TANTALLON CAPITAL

June 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
Jun 2016:	+5.44%	+0.95%	+4.49%
2016 YTD:	+1.24%	+0.25%	+0.99%
2015:	+0.24%	-7.53%	+7.77%
2014:	nm	+21.92%	nm
Inception:	+1.48%	-0.50%	+1.98%

Compound Returns	+1.78%	Volatility	+21.72%
3 month US T-bill	+0.24%	Sharpe Ratio	+0.071

The Tantallon India Fund closed +5.44% in June, after expenses, with the market seemingly shrugging off the negative headlines from Brexit, more lenders' angst in China, and continued uncertainty on global interest rates and election posturing/outcomes. *Cautious positioning ahead of the UK referendum certainly explains part of the market action over the last few days; but, it also reflects the growing recognition that global policy-makers are constrained in their ability to raise interest rates given the growing uncertainty over geo-politics and protectionism, and the second derivative negative implications on global trade, and growth.*

Our simple message remains: in a growth constrained world, India does stand out, on the cusp of a new investment cycle, and with earnings finally inflecting higher, we would like to reiterate our conviction in our portfolio companies compounding earnings at a 15%+ annual clip over the next 3 years.

What are we trying to think through at this point?

- *A 'weaker' pound seems almost inevitable* given (i) UK's trade and current account deficits, (ii) Osborne's counter-cyclical public spending measures creating a further drag on already strained public finances, and (iii) we are likely looking at a glut of new office supply coming on the market, without a bid. ***Beware the implications of a weaker pound for the euro, certainly, but, importantly, for the renminbi;*** *odds are that the Chinese will 'allow' the weakness in the pound and the euro to filter through to the yuan, and we should probably be starting to price in the yuan with a 7-handle.*
- ***Could Brexit's loss be EM's Gain?*** Over the last 3-4 years, rising political and policy risks, fragile currency fundamentals in the face of 'normalizing' US monetary policy, the spectacular commodity bust, and the slow-down in China, certainly re-enforced investors' risk aversion vis-à-vis emerging market assets. However, Brexit should mark another downshift in market expectations for the Euro area, Japan, and the US, reflected in falling medium-and-long-term interest rates, and over US$12 trillion in sovereign debt now yielding negative yields. *Surely the risk/reward for emerging market assets is becoming more compelling (especially given superior nominal GDP, revenue and profit growth, relative to their developed market counter-parts)?*
- While Modi's recent cabinet re-shuffle is largely a non-event (and reflects the compulsions of regional politics and the local state elections calendar – as to opposed to any signaling on intent or direction of reforms), ***Modi's choice of the new RBI Governor will be carefully scrutinized.***
    - We are disappointed that Rajan chose to 'opt-out' of seeking a second term as RBI Governor (amidst the uncertainty and volatility in capital markets globally, we would much rather a known quantity at the helm, explicitly committed to cleaning-up the banking sector, and to containing inflationary expectations).
    - However, Rajan's decision to stay above the fray, and to return to academia, protected the dignity of the office, and ensured that it remains a-political.
    - Rajan's legacy will be the institutionalization of an inflation-targeting mechanism to determine monetary policy, and the independence it bestows upon the RBI, no matter what the political compulsions of the day might be.
- Does the belated (and partial) approval of the Seventh Pay Commission recommendations, the recently approved minimum support price (MSP) for agricultural commodities, and the strong re-affirmation of investing in urban infrastructure suggest ***a 'loosening of the strings,' and the willingness after two years of fiscal***

FUND DETAILS
The Tantallon India Fund

AUM USD 15,000,000

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	+1.48%												
2016	+1.24%	-8.33%	-9.98%	+11.86%	+2.10%	+1.89%	+5.44%						
2015	+0.24%									-0.14%	+1.36%	-2.09%	+1.14%

consolidation, to finally shift gears in favor of 'reflation' – with obvious positive implications for growth and for earnings?

- And …***will the legislative make-up finally allow for a pro-reform agenda…****with the passage of a GST Bill being the catalyst the market is least expecting?*

Given the visible trends on urbanization, new job-creation in manufacturing and service sectors, and rising disposable incomes, our conviction is that the Indian urban mass market will be the key driver of consumption demand over the next decade, supporting a durable investment thematic.

- *India's current per capita GDP of US$1,650 is comparable to China in 2005* (China currently is tracking at US$8,000 in per capita GDP) – *we do have a sense of what the next decade will bring.*
- *India's consumption patterns will be shaped by its 440m millennials* – nope, that is not a typo! – where improving educational levels, rising disposable incomes and improving affordability, mobile and e-commerce connectivity, brand awareness, and access to consumer credit, will anchor substantially improved standards of livings, aspirational consumption, and a willingness to 'pay-up' for quality.
- *Brands and Quality matter; perceived "value for money" matters; and distribution/access matters.*
- *The investable categories that we are most excited by are: Consumer Finance and Insurance, Housing, Fresh and Packaged foods, Personal Care products, Jewelry, Mobile and E-commerce Connectivity, Entertainment, and Healthcare.*

The stock that we wanted to highlight this month is **Eicher Motors,** manufacturer of the *Royal Enfield* line of premium motorcycles, and light and medium commercial vehicles.

The motor-cycle business remains the key driver of revenues and earnings in the medium term.

- *Royal Enfield* (RE) is a genuinely aspirational brand, with a legacy that goes back almost a century, and has single-handedly created a category of premium motorcycles with distinct styling, higher engine displacement, and an enviable lifestyle brand cache. *The comparison with Harley-Davidson is apt.*
- Our conviction is that a unique product, management's unwavering focus on the brand, the expansion of a very high quality dealer network (500 dealers currently, with the goal of adding 100 new dealers every year for the next 5 years), and the improving access to vehicle financing (currently, just 30% of sales are financed) will *sustain volume growth compounding at close to 20% annually over the next three years, with 80-100bp in margin accretion annually to current blended EBITDA margins of 15% .*
- With a little over 500,000 units of annual sales, RE accounts for just 4% of the total 2 wheeler market in India, but dominates the 300cc+ segment with a 70%+ market share.
- Over the next three years, with a three month+ backlog of orders, management's goal is to double capacity to 1m units, and to drive the very profitable (50%+ EBITDA margins) merchandising business to 10% of revenues (2% currently, versus Harley-Davidson's merchandising business tracking at 20% of consolidated revenues).

The commercial vehicle business is unheralded, but potentially, a significant source of positive surprise in terms of both earnings and cash flows.

- The Volvo joint-venture is Volvo's explicitly designated global manufacturing hub for its Euro 3,4,5, and 6 engines; the contract manufacturing margins are margin accretive (with Blended margins in the CV business currently tracking at 7%); but, importantly, positions Eicher with product and technology in the domestic CV market that is as yet under-appreciated (current industry market share of 8%).
- As the export business scales, our expectation is that margins for the commercial vehicle business has bottomed.
- A recovery in the domestic commercial vehicle market is simply not being factored in at all.

After having funded capacity expanding 6x over the last 5 years, the company remains in a substantial net cash position.

- On the back of the new capacity creation, scale benefits, and mix improvements, we anticipate blended EBITDA margins to expand by 150bp annually over the next three years, and for EBITDA to more than double.
- We expect EPSe to compound at 30%+ over the next 3 years, with substantial room for improvement on the current 20% payout.

To conclude:

- ➢ Our portfolio remains anchored in our convictions on Indian ***demographics and consumption***; ***lower inflation and lower borrowing costs;*** and a government spending driven ***new investment cycle.***
- ➢ Demand recovery and strong operating leverage will drive our ***portfolio companies delivering on earnings compounding at a 15%+ clip over the next 3 years.***
- ➢ We ***expect equity multiples to be sustained on the back of visible earnings/cash flow growth, bolstered by Modi's pro-reform legislative agenda.***

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

Portfolio Overview

Top 5 Positions
Kotak Mahindra Bank Ltd
Orient Cement Ltd
Bajaj Finance Ltd
Natco Pharma Ltd
Asian Paints Ltd

Sectoral Break-down:	As % NAV
Agriculture:	4%
Autos:	8%
Building Materials:	14%
Consumer Discretionary:	19%
Financials:	21%
Industrials:	12%
Infra Backbone:	10%
IT Services:	0%
Logistics:	3%
Pharmaceuticals	8%

Sector Performance	MTD Performance
Agriculture:	+0.28%
Autos:	+0.18%
Building Materials:	+0.89%
Consumer Discretionary:	+1.28%
Financials:	+1.40%
Industrials:	+0.42%
Infra Backbone:	-0.18%
IT Services:	-0.05%
Logistics:	+0.32%
Pharmaceuticals:	+0.89%

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