TANTALLON CAPITAL

August 2016

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
August 2016:	+1.66%	+1.06%	+0.60%
2016 YTD:	+9.48%	+6.85%	+2.62%
2015:	+0.24%	-7.53%	+7.77%
2014:	nm	+21.92%	nm
Inception:	+9.74%	+6.05%	+3.69%

Compound Returns	+9.74%	Volatility	+20.56%
3 month US T-bill	+0.32%	Sharpe Ratio	+0.458

FUND DETAILS
The Tantallon India Fund

AUM USD 16,000,000

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)

The Tantallon India Fund closed +1.66% in August, after expenses; *the June quarter results season is behind us, bearing out our conviction that the corporate earnings cycle in India is inflecting higher in an environment where negative / historically low global interest rates have put a strong bid under higher yielding risk assets.*

Our first year is in the books, with the Tantallon India Fund having posted a net US$ return of +9.74% since inception. *We would like to take this opportunity to express a heartfelt "Thank You" to our seed investors; we are humbled by, and grateful to each one of you, for the confidence you have reposed in us, and for your unstinting support and encouragement. Onwards and Upwards!*

Our fundamental conviction stands:

- In a growth-starved world, driven by a new investment cycle, **India is poised to deliver on real GDP growth compounding at a 7%+ run-rate.**
- With the passage of GST as the cornerstone, **a pro-reform, pro-growth Modi government is clearly focused on sustained job creation and real income growth;**
- Our portfolio is invested in beneficiaries of the ***Indian demographic and consumption dividend, a strong rural recovery, and a new investment cycle.*** Given the prospects of structurally lower borrowing costs, **we expect strong valuation support for our portfolio companies compounding earnings at a 15%+ CAGR over the next 3 years.**

The appointment of Urjit Patel (the deputy Governor, and Rajan's key deputy in framing and implementing monetary policy over the last three years) as the next RBI Governor puts to rest months of speculation.

- As the primary architect behind India's new Monetary Policy Committee explicitly charged with adopting inflation-targeting to set monetary policy and interest rates, *Patel's own inflation-fighting credentials would suggest that errant expectations of aggressive (and pre-mature) rate-cuts will be disappointed.*
- We expect *Patel to maintain Rajan's aggressive stance on 'cleaning-up' the problem loans in the banking sector by March 2017,* eschewing regulatory forbearance in favor of securing long-term stability for the banking system.
- In addition, as part of the five member team, already appointed by the government to review its fiscal deficit target (and scheduled to present their recommendations by the end of October 2016), *Patel will have a significant voice in both framing the government's commitment to fiscal discipline, as well as in ensuring that the government does not crowd-out other borrowers,* impinging on the effective transmission of monetary policy.
- Patel's immediate key challenges are (i) *institutionalizing and establishing the credibility of the six-member Monetary Policy Committee;* (ii) actively *managing against the risk of short-them volatility in both interest rates as well as the rupee* given US$20bn+ foreign currency denominated bonds coming due for redemption in the September-November window; and (iii) *being proactive and decisive in dealing with non-performing loans within the banking sector.*

Bottom-line, we are really pleased with Patel's appointment as the next RBI Governor in that it signals continuity, the government's commitment to maintaining fiscal discipline and inflation-targeting to ensure longer-term macro-economic stability, and crucially, the commitment to be vigilant on non-performing-loan recognition and provisioning in the banking sector.

We currently have no exposure to the Indian IT Services Sector given our concerns on: (1) *legacy business models being compromised by the transition to digital,* and by customers aggressively embracing the Cloud and automation to reduce costs; (2) the *risk to margins* from falling

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+9.74%												
2016	+9.48%	-8.33%	-9.98%	+11.86%	+2.10%	+1.89%	+5.44%	+6.37%	+1.66%				
2015	+0.24%									-0.14%	+1.36%	-2.09%	+1.14%

utilization rates and competitive pricing pressure given the visible political compulsions to hire 'locally' both in the US and in Europe; and (3) *fundamentally lower growth prospects* for the sector given wide-spread customer uncertainty (and as a result, scaling-back of IT budgets) on Brexit/US elections.

- *Technology transitions and the digital opportunity/threat:* Quantifying the opportunity – and who wins? At current scale, we believe that the significant *constraints in scaling-up their digital platforms / offerings limit the opportunities for Indian vendors and their ability to off-set the erosion of their legacy businesses.*
- *Pricing pressure and further downside to margins:* In the short-to-medium-term we expect that *competitive pricing dynamics and falling utilization rates* will pose a threat to margins, and downside risk to consensus estimates.
- *Fundamentally slowing growth* – with Brexit and the US Election cycle clearly highlighting the distinctly populist tilt in elections globally, growing customer uncertainty is reflected in slower IT spending globally. The jury's still out - but our sense is that despite the sector's incremental revenue run-rate having visibly slowed over the last three years, *stock price multiples have yet to adequately price-in a growth-challenged outlook for the sector.*

Bottom-line, we continue to look for companies focused on delivering higher levels of efficiency and automation (and hence, cost-savings to the end customer) to 'protect' the legacy 'run-the-business' revenue opportunity, while concurrently investing in customer-centric, innovative digital initiatives to replace legacy platforms, and deliver on industry-disruptive revenue growth and margin expansion opportunities.

The stock that we want to highlight this month is ***Sharda CropChem,*** a Mumbai-based global crop protection chemical company. *Sharda's business model is predicated upon systematically identifying essential agro-chemical compounds which have gone off-patent, filing and securing registrations and product approvals with local regulators in multiple geographies, outsourcing the manufacturing supply chain to China, while investing in in-market distribution channels to grow the business organically.*

Sharda's well-diversified specialty agro chemical portfolio provides a long runway for growth, and the asset light model allows for superior long-term returns.

- *Pricing for generic agro-chemical compounds only corrects by about 20%-25% post a product going off-patent; entry barriers for new competitors remain significant.*
- Sharda's key differentiators are (1) a 20 year+ track-record of *discipline in identifying key molecules going off-patent*; (2) the *infrastructure to simultaneously file for product approvals in highly regulated geographies* like Europe (50% of revenues), North America (25% of revenues), and Latin America (20% of revenues), with significant new entry barriers; and (3) the *willingness/ability to invest in both the supply chain and distribution channels through the 6-7 year window to ultimately bring product to market.*
- *Sharda has currently filed 1,830 molecule registrations globally, with another 830 registrations in the pipe-line.*
    - To put that in context, currently, Sharda sells 60 molecules in 60 countries, with the top 10 molecules accounting for 50%+ of consolidated revenues.
- Management's key focus metrics are (1) *product diversification* (the largest molecule contributes less than 10% of revenues), (2) *geographic diversification* (to reduce extreme weather related and regulatory risks), and (3) *supplier diversification and quality control* (all manufacturing of active ingredients and formulations is outsourced to suppliers in China).
- The key risks to (re)evaluate are FX volatility (significant US$ strength relative to the Euro and EM currencies will potentially be a drag on margins), industry pricing stability, and the quality/reliability of the Chinese supply chain.

On the financials:

- Over the next three years, given the visibility on the registrations already secured, we remain comfortable projecting revenue growth (almost entirely volume-driven) compounding at a 15%+ CAGR.
- Given improving product mix, and the investments made in the B2C channel, we are comfortable projecting EBITDA margins tracking in an 18%-20% band.
- Given a net cash balance sheet (Rs.2bn+), with FCF accretions at Rs.1.5bn+ annually, and ROCE in excess of 30%, we would expect upside to the current dividend payout of 20%.

To conclude:

- Our portfolio is invested in the ***Indian demographic and consumption dividend***; a strong ***rural recovery;*** a ***new investment cycle;*** and ***structurally lower borrowing costs.***
- Improving utilization rates and and strong operating leverage will drive our ***portfolio companies delivering on earnings compounding at a 15%+ clip over the next 3 years.***
- ***The passage of GST will be the cornerstone of Modi's pro-reform investment agenda,*** *and will be a meaningful catalyst for the real economy, and in setting market expectations on growth, sustainable earnings, and the market multiple.*

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

Portfolio Overview

Top 5 Positions
Bajaj Finance Ltd
HDFC Bank Ltd - ADR
Kotak Mahindra Bank Ltd
Natco Pharma Ltd
Asian Paints Ltd

Sectoral Break-down:	As % NAV
Agriculture:	3%
Autos:	7%
Building Materials:	14%
Consumer Discretionary:	19%
Financials:	26%
Industrials:	10%
Infra Backbone:	9%
IT Services:	0%
Logistics:	3%
Pharmaceuticals	8%

Sector Performance	MTD Performance
Agriculture:	-0.18%
Autos:	+0.01%
Building Materials:	+0.92%
Consumer Discretionary:	+0.72%
Financials:	+1.03%
Industrials:	-0.51%
Infra Backbone:	-0.81%
IT Services:	0.00%
Logistics:	+0.19%
Pharmaceuticals:	+0.28%

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