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
January 2016:	-8.33%	-6.82%	-1.51%
2016 YTD:	-8.33%	-6.82%	-1.51%
2015:	+0.24%	-7.53%	+7.77%
2014:	nm	+21.92%	nm
Inception:	-8.11%	-7.52%	-0.59%

Compound Returns	-18.38%	Volatility	+13.85%
3 month US T-bill	+0.33%	Sharpe Ratio	-1.351

FUND DETAILS

The Tantallon India Fund

AUM USD 13,000,000

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)

What a month! Not a great way to kick-start 2016 – ***in January, the Tantallon India Fund was down 8.33% after expenses,*** as a massive *'risk-off'* in global equities saw significant margin calls and ETF redemptions roil the markets, with small and mid-cap stocks bearing the brunt of the sell-down in India.

- Yes, the markets starting to price-in (i) Chinese deceleration and policy "errors," (ii) growing concerns over the apparent withdrawal of the "Central Bank-put," (iii) falling energy prices, and (iv) rising developed market credit defaults risks, were the specific catalysts for global de-risking, and the bid for 'haven' assets.
- Yes, the global implications of a prolonged China 'melt-down,' tighter global liquidity conditions, and the implications of further global monetary and fiscal policy divergence/ unpredictability have wrecked havoc with investor psyche.
- Yes, the sell-off had nothing to do necessarily with what is happening on the ground in India.
- Yes, we are now at the point where valuations for Indian equities are looking increasingly compelling.
- *...and Yes, it's not been a fun few weeks!*

In the *'for what it's worth'* category, some simple observations reflecting on recent market volatility and trading patterns – (i) the *sell-off in global High Yield* would seem to suggest that there is more pain to come as credit default risks are actually realized; (ii) the *'consensus' momentum trades have been margin-called* (we would specifically point to the major stops being triggered on aggressive long USD/EUR, short USD/JPY, and US inflation/interest rate-expectation trades) and have seen arguably their worst performance since the crisis; (iii) the market implied probability of further Fed rate hikes continues to recede – *it would seem now that the next Fed rate increase is being priced-in for June 2017!*

Amidst the global "risk-off," we would make the point that despite the continued over-hang from potential ETF and Emerging Market redemptions and fund flows, **there remains a strong, real, domestic bid for Indian equities** – *no one is looking to prop-up the Indian market; locals are re-allocating to equities, and deliberately buying into the market sell-off, anticipating a strong, domestic, industrial and investment cycle, a recovery in employment and consumption, and a sustained tailwind from lower borrowing costs.*

On India specifically, in the middle of the gloom and doom, the green shoots are becoming increasingly visible: (i) 4Q Calendar Year 2015 GDP came in higher than expected at +7.3% - in stark contrast to the global growth fears; (ii) through September 2015, India's Foreign Direct Investment inflows are north of US$24bn, on-track for a 'best-ever' year, and auguring well for setting up of new manufacturing capacity and new employment opportunities; (iii) growth in fixed capital formation tracking at +6.8% (and significantly, faster than the growth in consumption spending) would suggest that the investment cycle is revving-up; (iv) non-oil imports have actually registered positive growth over the last quarter, suggesting improvement in real demand; (v) domestic air passenger traffic growth clocked in at a remarkable +20% in 2015.

Our recent meetings in Delhi, Bangalore, Hyderabad, and Calcutta, with companies, regulators, and state level bureaucrats would make the case that the fundamental growth drivers are intact, and that the 2H of 2016 should be substantially stronger –

1. The composition of ***Parliament will become more pro-reform oriented following the Rajya Sabha elections in April/May 2016.***

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Inception	-8.11%												
2016	-8.33%	-8.33%											
2015	+0.24%									-0.14%	+1.36%	-2.09%	+1.14%

2. Our expectation is for the ***January-March quarter to see GDP growth accelerate to +7.8%*** on the back of a nascent industrial recovery and strong growth in services. *The government's focus on driving infrastructure growth is starting to filter through to the real economy.*
3. We are particularly excited about the ***prospects of a strong urban revival,*** with the staggered Pay Commission hikes translating to visible consumption spending over the next 2 years.
4. We ***expect borrowing costs to decline by 75bp-100bp over the next 12 months*** – irrespective of the RBI cutting rates further – as the banks' lending rates start to reflect (falling) marginal funding costs.
5. We have been positively surprised by the slew of ***Land and Labor Reforms introduced at the State level as the states compete for new investments*** *– the BJP would seem to have found a solution for the impasse in Parliament!*
6. ***Visible spending on Roads, Renewables, Power Transmission, the Dedicated Freight Corridor, new Smart Cities, and on urban infrastructure.***

On the potential negatives, (i) GST is now increasingly looking like an April 2017 event, and (ii) the RBI has clearly signaled its disappointment with the slow pace of public sector bank NPL recognition and balance sheet recapitalization, and has hence, clarified a much more stringent NPL recognition policy going forward.

Two key issues to evaluate as the Modi government prepares the budget to be presented on February 29, 2016: (i) will the government be emboldened by the improving fiscal and current account balance *(thank you, Oil!),* to start to spend more aggressively on infrastructure and job-creation programs? and (ii) will Modi signal a more pro-reform tilt with a Cabinet re-shuffle?

The company we would like to highlight this month is **Asian Paints,** the largest paints company in India, operating in both the decorative (80%+ of revenues) and the industrial coatings segment. With 30,000 exclusive dealers across the country, Asian Paints is primed to benefit from the continued build-out of urban infrastructure and rural housing, and in particular, from a revival in urban discretionary spending and improving product mix trends, while lower input commodity prices and higher utilization rates will likely see margins continue to surprise on the upside.

- Asian Paints has established the dominant brand presence in the domestic paints market, and will be one of the key beneficiaries of a recovery in urban consumer confidence.
- Even acknowledging the helpful comps from the festive season in the December quarter, domestic volume growth tracking at 15%+ was substantially ahead of market expectations, under-pinned by the resilience in rural housing demand, strong industrial demand, and the first signs of a revival in urban demand.
- Looking out over the next three years, we expect volume growth to compound at 12%+ annually, and consolidated revenues to compound at 15%+ annually. We are most focused on the growth upside in the 're-painting' segment (which accounts for 90% of overall decorative paint demand in the country), and the nascent demand from new construction demand in rural and semi-urban centers thanks to the government's 'housing-for-all' initiatives.
- EBITDA Margins tracking at 19.2%, the highest level since 3Q 2010, was also a positive surprise. We expect that a benign input cost environment, an improving mix, and improving utilization rates to drive another 200bp of margin accretion over the next 3 years, translating to earning compounding in excess of 20% annually over the next 3 years.
- With US$300m in cash on the balance sheet, and FCF doubling over the next three years to US$300+ annually, we believe there is substantial room for the current 35% payout to be increased.

To conclude:

1. The external environment remains challenging *(China, prolonged commodity price weakness, major Policy dislocations, the risk of competitive devaluations, global margin calls, etc.)*, and ***market volatility will continue to test investor psyche and convictions.***
2. ***In a growth challenged world, India stands out:*** *we believe that the Indian economy is poised at a key inflection point in the investment cycle, and will compound at a 7%+ GDP growth run-rate over the next five years.*
3. ***Our portfolio companies are set to compound earnings at a 15%+ run-rate over the next 3 years*** on the back of strong barriers to entry in their respective businesses, and the operating leverage that will become increasingly obvious as capacity utilization ramps up.

Amidst the global volatility, we remain focused on the long runway ahead of us in Indian private financials, discretionary consumption, improving infrastructure, specialty pharmaceuticals, and the unique intersection of data and e-commerce.

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

Gong Xi Fa Cai!

Portfolio Overview

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

Sectoral Break-down:	As % NAV
Agriculture:	3%
Autos:	7%
Building Materials:	10%
Consumer Discretionary:	17%
Financials:	20%
Industrials:	15%
Infra Backbone:	12%
IT Services:	3%
Logistics:	3%
Pharmaceuticals	10%

Sector Performance	MTD Performance
Agriculture:	-0.21%
Autos:	-0.47%
Building Materials:	-0.47%
Consumer Discretionary:	-1.54%
Financials:	-1.11%
Industrials:	-1.86%
Infra Backbone:	-1.13%
IT Services:	-0.01%
Logistics:	-0.04%
Pharmaceuticals:	-1.49%

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