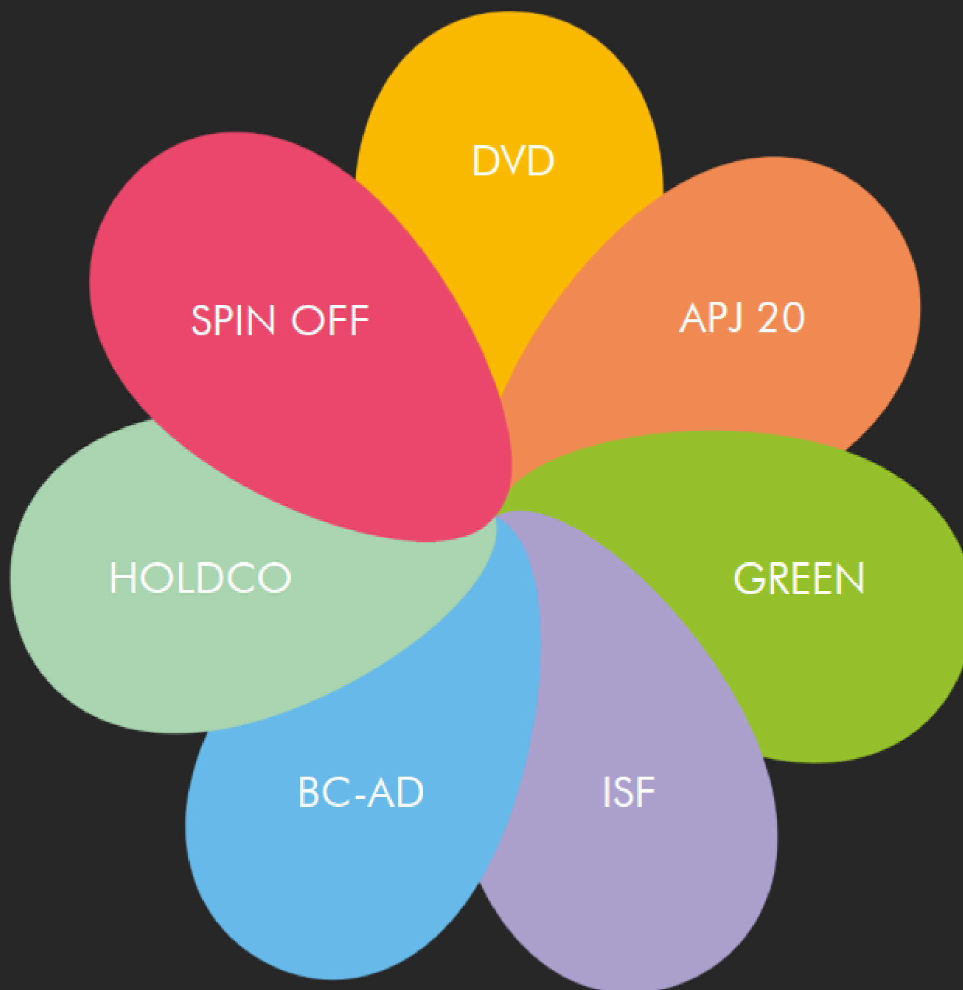
UNIFI Capital

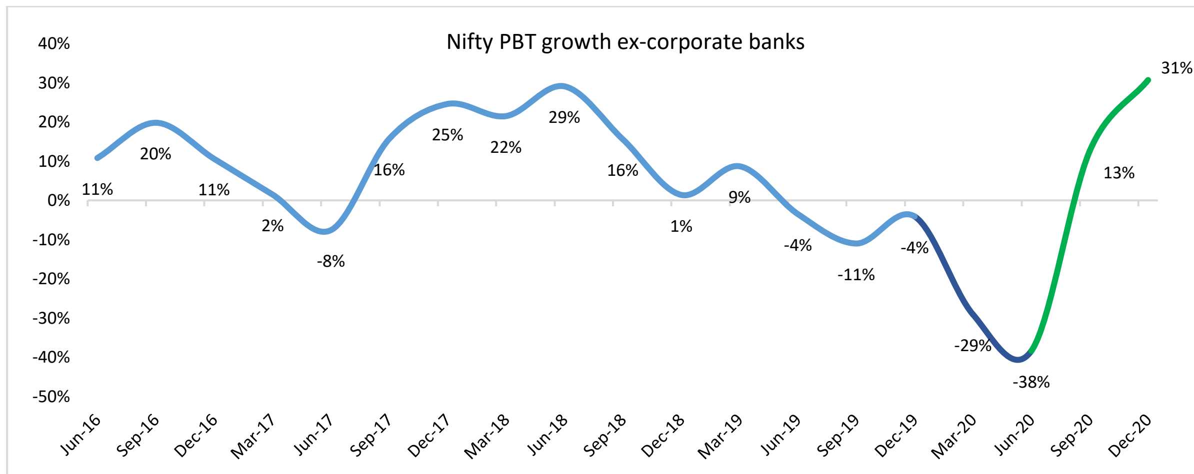


THE BLEND FUND

8th Quarterly Review – March, 2021

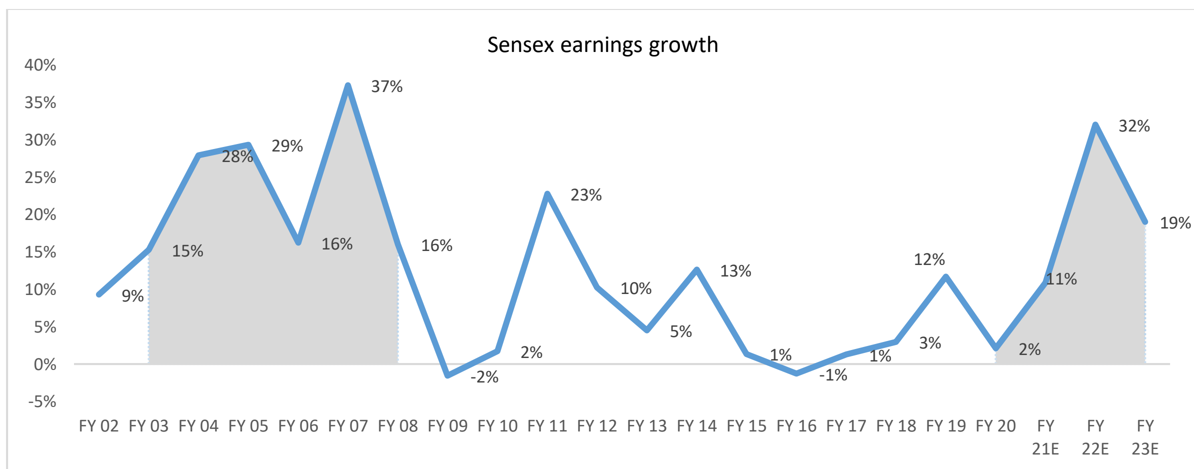
CY 2020 – Putting Roller Coasters to Shame

2020 was emblematic of the flaws in most financial and economic theories and did a remarkable job of exposing the complex systems we inhabit. While the markets discount deterioration sooner than one thinks it does, it is also much more forward looking than we give it credit for. In other words, the sharp recovery in prices we are witnessing today, is now almost perfectly explained by the sheer weight of earnings growth that is coming in by the day. With the benefit of hindsight, it adds up perfectly.



As the numbers indicate, India has come out of the pandemic much faster than anyone anticipated.

The environment supporting this pace of earnings growth requires us to contemplate the direction of change underway. Ergo, prices have moved from discounting a margin of safety, to chasing the margin of upside, given the sheer quantum of earnings growth. As the next chart indicates, India has not witnessed this direction of expected earnings growth in more than a decade; almost 60% across FY21-23e.



The simple observation is that the prevailing circumstances have not only lowered the cost of capital, resulting in drastic repricing of equities (upside), but improved the prospects of most of our investee companies. Although it is early to call the likelihood of permanent change, the signs of (a) inflection among sector leaders, and (b) consolidation are clear, and these form the bedrock of Unifi's approach to investing. The numbers reflect that.

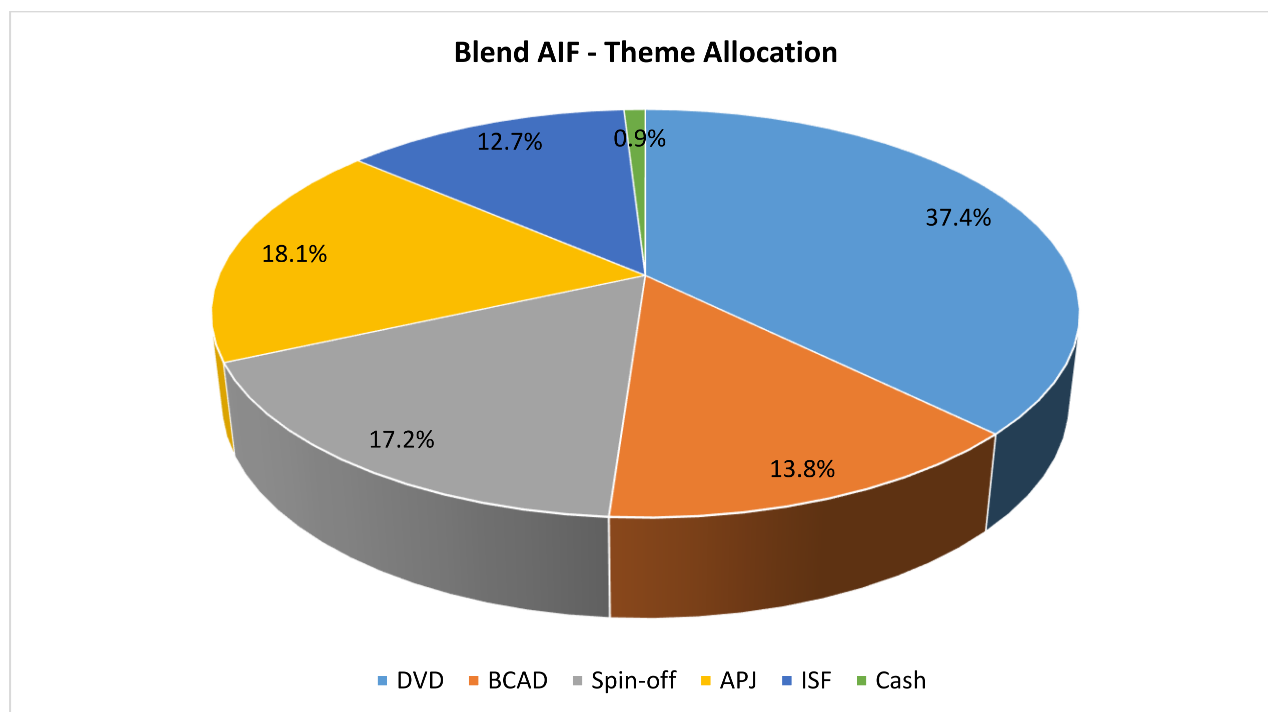
An Encore

FY03-FY08 was among corporate India's finest years with the Sensex recording an earnings growth of 25% CAGR. This was a result of the various reforms implemented in the previous years across the core of India's economy. In the following years, as India reverted to the classical school of fiscal prudence, the imperative of creating growth took second seat to managing the fiscal, and inflation. This crisis forced the Government to revisit its policy template and push for tangible expansion in the real economy.

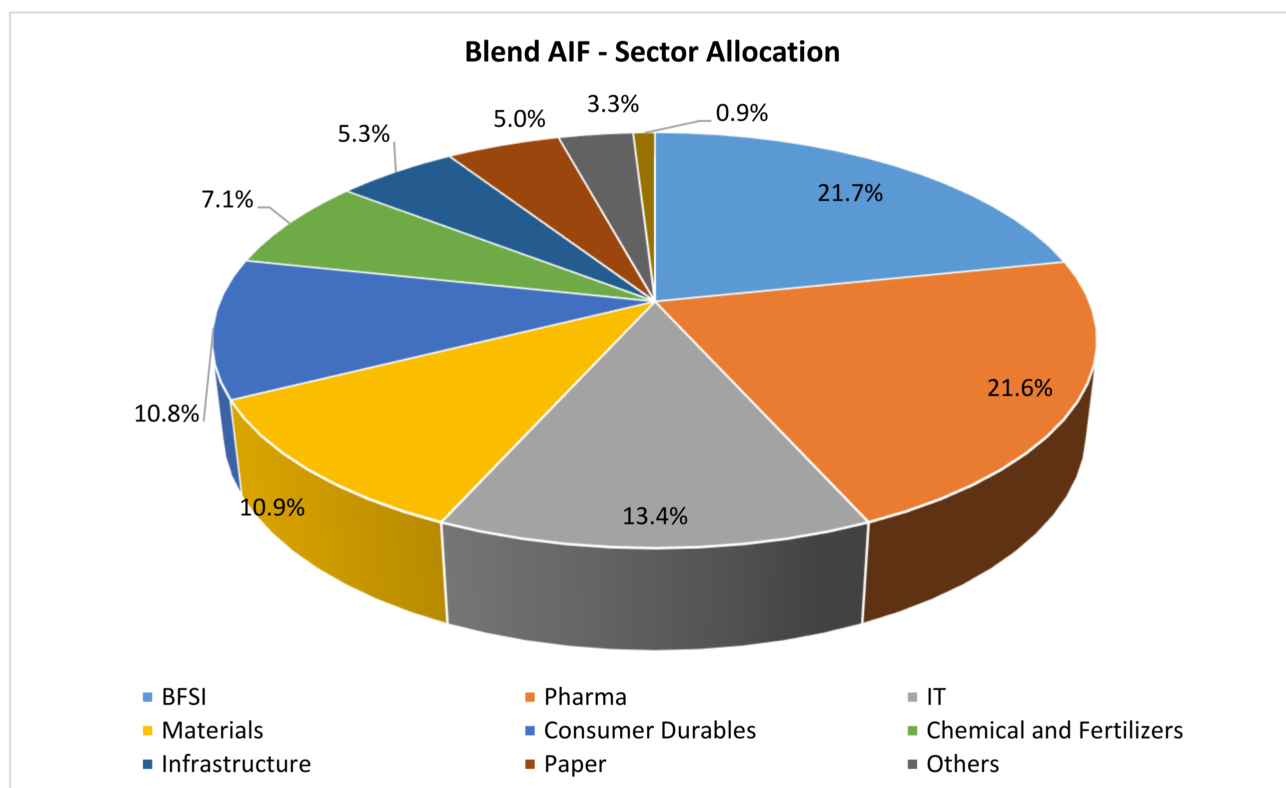
Breaking out of the IMF framework, the Union Budget of 2021 set clear its emphasis on capex-led growth at the cost of near-term fiscal pressures. This will augur well for corporate India in the times to come as (a) the groundwork for multiplier effect is laid on higher government spending and (b) push on rightly incentivized domestic manufacturing, will ultimately abet the transmission of money supply across the economy. The focused push for domestic manufacturing by way of PLI schemes in Electronics, Pharmaceuticals, and several other sectors will catalyze India's capex push for the next several years. Coupled with India's rapid GST led formalization, and turning of India's credit cycle, this presents the perfect platform to deliver growth on for multiple years ahead. From a micro economic level, pent-up demand is not a two-quarter phenomenon. The uncertainties at the macro level have hindered investment decisions over the past several years and the coming years promise to make up for them. To sum it up, we are set for interesting times.

At Unifi, we are aligned with each of the above trends, but at the same time stay true to our core principles of seeking the right mix of risk and reward in each of our investments.

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



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



Q3 FY21 | Result summary

The earnings outcomes from Q3-FY2021 have firmly established the trend of consolidation by the sector leaders in our portfolio companies. All our investee companies have seized the moment [carpe diem!], strengthening several aspects of their operating metrics, and in the process delivering significant corporate and shareholder value.

Since our last letter, the fund has increased exposure towards sectors like financials, information technology and taken exposure to newer sectors like the paper industry. At 22%, financials constitute the largest segmental exposure. The retail-focused institutions, ICICI and Axis Bank seem to be having lower than anticipated asset quality challenges and are poised to emerge stronger. We have taken exposure to State Bank of India (SBI), India's largest bank. We believe that SBI is at the cusp of the upcycle in terms of capital efficiency and profitability and would benefit from the revival in the credit cycle post the clean-up of the corporate loan-related stress. ICICI Securities continues to launch innovative products to successfully capitalize on the increased capital market activity and diversify into a more broad-based financial services platform.

Both our investments in pharmaceuticals, which together form 22% of the portfolio, continue to benefit from various bottom-up initiatives undertaken by them. Suven Pharma will benefit from growth in its core CRAMS business and the commercial launch of new molecules in the specialty side of the business. JB Chemicals, under new management, continues to report strong momentum both in domestic and export markets. The company has taken several initiatives to expand its product portfolio, increase MR (medical representative) productivity and improve operational efficiency.

Other major sector exposure includes information technology (13%), textile materials (11%) and consumer durables (11%). The underlying investments in each of these sectors have reported good results. We have

initiated exposure to JK Papers, a play on the revival of domestic paper consumption driven by the reopening of offices and educational institutions. The company is increasing its capacity from 4.36 lakh tons to 7.42 lakh tons which will contribute to earnings growth. We have also initiated a position in DCM Shriram. The company has two key segments: Sugar and Chloro Vinyl. The sugar business is relishing tailwinds led by regulatory changes and the Chloro Vinyl segment is set to witness an uptick in profitability led by improvement in realizations.

With Unifi's philosophy of aligning the portfolio with a favourable risk-reward equation, we exited Himadri Speciality and Petronet LNG as we found relatively better mix of risk-reward in the names mentioned above. As our thesis played out, we also exited IDFC.

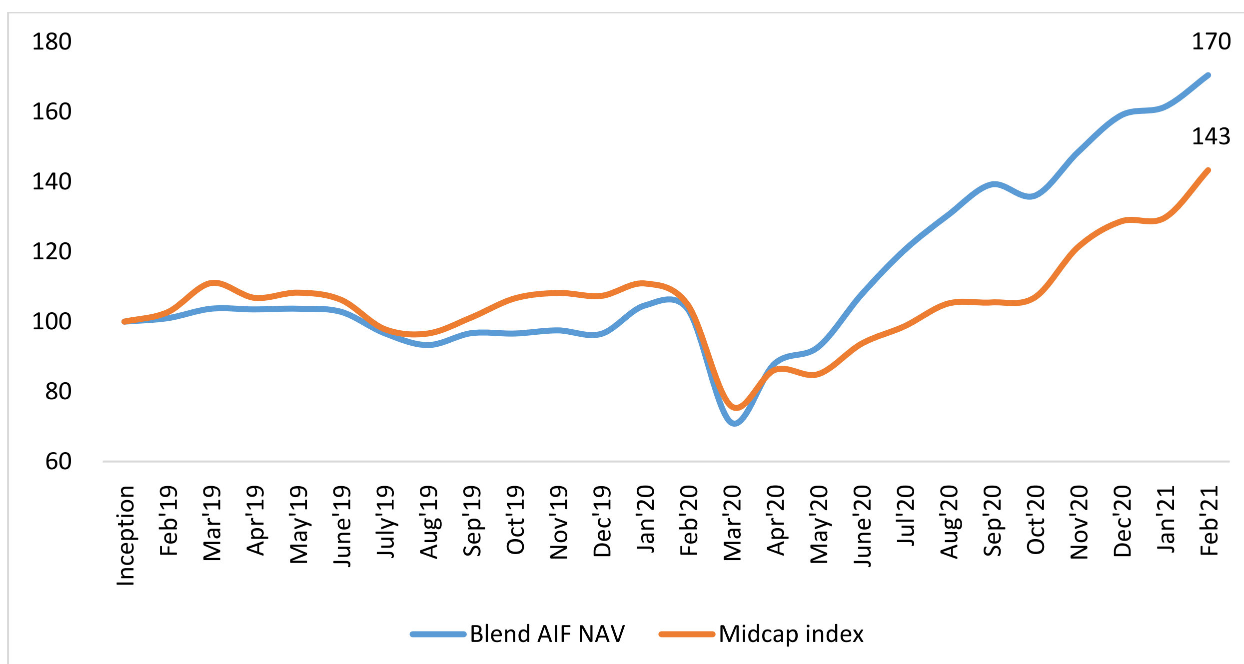
The following annexure presents a brief on our top holdings:

Suven Pharma	Suven Pharma reported good in-line results w.r.t Q3FY21. Sales and EBIDTA were up 52% and 70% on a YoY basis & 18% and 45% on a QoQ basis respectively. PAT grew by 95% YoY and 53% QoQ. The impressive results were due to the product mix and profit-share eligibility from the U.S. formulations business. The nature of Suven's research services segment and campaign based commercial supplies necessitates tracking its annual progress rather than quarter-wise. From that standpoint, the 9MFY21 numbers indicate a growth of 15% YoY both in terms of revenues and profits which is as per our expectations. Suven currently has six commercially launched intermediates and specialty chemicals and is looking to add two more in FY-2022. SPL has also diversified into formulations by building appropriate capacities and obtained USFDA approvals. Company has launched 3 ANDAs (formulation drugs) in 9MFY21 and looks to launch 1 more in Q4. It also targets to launch 3-4 ANDAs every year over the next 5 years. The pace of additions to research projects have increased post the lull in H1 and this bodes well for billings in the coming quarters. The sequence of the proposed Rs.600cr multi-year capex would be discussed in the ensuing quarterly call. The performance of Suven's associate Rising Pharma (USA) is progressing better than expectations and opportunities for commercial contracts could arise in the future from them. Key risks - Management bandwidth (COO hiring delayed) and low traction in research activities due to COVID are the key concerns.
Garware Technical Fibres	Garware delivered revenue growth of 18% YoY to Rs.278cr. EBITDA and Operating PBT registered growth of 54% YoY and 65% YoY to Rs.58cr and Rs.50cr respectively. Export business delivered growth in excess of 20% with increase in contribution from value-added products. Gross margins were flat at 73% despite hike in the prices of crude linked raw materials. The strong EBITDA growth was driven by favourable operating leverage. We remain positive on Garware given the company's focus towards value added products (which now makes 70% of overall business), its leadership position in technical textile segment and strong balance sheet with cash of Rs. 359 cr. The company continues to win new patents and launching new products, which we believe will drive growth and profitability. Key risks: Decline in the prices of Salmon, sharp increase in crude oil price and failure of newer products to garner market share.
JB Chemicals	JB Chemicals reported revenue growth of 28% YoY to Rs.548cr. EBITDA and Operating PBT registered growth of 91% YoY and 112% YoY to Rs.171cr an 153cr respectively.

	Domestic business delivered growth of 26% YoY driven by key chronic segments - cardiovascular/anti-hypertensive. MR Productivity had improved from Rs. 3.6 Lakh in FY20 to Rs. 4.4 Lakh in 9M FY21. Exports grew by 31% YoY. Exports for Q3 FY21 had been incrementally strong as it also included revenue deferred from Q2 FY21. The company registered 31.2% EBITDA margin as against 20.9% last year on the account of operating leverage and cost optimization initiatives by the new management. 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. Key risks: Supply chain disruptions, Pricing pressure in Domestic Business and unexpected regulatory developments.
Axis Bank	Axis Bank reported NII growth of 14% YoY and 1% QoQ to Rs.7,373cr on the back of healthy expansion in NIMs. Advances grew by 6% YoY to Rs.5.82Tn with retail advances forming 54% of the same. Operating profit increased 6% YoY and down 12% on QoQ basis to Rs.6,096cr. The provisions were flat on a sequential basis at around Rs.4,604cr. Overall, PAT was lower by 36% YoY and 34% QoQ at Rs. 1,117cr. The asset quality remained resilient, with GNPA and NNPA at 4.55% and 1.16% respectively. The bank surprised positively on the restructured accounts with the same being only at 0.42% of the loan book and have been adequately provided for at 26%. With an additional COVID provision buffer of Rs.12,000cr, the bank is in a comfortable position to take care of any incremental stress in asset quality in FY22. The collection efficiency for the month of December was 98% vs 94% in September and 97% in the pre-COIVD quarters. Axis Bank is well placed to get back to normalcy from FY2022 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. The bank has cleaned up its loan book and would benefit from the upcoming credit cycle thanks to its strong franchise in the Indian banking space. Key risks would include deterioration of asset quality leading to higher-than-expected credit costs and decline in NIMs due to falling yields.
ICICI Bank	ICICI Bank reported NII growth of 16% YoY and 6% QoQ at Rs.9,912cr, while their non-interest income dropped 3% YoY due to lower business volumes. Their cost to income ratio fell to 40% from 43% in Q3 FY20, on the back of lower operating expenses. Overall, POP was higher by 17% YoY at Rs.8,820cr. Advances were up 10% YoY & 7% QoQ at 6.9Tn with retail forming 66% of the same. The bank continues to enjoy a strong consumer franchise with a CASA ratio of 45%, 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.
Tech Mahindra	Tech M delivered revenue growth of 3.5% QoQ and a decline of 3.3% YoY to USD 1,309 mn. In INR terms, the company delivered EBIDTA and PAT growth of 21% and 13% YoY respectively. EBITDA margin had seen a steep increase to 19.6%, driven by better off shore and lower sub-contracting costs. Technology, Media & BFSI delivered 20% YoY growth and retail had shown a recovery with 6% YoY growth. The 5G technology spends

	would drive the enterprise growth in FY22. The company will continue to maintain margins at these levels. Risks: Slower than expected economic recovery in the US & Europe and cuts in discretionary IT spends by enterprise clients.
CG Consumer	Crompton Greaves Consumer delivered Sales, EBIDTA and adjusted PAT growth of 26% / 46% and 45% YoY basis respectively. The lighting segment had grown by 10% YoY and consumer durables had grown by 32% YoY. In each of the 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 is 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.
Sheela foam	Sheela Foam delivered 17% YoY growth in domestic revenue, recovering strongly across all product categories. Gross margin was down to 43% levels due to increase in raw material prices. However, EBITDA was up 38% YoY to Rs.99cr, aided by better cost control and operating leverage. The Spanish & Australian subsidiaries continued their good run and contributed Rs.23cr to PAT. Overall, consolidated PAT was up 54% YoY to Rs.101cr. 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 branded mattresses as a portion of consolidated revenue 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.
KEC International	KEC reported revenue growth of 7% YoY to Rs. 3289cr as the COVID impact in Brazil continued to be severe. Ex- Brazil, revenue growth is 15% YoY. During the quarter, company also reduced the pace of execution for few of the projects as there had been a steep increase in the raw material prices. The EBITDA declined by 6% YoY to Rs. 299cr given the elevated metal prices. PAT had been flat on YoY basis at Rs. 145cr given the lower interest expense. The revenue growth is expected to bounce back from Q4 as the raw material prices are on declining trend and Brazil is coming back to normal operations. During H1 of the year, the order intake had been muted as many government agencies could not operate fully given the circumstances. Project tendering and awarding has gained traction from October. KEC has an order book and L1 position for Rs.24,000cr., which gives revenue

	visibility for several more quarters. The higher infra expenditure in the budget augurs well for KEC and we expect company to be a good proxy play for the infra. Key risks include entail higher receivable cycles and unforeseen project delays.
ICICI Sec	ICICI Securities delivered a good quarter, with the broking segment growing by 61% YoY to Rs.362cr. I-Sec saw its market share in Equity ADTO decrease from 11.1% to 10.5% due to the regulatory change in December which led to lower transaction sizes by clients in intraday segment. The company added about 139,000 clients in the quarter, taking the total count of clients to 5.07mn. The distribution revenue was up 9% on a YoY basis due to improvement in mutual fund revenue. On the back of robust revenue growth and measured operating expenses, PBT was up 93% YoY at Rs.358cr, and PAT was higher by 95% YoY at Rs.267cr. 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 Dec 2020, the proprietary electronic brokerage platform ICICI Direct had approx.5.07 Mn operational accounts of whom about 1.3Mn had traded on NSE in last 12 months. I-Sec is also the second largest non-bank MF distributor with an AUM of Rs.383bn. 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.
JK Paper	JK paper reported revenue decline of 9% YoY to Rs. 745cr. EBIDTA and PBT declined by 33% YoY and 51% YoY to Rs. 155cr and Rs.103cr, respectively. While YoY numbers reflect that the company is still below pre-COVID profitability, there was sharp PBT improvement of 69% QoQ. Further the company is increasing its capacity from 4.36 lakh tonne to 7.42 lakh tonne driven by green field packaging board expansion in Gujarat with capacity of 1.7 lakh tonne and addition of 1.36 lakh tonne from inorganic acquisition of Sirpur paper mills. The medium-term earnings growth would be driven by volume increase, cost optimization and better realization. Key risks would be delay in capacity addition, decline in realizations and extended impact of COVID.
Chambal Fert	Chambal delivered flat YoY volumes in Urea business as the company is operating at optimum capacity utilization whereas non-urea business delivered volume growth of 15.6% YoY. On the back of continuous cost optimization at the operating level mainly led by improvement in gas efficiency, EBIDTA registered 17% YoY growth to Rs.797cr, while PBT growth was even better at 33% YoY to Rs.682cr led by extended cushion from the operating leverage flowing down to PBT. The deleveraging cycle continued with finance cost down by 52% YoY and 36% QoQ. In Jan'21, the company has received Rs.3,165cr against subsidy arrears and expects to clear entire subsidy by the end of FY21. This will result in reduction in gross debt from Rs.9,400cr in Mar'20 to Rs.4,000cr in Mar'21. Key risks to the investment could be rising gas prices, unexpected regulatory developments, and the erratic monsoon.



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 28th Feb 2021)	FY2020	FY2021E
P/E Ratio	27.7	25.5
Earnings Growth *	33.8%	17.5%
Debt Equity Ratio	0.16	0.15
ROE %	27.6%	26.2%
PE/ Growth Ratio	0.82	1.46

**Adjusted for one-off to make figures representative.*
^ex-BFSI

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 4th 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	(Feb 28th)	Q3 FY20	Q3 FY 21		FY 20	FY 21E	FY 21E	FY 21E	
Suven Pharma	12,219	78	148	89.7%	316	365	33	31%	11.7%
Garware Tech	4,946	38	59	55.3%	129	150	33	19%	10.9%
JB Chem	8,764	88	208	136.4%	273	451	19	28%	9.9%
Axis Bank	230,755	2,272	1,491	-34.4%	1,627	6,834	34	7%	6.7%
ICICI Bank	442,668	6,765	7,558	11.7%	7,930	17,000	26	13%	6.7%
Tech Mahindra	92,592	1,474	1,716	16.4%	4,033	4,646	20	20%	6.3%
CG Consumer	23,974	139	203	46.0%	443	472	51	28%	5.5%
Sheela Foam	9,854	86	135	57.0%	194	257	38	25%	5.4%
KEC INT	10,794	203	199	-2.0%	566	575	19	19%	5.3%
ICICI Sec	13,179	185	358	93.5%	542	989	13	72%	5.1%
JK Paper	2,487	188	103	-45.2%	475	222	11	9%	5.0%
Chambal Fert	9,648	394	663	68.3%	590	1,226	8	38%	4.7%

CLASSIFICATION OF MARKET CAP

Segment	Basis	%
Large Cap	> Rs. 28,900cr	28.20%
Mid Cap	> Rs. 8,340 cr < Rs. 28,900 cr	47.55%
Small Cap	< Rs. 8,340cr	23.0%
Cash		0.95%
Total		**100%**

LIQUIDITY ANALYSIS

Segment	% of portfolio
1 day	25.22%
Between 1 & 3 days	25.23%
Between 3 & 7 days	33.02%
Greater than 7 days	15.58%
Total	**99.05%**

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. 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 certain 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	India 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 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 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 less than 10% of value.
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 the costs due to illiquidity.
Key Man Risk	Small and mid-caps are frequently managed by a key promoter / 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.