for evacuation & integration of the renewable energy, c) smart city infrastructure and d) solar EPC services globally.

In Q4-FY20, KEC reported a 4% YoY decline in revenues to Rs.3,671cr as the lockdown in March impacted their execution. Revenues of Rs.500-600cr were deferred to FY21. However, the company was able to maintain its EBITDA margin and PAT was flattish at Rs.193cr due to lower tax rate. Post the gradual relaxation of lockdown, KEC has ramped up operations. Currently 95% of the construction sites are operational and labour availability has now improved to 65%-70% of the pre-covid levels. The construction activity at the sites are now at 75-80% of the pre-covid levels and by

end of July it is likely to reach almost pre-Covid levels. The International business of KEC has been very minimally impacted.

KEC has an outstanding order book of more than Rs. 20,000cr resulting in revenue visibility over the next six quarters. The company has not seen any delays in their payment cycles from key customers: Power Grid and Indian Railways. The company is a proxy play for infrastructure spends in India and we like the company for its ability to navigate the environment cautiously, and profitably. KEC has good presence in international markets where working capital cycles as well as margins are better.

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

KPIT continues to demonstrate strong momentum in its business, delivering (USD) revenue growth of 11% YoY at $77m. In INR terms, Revenues, EBIDTA and PAT are up 11%, 25% and 28% respectively for the quarter. Margins are up sequentially on flat revenues and -1.5% billing loss, indicating scope for margin expansion under normal conditions going forward. The company has grown 14% for the first full year in USD terms, one of the strongest in IT sector. While Q1 of FY21 will see the effect of COVID induced disruption, the growth momentum is expected to ramp up by H2 of FY21.

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. With Rs.300cr in EBIDTA for the year on a market capitalization of Rs.1,700 Cr (30th Jun), the company trades at 5.0x EV/EBIDTA, and is amongst the most reasonably valued firms in the sector, relative to their peers demonstrating earnings growth. On the back of ramp up in R&D spends committed by their clients, KPIT has strong 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.

Crompton Consumer was another new addition to the fund. The company is one of India's largest players in the consumer durables Industry. After acquisition of Avantha group's entire 34.37% stake in April 2015 by private equity firms Advent International and Temasek (owned by Govt of Singapore), who are the current promoters, the company has transformed into an innovative and capital efficient player with strong management pedigree that has exhibited solid execution over the past few years. Crompton is the growth leader in segments spanning premium fans, residential pumps and LED's and over the next two years, has multiple levers to drive growth from forays into newer product areas and from consolidating its leadership across existing product lines.

The company had Q4-FY20 shaping to their best ever operating quarter. In the fans segment, which is 40% of their revenues, they delivered 21% in volume growth in Jan and Feb of 2020, which is significantly higher than the industry and indicative of the strength of their franchise. The B2C LED segment grew 35% in volumes and appliances grew at 48% in Jan and Feb (small but growing base) while domestic pumps also did well with 19% YoY growth. The last three weeks of March are a significant stocking season for the industry, and this was completely lost as a result of the COVID induced lockdown, on the back of which, revenues and earnings were down 16% and 12% to Rs.1,026cr and Rs.102cr respectively.

At a margin level, significant cost savings and normalcy in LED pricing resulted in sequentially better margins. Employee costs were lower by 10% QoQ and going forward other areas of operating expense are likely to be down materially. The company has identified Rs.100cr of incremental cost savings for FY-21 at the COGS and Opex level which can potentially benefit margins by 200bps incrementally. Going forward, since the 3rd week of April, all the factories have reopened and the pace of normalization has been reasonable.

Key risks to the investment could emanate from drop in consumer purchasing power translating to lower sales of consumer durables.

Triveni Turbine had a good first 9 months of FY-20 with revenue growth of 11% and PBT growth of 25%. However, in Q4-FY20, revenues fell 36% YoY to Rs.154cr and as negative operating leverage played out operating margin fell to 11.6% vs 17% YoY. The company has indicated that revenue was impacted by about Rs. 50cr in Q4 due to Covid. Adjusting for that, the revenues are down 15% YoY and thus even after accounting for Covid disruption the results are very weak. The fall in revenue is the primary driver of weak results as most of the cost items were in line with expectation. Key risks include failure to strengthen order book in FY21 and a global slowdown that can lead to lower demand.

II Safe Chemicals: This segment constitutes about 19% of the fund's total investments with exposure to a) Suven

Pharmaceuticals Ltd – a life sciences company and b) Galaxy surfactants, a manufacturer of oleo chemical-based surfactants.

Suven Pharma Limited (demerged entity) delivered numbers that were as per expectations at the standalone level and above expectations at the consolidated level. Due to the nature of R&D projects billing that could vary among quarters, we typically look at the annual progress rather than quarterly results. In FY20, Revenues were up 29% YoY and EBIDTA was up 47% YoY due to margin expansion from favorable business mix and no drug discovery R&D costs post demerger. PAT growth was an impressive 90% YoY abetted by Rs.48cr share in profits from its associate company Rising Pharma. Further business synergies with Rising Pharma that will help shore up Suven's formulations segment is underway.

SPL revenues arise from contract research services, commercial scale intermediate supplies and select specialty chemicals sales. SPL looks to move into APIs as well as formulations and is building capacities in this regard.

Management bandwidth and no new research orders in the COVID affected Q1FY21 are the key concerns.

Galaxy Surfactant's reported volume growth of just 1.2% on back of Covid related disruption. While this was lowest in last several quarters, EBIDTA and PAT growth was better at 8% and 10% YoY due to better gross margins and lower tax rates. For the full year FY20, EBIDTA growth was similar to the volume growth of about 4.5%. Galaxy's capacity utilisation is about 62% leaving considerable headroom for growth without a large capex over the next 2-3 years.

Galaxy Surfactants is a leading manufacturer of oleochemicals based surfactants and other specialty ingredients for the personal care and home care industries. The ingredients company manufacture are commonly used in consumer-centric personal care and home care products like skin care, oral care, hair care, cosmetics, toiletries and detergent products. Galaxy surfactants product portfolio includes over 200 product grades, which are marketed to over 1,700 customers in 70 countries. Both domestic and MNC FMCG companies have been its long standing clientele. Galaxy offers steady growth prospects due to its linkages to the defensive FMCG segment.

A prolonged economic slowdown and lower spends on non-essential consumption is a key risk for the company.

III Water Infrastructure: This segment constitutes about 15% 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 (coking coal and iron) cost, we expect significant improvement in operating performance in coming quarters.

Srikalahasti Pipes reported stable earnings for Q4-FY20. Sales volume during the quarter was 75,117 tonnes vs 78,706 tonnes in Q3FY20 and 79,440 tonnes in Q4FY19. About 10,000-15,000 tonnes of sales was lost during the quarter due to lockdown. Gross margin improved by 400 bps QoQ due to lower coking coal price. Overall PBT at Rs. 64cr was flat QoQ and increased from Rs. 47cr in same quarter last year.

After restarting operations post lockdown, the company is operating at 60-70% capacity utilization and expects to reach full utilization by Q2 of FY-21. Srikalahasti pipes' order book stands healthy at 3 lakh tonne (equals their capacity) and this is executable over the next 8-10 months. Their capacity expansion plan to increase DI pipe capacity from 3 lakh tonne to 5 lakh tonne is delayed and expected to be commissioned by Q1-FY22. Overall, the company reported its best ever profitability in FY-20 at Rs. 188 cr. In the times to come, the company is expected to benefit from lower raw material costs, higher sales volume and benefits of backward integration.

Key risks include increase in raw material costs, delay in infrastructure spending by government and extended impact of COVID-19.

Tata Metaliks reported robust performance in Q4FY20 despite losing a key dispatch period during last week of March'20. External sales of pig iron increased by 14% YoY and DI pipe sales volume declined by 25% YoY. The highlight during the quarter was lower RM costs. Last year, Tata Metaliks commissioned the pulverised coal injection system (PCI) and oxygen plant to reduce their coke cost and the benefit of this has begun starting in Q3 & Q4 of FY20. As compared to gross margin of 37.82% in H1FY20, company reported 44.7% in H2FY20. With coal injection system now in place, in every one ton of coking coal - about 80 kg of thermal coal is now substituted.

Overall, company had ended FY20 with PAT of Rs.167cr vs Rs.183cr in FY19. Lower raw material costs like coking coal

will help company to report better operating performance in near term. Their 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 delayed due to the pandemic and is expected to start contributing from H2FY22.

Key risks include spike in raw material costs, delay in infrastructure spending by government and extended impact of COVID-19.

b) Micro Irrigation: The fund is invested in a Mahindra group company, **Mahindra EPC Irrigation Ltd** which reported robust earnings for Q4-FY20 driven by stable revenues and jump in gross margin. Overall revenue grew by 12% YoY and gross margin improved by 300 bps. We expect this to improve further as company stands to benefit from lower crude price. Absolute increase in gross profit was 24% YoY during the quarter. Driven by lower other expenses, company reported life time high EBIDTA margin of 17%. Overall, company reported earnings of Rs.23cr in FY20 vs Rs. 11cr in FY19.

While the company's plants were shut in month of April, it is now operating at 80% utilization. Collapse of market leader in micro irrigation sector, favorable government policies 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 payments from the government, higher raw material prices and extended impact of COVID-19.

IV Alternative Energy: This segment constitutes about 14% of the fund's total investments with exposure to a) Petronet – a leading natural gas re-gassifier and b) Hindustan Oil Exploration Company – a unique oil and gas producing firm.

Petronet delivered 7% YoY growth in regassification volumes on the back of the lockdown that impacted the utilization of Dahej terminal, barring which, the company would have registered growth of 15% YoY. Correspondingly, the company delivered PBT growth of 10% YoY to Rs.723cr.

The utilization of their Dahej terminal had fallen to a low of 55% in April due to the nationwide lockdown, but that has now recovered to normal levels of 100%. The Kochi-Mangalore pipeline is expected to commission in July and this will improve the utilization of their Kochi unit to 35-40% vs. 20% currently.

Petronet is a play on India's increasing domestic natural gas consumption. India's domestic production of natural gas is not on pace with demand growth, leading to increasing imports, and Petronet is very well poised to capture this opportunity. The company is very well capitalized and is well suited to withstand a difficult economic environment.

Key risks will be competition from Adani's new terminal and a slowdown in economic activity.

Hindustan Oil Exploration Company (HOEC) reported inline performance in Q4-FY20. Their revenue declined by 32% YoY reflecting lower offtake at its fields and decline in price of natural gas and crude oil. However, as the operational cost of their fields is considerably lower, company reported positive PBT of Rs.10cr. After initial decline in production during month of April, its key field in Assam is back to 100% utilization. HOEC's next venture, an offshore field near Bombay high is progressing well and is likely to be commissioned by Dec-2020. The profitability of the company is expected to double once this field commences. Overall company ended FY20 with PAT of Rs.111cr vs Rs.155cr in FY19. The company has a strong Balance sheet with cash of Rs.171cr and zero leverage. We like HOEC due to its focus on fast turnaround of discovered oil and gas fields, strong pipeline of assets to be monetized in future and debt free balance sheet.

Risks: Prolonged weakness in the prices of natural gas & crude oil and extended impact of COVID-19.

V Recycling: Recycling constitutes about 8% of the fund's exposure and the various sub-segments within this include: *lead and glass recycling.*

a) Lead Recycling: The fund is invested in Gravita India and has completely exited its position in Exide Industries.

Gravita India's profitability has improved in FY20 with reported PAT of Rs. 38cr vs Rs.21cr in FY19. Led by ramping up of newer capacities in Ghana and Tanzania and implementation of hedging policy in the lead division, earnings for Q4-20 showed marked improvement in profitability with recycled lead volume growing by 15% YoY. Reported profitability in Q4FY20 was Rs.12cr vs Rs.4.3cr in the same quarter last year. The lead plant in Ghana with capacity of 12,000 tons has been operating at 70% utilization even during months of April and May. The plant in Tanzania is operating at 60%. Company's aluminium and plastics divisions' performance was strong during the quarter. While the aluminium division benefitted from the ramp up of capacity in Tanzania, the plastics division did well due to lower raw material costs. The company is now looking to debottleneck existing capacities to increase sales volume without much capital expenditure.

Key risks would arise from lower off take of lead volume, geo-political disruptions and extended impact of COVID-19.

The fund's exited its investment in **Exide Industries**. The investment in Exide was made when they pioneered the launch of 'Punched Grid' technology batteries in India. Their focus on regaining lost market share also seemed like a turning point for the company. However, their new battery technology was not completely successful and it has resulted in higher warranty costs. There is a persistent threat from electrical vehicles to the lead acid battery industry and the company's strategy to set up a Lithum Ion battery assembly plant has been delayed a couple of times.

b) Glass Recycling: The fund is invested in a Gujarat based container glass manufacturing company, **Haldyn Glass** which reported inline performance in Q4-FY20. Revenue at Rs.51cr declined by 10% YoY. Adjusted for one-time provisions, company reported operating margin of 10.8% which is 70 bps higher QoQ. The company has ramped up its production quickly post lockdown and is currently operating close to 100% utilization. Most of raw materials required for manufacturing container glass – caustic soda, cullet and power are in a declining trend which should help in reporting stable operating performance in midst of challenging environment. Overall, the company closed FY20 with PAT of Rs. 12cr vs Rs. 5.6cr last year. Their JV with Heinz glass also reported better performance with FY20 operating profit of Rs. 12cr vs loss of Rs.2cr in FY19.

Risks: Increase in raw material costs, decline in demand with end user (Alcohol industry) and extended impact of COVID-19.

The fund exited its investment in a refractory recycling company: Orient Refractories and a plastic recycling company - Ganesha Ecosphere. In case of Orient Refractories, the decision to merge parent company's (RHI Magnesita) unlisted business in India was a major turning point for company. However, this has now been cancelled by the NCLT court. We expect the growth in the existing listed company to be muted due to lower demand from steel sector. The decision to exit Ganesha Ecosphere was due to a reduction in availability to their key raw material, PET bottle scrap and delay in commission of their capex in South India.

Financial Details of Portfolio Companies

(Rs. in Cr)	Exposure As on 30 Jun 2020*	PAT			Debt	Equity	D/E Ratio	ROE
Company		Q4FY20	FY2019	FY2020	FY2020	FY2020	FY2020	FY2020
Suven Pharma*	15.20%	74	164	316	180	845	0.21	37%
Petronet LNG	9.50%	534	2,154	2,762	0	11,121	0.00	25%
Sri Kalahasthi Pipes	7.00%	51	118	188	489	1,416	0.35	14%
Triveni Turbine	5.90%	14	100	122	0	530	0.00	27%
HIL	5.30%	23	102	106	637	742	0.86	15%
KEC International	5.00%	193	496	566	2207	2798	0.79	22%
Hind Oil Exploration	4.90%	11.5	155	111	0	680	0.00	18%
Mahindra Epc	4.60%	9.6	11	23	13	170	0.08	14%
Haldyn Glass	4.60%	2.94	6	12	1.43	139	0.01	9%
Tube Investment of India	4.30%	81	240	328	269	1806	0.15	20%
CG Consumer	3.90%	102	401	443	178	1468	0.12	35%
Galaxy Surfactants	3.80%	63	191	230	318	1068	0.30	24%
Gravita India	3.60%	12.6	21	38	253	225	1.12	19%
Symphony	3.70%	44	115	186	211	643	0.33	28%
Tata Metaliks	3.40%	77	183	167	297	919	0.32	20%
KPIT Technologies	1.20%	40	55	147	19.5	1050	0.02	20%
Honda Power	0.90%	5	54	67	0	570	0.00	12%

*As percentage of total AUM; Note: Financials for Suven Life Science are only for CRAMS division. *Himadri & Shreyas Shipping are yet to report Q4 results.*

Portfolio Characteristics

Valuation Parameters	FY20
P/E Ratio	15.2
P/B Ratio	3.8
Earnings Growth	37%
Debt Equity Ratio	0.2
ROE %	21%
Wt. Avg Mcap	Rs.7,068cr

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.*