TANTALLON CAPITAL

February 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
February 2016:	-9.98%	-7.59%	-2.39%
2016 YTD:	-17.48%	-13.89%	-3.59%
2015:	+0.24%	-7.53%	nm
2014:	nm	+21.92%	nm
Inception:	-17.28%	-14.54%	-2.74%

Compound Returns	-31.60%	Volatility	+17.13%
3 month US T-bill	+0.31%	Sharpe Ratio	-1.862

The Tantallon India Fund was down 10% after expenses in February, -17.5% y-t-d. The broad uncertainty in global equity and currency markets has taken toll on our portfolio – nothing necessarily specific to the stocks themselves. The volatility of the last six weeks is a numbing reminder of the linkages across global capital markets in setting global risk appetites, and in determining fund flows. *Not surprisingly, the positioning led short-squeeze in the first week of March just exacerbates that sense of unease.*

As of the February close*, on trailing 12 months, the MSCI India (-27.4%) now lags the broad MSCI EM universe (-25.2%).* The Modi 'feel-good' has long since dissipated; the frustration of global investors with the reform constraints within a democratic process is palpable; and short-term flows have simply overwhelmed the green shoots that are become increasingly visible as a nascent capex cycle takes root.

The good news: having thoroughly re-validated our portfolio convictions through the earnings season, we find ourselves actually *raising* our estimates for all but one of our portfolio holdings (where the currency headwinds in Latin America and Eastern Europe have eroded export profitability). ***Our portfolio companies are set to compound earnings at a 15%+ run-rate over the next 3 years*** on the back of organic volume growth, with the barriers to entry in their respective businesses allowing for significant operating leverage as capacity utilization ramps up.

So, what happened in February, the worst pre-budget month in 25 years?

- *Flows matter:* for the month, foreigners sold US$850m in equities (-US$2.5bn y-t-d), and US$1.2bn in debt, off-set to some degree by domestic institutions continuing to see inflows (the 22nd consecutive month of inflows) and being active buyers in the market (+US$1.2bn for the month).
- *Margin-called, retail and high net worth individuals sold US$400m in the futures market.*
- *91% of the BSE200 traded below their 200 day moving average – a level last seen in 2009.*

The February 29 budget, reassuringly, delivered on a fine balancing act:

- Despite the rhetoric, the unambiguous message was (1) of ***fiscal consolidation*** (with the fiscal deficit targeted at 3.5% next year from 3.9% in the current year), and (2) invigorated focus on ***infrastructure spending*** (+24% y-o-y), ***affordable housing,*** and ***rural roads and irrigation.***
    - The budgetary discipline is clearly positive for bond yields, and arguably sets the stage for the Reserve Bank of India to further ease policy rates (or possibly, cut Bank reserve requirements).
    - We continue to ***expect borrowing costs to decline by 75bp-100bp over the next 12 months*** – even if the RBI holds the line on further rate cuts – as the banks' lending rates start to reflect (falling) marginal funding costs.
- *A corollary:* the RBI's regulatory forbearance in announcing, post-budget, the ***easing of bank capital norms*** to allow Tier 1 capital to include a) Discounted revaluation reserves, b) foreign currency translation reserves, c) deferred tax assets, arising from timing differences does allow the public sector banks some breathing space.

FUND DETAILS

The Tantallon India Fund

AUM USD 12,000,000

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 disappointments were (i) the continued delay in the introduction of GST, (ii) the limited recapitalization of the public sector banks, and (iii) an increase in the effective urban tax burden.

Amidst the uncertainty, we would point to two particularly strong positive data points: (1) all India cement production was up 9% y-o-y on the back of strong rural housing and infrastructure demand, and (2) Medium and Heavy Commercial Vehicle sales posted +29% y-o-y growth thanks to the pick-up in infrastructure activity on the ground, and improved fleet operator profitability encouraging replacement demand.

We would like to highlight two stocks this month: ***J Kumar Infrastructure*** *and* ***Blue Dart;*** both stocks have traded sharply lower over the past few weeks, even as our conviction in the underlying thesis has been significantly strengthened.

- These companies have precious little to do with a China-related slow-down, or competitive devaluations across Emerging Markets, or any commodity price contagion!
- Instead, they are genuinely differentiated, focused, and very cash generative business models, leveraged to the domestic Indian investment cycle, and in particular, to the investments in infrastructure, and the growing propensity to "consume" on-line.

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Inception	-17.28%												
2016	-17.48%	-8.33%	-9.98%										
2015	+0.24%									-0.14%	+1.36%	-2.09%	+1.14%

J Kumar Infrastructure *is a niche urban infrastructure contractor* with a core specialization in Transportation Engineering (Metro, Roads, Flyovers, Bridges, Drainage, Runways, Tunneling), and Civil Construction (commercial buildings, railway and metro stations).

- The stock has corrected on the back of a potential six month delay in confirming the award of the Mumbai City Metro Rail Project, and the resultant 1-2 quarter delay in recognizing the substantial boost to the order-book and the booking of revenues.
- Our focus instead, is on the long runway of growth ahead given the company's specific skill-set in building out urban infrastructure, its strong balance sheet, and management's track-record and discipline in bidding for and executing on well-funded and well-defined marquee projects, without compromising margins and returns.
    - As of December 2015, the order book stood at a little over US$500m, 70% of which has been awarded in the last 12 months – contrary to perception, there is substantial urban infrastructure tender activity taking place on the ground – providing us good revenue and margin visibility for the next three years.
    - Given their track record and expertise in niche urban transportation infrastructure, our expectation is for the current order book to at least double over the next three years as cities across the country invest meaningfully in metros, elevated highways, link road expansions, and new airports.
    - The focus on having the government back-stop the order-book is now being clearly vindicated as the government does pay its bills – net working capital to revenues is at 50% currently, and trending lower, best in class for the industry.
    - Management's focus on complex engineering projects (with limited competition) and on margins (as opposed to inflating the order book with low quality bids), and the discipline with the balance sheet (net debt/equity remaining under 30%) and working capital, will sustain 17-18% EBITDA margins, and earnings doubling over the next three years.

Blue Dart, a DHL subsidiary, is the largest courier and package transportation company in India, with a dominant (50%+) market share of total air freight in the country (which accounts for nearly 75% of revenues), and a 15%+ market share of the organized ground shipment segment. Over the past decade, Blue Dart has systematically invested out of free cash flow in a technology-centric, packaging collection and dispatch business, mapping customers against close to 35,000 local collection centers, e-fulfillment centers, and warehousing facilities, creating a genuinely pan-national, non-replicable network, and ubiquitous first and last mile access.

- The stock has corrected over disappointment in the delay in introducing GST, the slow-to-recover B2B business given a protracted industrial slowdown, and the one-offs from the disruption caused by the Chennai floods in the last quarter and the delay in recovering the "Green Cess" imposed in Delhi.
- Growing internet penetration and internet sales will be a significant driver of the B2C business – given the pan India network and the investments in technology, warehousing, and fulfillment centers, Blue Dart remains the 'partner of choice' for both the established companies, as well as the e-commerce start-ups that have proliferated across the country, and is, in fact, the one genuinely profitable proxy for the explosive growth in the Indian e-commerce sector.
- Additionally, we believe that the B2B business may well be the surprise growth driver over the next 3-5 years. Our conviction is that come July, Modi will have a functional majority in the Upper House as well, and that GST will likely be introduced effective April 1, 2017, creating a significant tailwind for both manufacturing and for direct consumer sales.
- The operating matrices of the business are enviable: given the track-record and the network, Blue Dart commands a 25% price premium over the competition, having maintained a 13%+ EBITDA margin, ROEs of 30%+, with net gearing under 10%.
    - As capacity utilization ramps up across the network of warehouses, routes, and delivery teams, we expect that margins have room to expand by 100bp+ over the next 3 years.

To conclude:

1. We would simply repeat what we wrote last month: ***market volatility will continue to test investor psyche and convictions.***
2. We believe that the composition of the Parliament becoming more reform-oriented (as Modi secures a majority in the Upper House by July 2016) will serve as ***a catalyst for more structural reforms*** being initiated, facilitating the ramp-up of a new investment cycle, and a market re-rating.
3. ***Against the backdrop of GDP growth compounding at 7%+, our portfolio companies are set to compound earnings at a 15%+ run-rate over the next 3 years.***

Please do let us know if you would like a follow-up conversation, or a catch-up: we like the market; valuations are compelling; and we have conviction in our portfolio companies to deliver on strong earnings and cash flows.

Portfolio Overview

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

Sectoral Break-down:	As % NAV
Agriculture:	3%
Autos:	8%
Building Materials:	11%
Consumer Discretionary:	18%
Financials:	21%
Industrials:	14%
Infra Backbone:	11%
IT Services:	3%
Logistics:	3%
Pharmaceuticals	9%

Sector Performance	MTD Performance
Agriculture:	-0.25%
Autos:	+0.28%
Building Materials:	-0.41%
Consumer Discretionary:	-1.58%
Financials:	-1.31%
Industrials:	-2.61%
Infra Backbone:	-1.90%
IT Services:	-0.17%
Logistics:	-0.49%
Pharmaceuticals:	-1.55%