TANTALLON CAPITAL

December 2015

TANTALLON INDIA FUND

The Tantallon India Fund is a fundamental, long-biased, India-focused, total return opportunity fund, registered In the Cayman Islands and Mauritius. The Fund invests with a 3-5 year horizon, in a concentrated portfolio (25-30 unlevered positions), market cap/sector/capital structure agnostic, but with strong conviction on the structural opportunity, scalable business models, and in management's ability to execute.

Tantallon Capital Advisors, the advisory company, is a Singapore-based entity, set up in 2003, holding a Capital Markets Service License in Fund Management from the Monetary Authority of Singapore.

Performance, in USD

(*Inception on September 1, 2015*)

	Tantallon India Fund	MSCI India($)	Over/Under Full Performance
December 2015:	+1.14%	+2.46%	-1.32%
2015 YTD:	+0.24%	-7.53%	+7.77%
2014:	nm	+21.92%	nm
Inception:	+0.24%	-0.75%	+0.99%

Compound Returns	+0.73%	Volatility	+5.49%
3 month US T-bill	+0.20%	Sharpe Ratio	+0.10

At the outset, a very Happy, Healthy, and Prosperous New Year to you all!

The schizophrenic trading action of the first few days of 2016 would suggest that we are already far removed from 2015 – **for the record, after expenses, The Tantallon India Fund eked out a marginal positive return: +0.24% since the September 1 launch, versus the MSCI India at -0.75%, the MSCI EM at -3%.**

We have been 'here' before –

- All at once, the market seems to have finally woken up to the collective risks embedded in direct or derivative exposure to (a) China, and a depreciating renminbi, (b) the possibility of much lower crude prices, and (c) escalating tensions in the Middle East! *Nothing "new" necessarily; but panic, and a "risk-off" mode has set the tone in early trading for the year.*
- Given the intensity of the sell-off, *you try to re-establish some semblance of 'control' by grinding through data, looking for optically 'cheap' (but, intrinsically lower quality) stocks, or trying to look for parallels in prior market melt-downs.*
- It is humbling to acknowledge that in the short term, amidst 'rear-view mirror pontification,' and occasionally, outright panic, *markets anticipating capital flows/flight, and further regulatory 'intervention,' will almost certainly 'over-react,' testing investor fortitude.*
- Not surprisingly, at moments of extreme volatility, *it is most difficult to try and filter out the 'noise,' and simply stay the course, invested in a handful of high conviction, structural opportunities that continue to provide good visibility on revenues, margins, and earnings.*

***In the 'for what it's worth' category:* there would appear to be an inevitability to China opting for the path of least resistance, and further depreciating the renminbi.**

How many remember that in 1992/1993, China had a two-tiered exchange rate program? There was an official yuan exchange rate pegged at 5.8 to the US$, and there was a swap rate, allowing for genuine market transactions. The swap rate depreciated sharply in 1993 to 12 to the US$, culminating in the January 1994 devaluation of the official yuan rate to 8.7 to the US$.

China's challenges are real: (i) an increasingly visible industrial recession given structural over-capacity/weak demand; (ii) a collapse in corporate profitability/cash flows; (iii) sharply higher financial leverage given policy/political compulsions to sustain the 'walking dead,' exacerbated by (iv) Xi's strident anti-corruption drive and witch-hunts; and unfortunately, (v) inexperienced, and increasingly panicked/reactionary hands on the regulatory tiller – *even within the PBOC.*

We should expect that sustained capital flight will continue to test the 'band,' and the resolve/credibility of Chinese policy-makers and politicians who, on current evidence, seem quite naïve (or perhaps, constrained?) in their ability to assess and resolve systemic financial risks, while seemingly being oblivious to *the very dangerous implications of an off-shore yuan market becoming the tail that wags the dog – as the swap rate once did.*

- *Top of mind therefore, is the risk of a more pronounced depreciation of the renminbi, and (further) competitive devaluations across the region.*
- The rupee will not be immune, and despite the significant buffer for the current account thanks to lower crude prices, *working through the implications of the rupee breaking through Rs.70/US$ is now more than just a theoretical exercise.*

FUND DETAILS

The Tantallon India Fund

AUM USD 14,000,000

Investment Advisor: Tantallon Capital	**Minimum Investment:** USD 5,000,000
Administrator: Trident Trust Company (Mauritius) Ltd	**Fees:** 1.5%pa Management fees 12.5% on annual returns in excess of 7.5% USD hurdle
Domicile: Mauritius	**Dealing:** Monthly
Feeder funds US Feeder and Non-US Feeder (Cayman Islands)	**Lawyers:** Maples & Calder; Shearman & Sterling LLP; Rajah & Tann Singapore LLP
Auditor: KPMG	**Contact:** Alex Hill (alex@tantalloncapital.com)

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Inception	+0.24%												
2015	+0.24%									-0.14%	+1.36%	-2.09%	+1.14%

In sharp contrast with the Chinese slow-down, India's real economy would appear to have bottomed at some point in the 2H of 2015 (with nominal GDP for the September quarter falling to a 15 year low of +6%), validated by multiple trending high frequency indicators.

- We are particularly enthused by the surge in reported tax collections, improving industrial production, rising power generation, air passenger traffic growth, and sustained commercial vehicle demand.
- Just as encouraging is stable property prices and new launch activity across the 30 cities we track, and improving data on railway freight traffic, steel and cement production, credit and deposit activity, and rural wages.
- Government spending (+60% y-o-y, albeit on a low base), and in particular, on roads and railways, has decisively kick-started the capex cycle.
- …and yes, corporate capex will likely lag by 12-18 months given current capacity utilization rates still trending around 75%.

The markers we are paying the most attention to at this point:

- **The real surprise will likely be deliberate State land and labor reforms** in states controlled by the BJP (modeled after reforms initiated in Rajasthan last year) that will drive clear development policies, helping industrialize and create jobs in some of the most poverty-stricken states.
- **We expect another 100bp+ cut in lending rates over the next 12 months,** as bulk deposits start to re-price, and as banks pass on the full impact of the RBI's interest rate cuts last year.
- **GST will be a game-changer,** and while the legislative math remains challenging, our sense is that government and the Congress seem to be moving closer towards a middle ground.
- With 12 states having already signed on, the **government's sweeping power sector reform proposals** now have a genuine chance of succeeding.
- After the past 5 years of earnings compounding at just 7%, **we expect earnings growth of 15%+ for the fiscal year ended March 2017 on the back of an improving revenue outlook, operating leverage, and lower effective taxes and borrowing costs – while market multiples are now under the 10-year average forward PE multiple of 15x.**

The stock we want to highlight this month is Titan Company. Titan is India's largest jewelry (80% of revenues) and watch (15% of revenues) retailer, with 1,250 exclusive stores, and a distribution reach of >11,000 multi-brand outlets.

- Titan has established a very strong brand presence with *Tanishq, Gold Plus,* and *Zoya* in the jewelry segment, and wth *Titan* in the watch segment.
- Titan benefits from excellent *scale economics* (and in particular, on procurement, advertising, and sustained product innovation), and the systematic, asset-light *penetration into second and third tier cities* on the back of franchisees, where strong brand awareness, product quality, and product innovation will drive continued market share gains at the expense of the mom and pop stores that still account for 70%+ of all jewelry sales nationally.
- The market's concerns in the short term are centered on the volatility in gold prices, and the uncertainty with regards to the government's attempts to curtail the black economy by forcing retailers to secure PAN card identification for purchases above a certain threshold – and hence, *the perception of potential market share losses to an unorganized sector likely to be less 'diligent' in securing appropriate verification.*
- Instead, *our conviction is that the market is under-estimating the significant operating leverage* into an urban consumption recovery, and as the 375 odd stores that have been opened over the last 3 years (as the other retailers were pulling back and consolidating operations) mature, and start to contribute meaningfully to the bottom-line.
- On margins, our expectation is that we will see *150bp+ of margin improvement over the next three years to 10.5%* in the FY ended March 2019. We expect *earnings to compound at close to 20% annually* over the next 3 years.
- We expect *FCF to compound at 25%+ annually,* and with U$450m in net cash on the balance sheet currently, we expect management to continue to augment the current 25% payout.

Yes, the environment is challenging, and extreme market volatility will continue to test conviction. *The Tantallon India Fund remains focused on the long runway ahead of us in India, at a key inflection point in the investment cycle, invested in private financials, recovering urban consumption, improving operating leverage, the infrastructure roll-out across the country, specialty pharmaceuticals, and the toll-operators on the data/e-commerce highway.*

All the very Best in 2016!

Please do let us know if you would like a follow-up conversation, or a catch-up in the New Year.

Portfolio Overview

Top 5 Positions
Natco Pharma Ltd
Bajaj Finance Ltd
ZEE Entertainment Enterprise
Kotak Mahindra Bank Ltd
Asian Paints Ltd

Sectoral Break-down:	As % NAV
Agriculture:	2%
Autos:	7%
Building Materials:	10%
Consumer Discretionary:	18%
Financials:	20%
Industrials:	15%
Infra Backbone:	12%
IT Services:	3%
Logistics:	2%
Pharmaceuticals	11%

Sector Performance	MTD Performance
Agriculture:	+0.04%
Autos:	-0.01%
Building Materials:	-0.22%
Consumer Discretionary:	-0.11%
Financials:	+0.75%
Industrials:	+0.21%
Infra Backbone:	+0.17%
IT Services:	-0.03%
Logistics:	+0.02%
Pharmaceuticals:	+0.31%

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