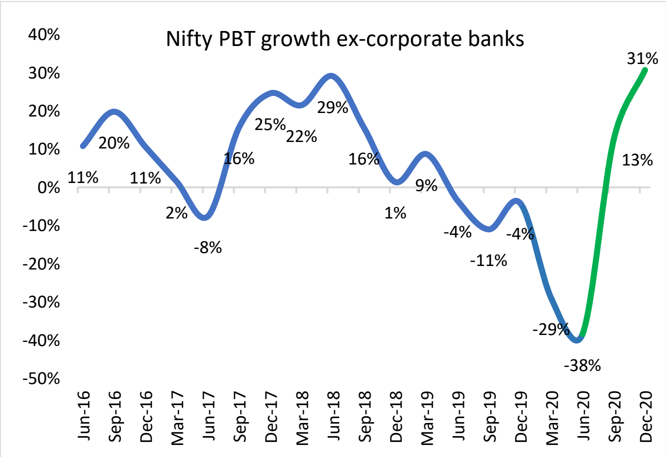
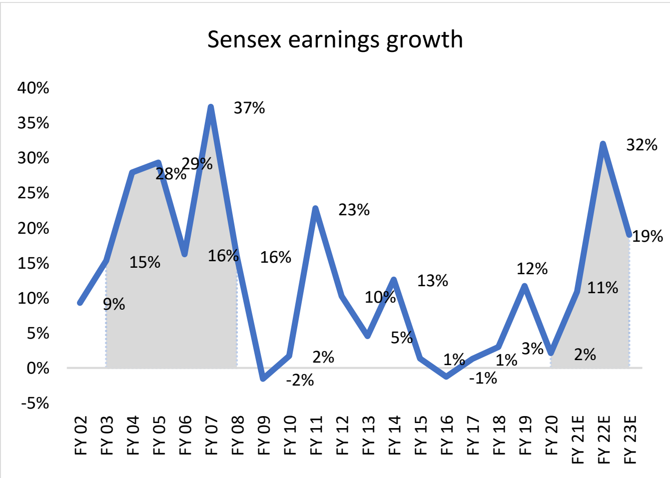
CY 2020 – Putting Roller Coasters to Shame

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.

The Investment Approach wise composition of the Rangoli fund is as below:

Theme wise Allocation (28th Feb 21)

Deep Value Fund	30.74%
Insider Shadow Fund	28.83%
APJ	23.43%
Spinoff Fund	7.89%
BCAD Fund	5.28%
Holdco Fund	3.12%
Cash	0.71%
Total	**100%**

Q4-CY20 | Results summary

The earnings outcomes from Q4-CY2020 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.

At 19%, financials now constitute the largest segmental exposure. The retail-focused institutions, ICICI and Axis Bank are poised to emerge stronger and will benefit from the revival in the credit cycle post the clean-up of their stressed loan books. 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 15% 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 (19%), textile materials (11%), infrastructure (8%), and fertilizers (8%). During the quarter, we advised taking exposure each to JK Paper and KPR mills. JK paper is a play on revival of domestic paper consumption driven by the reopening of offices and educational institutions while KPR Mills, a large player in textile and sugar has several fundamental tailwinds ahead. We recommended trimming exposure in Garware Technical, Suven Pharmaceuticals, JB Chemicals, and Chambal Fertilizers to fund the new purchases.

The following annexure presents a brief on our top holdings:

Sonata Software	Sonata delivered sales growth of 13% YoY driven by both their seasonal products sale in Q3 FY21 which almost doubled sequentially to Rs.1100cr (21% YoY) and IT services sales of Rs.300cr with 4.5% QoQ growth. Their IT services EBIDTA margin improved 450 bps QoQ to 28.9% thereby showing 110bps YoY improvement. This has propelled their overall EBITDA margins to improve 150bps YoY and 250bps QoQ to 11% (Products have modest 2.5% EBIDTA Margins). The adjusted earnings post the Vivaad se Viswas tax provision was flattish YoY, also on back of the weakness in their top account from the travel vertical which persisted YoY. However, PAT improved 72% sequentially from Q2-FY21 on the back of a recovery in the stressed travel segment and recovery is expected to continue with stable macro conditions. Sonata is a key partner to Microsoft in their global product development initiatives and has a strong domestic products re-selling business. With the worse of the pandemic induced stress in their travel business behind them, we expect the traction in earnings to return sequentially over the next few quarters. There is a trend of better off-shoring that is being witnessed on the back of industry wide work-from-home initiatives, and this is likely to be margin accretive in the times to come. Risks: Slower than expected economic recovery in Europe and cuts in discretionary IT spends by enterprise clients.
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.
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.
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.
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 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.

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.
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.
ICICI Securities	ICICI Securities delivered a good quarter, with the broking segment growing by 61% YoY to Rs.362cr. ISec 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. The focus for the times ahead would continue to be on rationalization of human resources and push to digital initiatives. On the back of robust revenue growth and measured operating expenses, PBT was up 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.
DCM Shriram	The company reported revenue, EBITDA and PBT YoY growth of -2%, 40% and 47% respectively. The growth in this quarter was primarily contributed by improved margin in chemicals business and stable performance in sugar business. DCM Shriram is predominantly present in chlor-alkali and sugar segments along with agriculture products like fertilizers, bio seeds and other farm solutions. The demand for caustic soda is now coming back to pre-COVID levels and this is expected to result favorably on numbers in the times to come. Further, the company has announced entry into newer products like Epichlorohydrin, Hydrogen peroxide and Aluminum chloride. These are value added segments within the chlorine value chain and hence will contribute positively towards overall profitability.

	Key Risk: Unexpected regulatory developments in sugar/ethanol business and decline in caustic soda prices in the international market.
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.
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.

PORTFOLIO VALUATION METRICS

Weighted	FY 21E	FY 22E
Earnings Growth	24.9%	26.0%
Price to Earnings Ratio	19.8	16.0
RoE	22.2%	21.9%
Price to Book Ratio	3.8	3.2
Weighted Avg Market cap (Crs)	56,647	

TOP 10 HOLDINGS

	Weights %
Position 1	9.06
Position 2	9.02
Position 3	8.78
Position 4	8.02
Position 5	7.89
Position 6	6.68
Position 7	6.63
Position 8	5.28
Position 9	5.04
Position 10	4.96
Total	**71.36**

SECTOR EXPOSURE

Sector	%
Banking & Fin Serv	18.81
IT	18.61
Pharma	14.67
Others*	12.84
Textile Material	10.73
Paper	8.84
Fertilizer	8.13
Infrastructure	8.08
Total	**100%**

**OTHERS INCLUDE CHEMICALS, FOOD PROCESSING AND MEDIA*

CLASSIFICATION OF MARKET CAP

Segment	Basis	%
Large Cap	> $2000mn	22.98%
Mid Cap	> $200mn < $2000mn	77.02%
Small Cap	> $50mn < $200mn	0.00%
Micro Cap	< $50mn	0.00%
Total		**100%**

LIQUIDITY ANALYSIS

Segment	% of portfolio
Less than 1 day	100.00%
Between 1 & 3 days	0.00%
Between 3 & 5 days	0.00%
Greater than 5 days	0.00%
Total	**100%**

Portfolio metrics are as of 28th Feb, 2021.

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.
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.