TANTALLON CAPITAL

March 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.

The Tantallon India Fund closed up 11.86% for March, after expenses, translating to a 7.69% decline for the quarter.

- ***Volatility is the uncomfortable reality we need to work with.*** In the short term, global capital market linkages and sentiment (probably best articulated in asset allocation driven ETF flows), and leveraged trading strategies are setting prices as the market fixates (on occasion, simultaneously!) on China, Yellen-speak and US$ strength, global commodity prices, a myriad of Elections and referendum outcomes, and the implications of populism, anti-immigration sentiment, and terrorism for geo-politics, global trade flows, and on currencies.
- ***Our structural long-term convictions are intact:*** the Indian demographic tailwind and strong consumption dynamics, inflation and interest rates trending lower, significant new investments in mass housing, water, and urban infrastructure, and the revival in the cap.ex. cycle, and specifically, in the light industrial/export sector.
- ***Our portfolio companies are set to compound earnings at a 15%+ run-rate over the next 3 years.***

Having just returned from visiting companies in Bangalore, Chennai, Delhi, and Mumbai, we would highlight the following:

- The **frustration over the non-introduction of GST** is palpable – *our expectation is that elections to the Upper House over the next 3 months should allow the BJP to establish a Parliamentary majority, and for the Bill to finally be introduced.*
- **The government has maintained fiscal discipline *AND* having reduced regulated interest rates on small savings accounts,** did set the stage for the **RBI to cut policy rates by another 25bp,** and *explicitly commit to a new liquidity regime to improve monetary policy transmission across money markets, bond markets, and bank lending rates.*
- The **pick-up in transparent tendering and actual contract awards across a slew of urban infrastructure projects** is a stand-out feature: roads, fly-overs, metro link projects, water and sewage treatment plants, and low income mass housing.
- **Rural sentiment and consumption trends remain subdued** given the lingering drag of consecutive poor monsoons, and the government scaling back subsidies and support for agri-crop prices. *Over the next 3 years, we expect the government to be explicitly focused on rural infrastructure (electrification, roads and irrigation projects) and housing.*
- **…and even accounting for the additional day of output in February, broad economic activity indicators corroborate growth accelerating to a 12 month high -** Electricity generation growth accelerated further to 9.2% (versus 0.7% in November); Port traffic growth improves to 13.4% versus 1% in November; Cement production growth accelerated to 13.5% in February (versus 8.7% in January); Refinery petroleum output at +8% y-o-y is at the highest levels since November 2014; 2-wheeler sales rose 10%+ in February and March; commercial vehicle sales are tracking close to +30% y-o-y growth; and foreign tourist arrival growth improved to 11.3% in February. *The key negatives were muted railway traffic and weak steel demand.*

Performance, in USD

(*Inception on September 1, 2015*)

	Tantallon India Fund	MSCI India($)	Over/Under Full Performance
March 2016:	+11.86%	+12.71%	-0.85%
2016 YTD:	-7.69%	-2.94%	-4.75%
2015:	+0.24%	-7.53%	+7.77%
2014:	nm	+21.92%	nm
Inception:	-7.47%	-3.67%	-3.80%

Compound Returns	-12.47%	Volatility	+24.97%
3 month US T-bill	+0.22%	Sharpe Ratio	-0.508

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)

Yes, GST is not yet a reality – but, Modi has actually exceeded our expectations:

- **Fiscal Discipline, Financial Inclusion, and Facilitating investments and job-creation:**
    - Leveraging the 900m+ unique identification (UID) cards that have been issued, and the opening of 200m no-frills bank accounts, replacing wasteful subsidies with Direct Benefit Transfers into the bank accounts of the most needy.
    - Reducing regulated interest rates on small savings accounts and moderating minimum support prices for agri-crops will rein-in inflation and inflationary expectations.
    - The passage of the Real Estate Regulation and Development Bill and the amendments to the Mines and Minerals Development and Regulation Act bring transparency to process, improving project visibility, and encouraging fresh investments.
    - The transparent e-auctioning of mineral and coal mines, and radio and telecommunications spectrum (the historic source of much graft), is transformational.

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Inception	-7.47%												
2016	-7.69%	-8.33%	-9.98%	+11.86%									
2015	+0.24%									-0.14%	+1.36%	-2.09%	+1.14%

- Massive restructuring of the debt taken on by the State Electricity Boards, and the framework on tariff revisions, and the specific incentives to develop renewables and reduce transmission and distribution losses, have won grudging recognition even from the non-BJP states.
- Encouraging the BJP-led states to relax rigid state labor laws (effectively by-passing the stalling of the labor reform bill in Parliament) in order to encourage investments (and employment) by the manufacturing sector.

- **Renewed push on infrastructure:**
  - Increasing the cap.ex. for the Railways by 50% while allowing for 100% FDI in railway infrastructure; the dedicated freight corridor between Delhi and Mumbai has been completely tendered out.
  - Increasing the budgetary allocation to roads by 70%; the pick-up in activity on the ground is visible.
  - Boosting FDI limits in the defense sector in return for specific local content rules.
  - A robust new public-private partnership framework for investments in highways, ports, and gas pipelines.
  - Establishment of a REIT mechanism specific to property and infrastructure assets.
  - Easing of liquidity requirements for banks taking on long-term infrastructure assets.

We would like to specifically highlight the significant commitment being made to water related infrastructure spending: the ambitious Namami Ganga Project requiring the set-up of 4,000+ Sewage Treatment Plants, the deliberate increase in spending on identified irrigation projects in the Budget and the creation of a Long Term Irrigation Fund, AMRUT with a specific focus on sanitation and clean drinking water, and the Smart City Program, with 20 cities having been specifically identified where adequate drinking water supply, waste water and sewage treatment, and deliberate water re-usage programs are integral long term solutions.

Our conviction is that the government's espousal of a thoughtful hybrid annuity model will create a sustainable and highly accretive investment opportunity in water related infrastructure over the next decade (40% direct funding by the government, matched by private sector investments with a 70% debt/equity mix, incentivized with a 15 year operations and maintenance contract). ***In our portfolios, VA Tech Wabag and the cement companies (Orient Cement, and Shree Cement) are the key beneficiaries.***

VA Tech Wabag is a Chennai-based global water and sewage treatment company, and thanks to the reverse takeover of the Austrian parent, enjoys a unique, internal IP-driven portfolio of water and sewage treatment solutions.

- Thanks to low cost India-based design and engineering capabilities, and an asset-light business model, VATW is the low cost global provider of turnkey solutions in waste water management/treatment.
- On the back of new order wins internationally over the last six months, the order book is tracking at just over US$1bn, *providing us three years of visibility on revenues and margins.*
- The tie-up with Sumitomo does provide the financial wherewithal to bid outright for the larger projects – as opposed to bidding as a sub-contractor for smaller packages.
- Given the massive domestic new order pipeline we see with the Namami Ganga Project, the desalination and sewage treatment plants that have been mooted by several state governments, and the aspirations in terms of sustainable drinking water supply and waste and industrial water treatment/re-usage, *we expect the order book to double over the next 3 years.*

The stock has lagged over the past several months on concerns over international contracts potentially being negatively impacted by lower crude prices (the Middle East, Africa, and Malaysia), the low margin APGENCO project that had been stalled for 6 months, pushing up receivables, and the delays in calling for the various domestic tenders.

Over the next three years, we expect the order book to be increasingly skewed towards India and South East Asia (primarily the Philippines and Malaysia), driving significant mix and margin improvements.

- We expect the top-line to compound at a 20%+ run-rate, suggesting revenues tracking well above US$600m by March 2018.
- EBITDA margins currently tracking at 8%, will improve by 250bp over the next three years (better mix and operating leverage), and potentially by another 300bp by 2020 as mix continues to improve with increasingly complex orders, and as cost efficiencies in design, engineering, and procurement, are sustained.
- We expect earnings to compound at close to 25% annually over the next three years, and with net working capital improving to under 80 days, for FCF compounding in excess of 40% annually, and for upside to the current 20% payout.

To conclude:

1. No question, ***market volatility will continue to test our convictions and our willingness/ ability to focus on the longer-term.***
2. ***Improving fundamentals and growth visibility underpin our conviction*** in our portfolio companies delivering ***on earnings compounding at a 15%+ run-rate over the next 3 years.***
3. We believe that Modi will secure a majority in the Upper House by July 2016, allowing for a series of ***structural reforms being initiated***, facilitating the ramp-up of a new investment cycle, and a market re-rating.

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

Portfolio Overview

Top 5 Positions	Sectoral Break-down:	As % NAV	Sector Performance	MTD Performance
Bajaj Finance Ltd	Agriculture:	3%	Agriculture:	+0.45%
Asian Paints Ltd	Autos:	8%	Autos:	+0.88%
Kotak Mahindra Bank Ltd	Building Materials:	12%	Building Materials:	+1.00%
ZEE Entertainment Enterprise	Consumer Discretionary:	17%	Consumer Discretionary:	+1.72%
Natco Pharma Ltd	Financials:	21%	Financials:	+2.79%
	Industrials:	14%	Industrials:	+2.27%
	Infra Backbone:	11%	Infra Backbone:	+1.87%
	IT Services:	2%	IT Services:	+0.08%
	Logistics:	3%	Logistics:	+0.40%
	Pharmaceuticals	9%	Pharmaceuticals:	+0.38%

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