May 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 +1.89% in May, after expenses. The US interest rate curve would seem to have priced in higher rates in the near-term. However, our sense is that the relatively sanguine reaction in stocks, commodities, and emerging markets broadly, seems to be more a function of 'de-risked' portfolios and positioning reflecting ongoing concerns on China, Brexit, US elections, geo-politics, commodity prices, etc. – as opposed to any real conviction on markets moving higher.

That said, what we are most focused on is a market with positive earnings growth (in fact, India has just delivered its first quarter of earnings growth after 6 quarters of earnings declines!), and importantly, on the second anniversary of Modi having assumed office, the increasingly visible green shoots in the real economy as the structural reforms put in place start to take root.

Two years into the Modi administration, it is worth a pause to reflect on 'expectations' versus the 'deliverables.'

- **The Central government has remained steadfast on a path of fiscal consolidation,** continuing to cut back on subsidies and wasteful expenditure. *Without the government crowding out private sector borrowing, we believe that inflation, inflation expectations, and borrowing costs will continue to decline structurally.*
- **Yes, still no GST; however, the Land Reform Bill, the Minerals and Mining Bill, and the new Bankruptcy Code, are game-changers.** Contrary to initial (and unrealistic) expectations, Modi is just not one for big-bang reform announcements; he will continue forward on a path of incremental changes/reforms which will, over a 5 year+ period, have a significant *cumulative* positive impact. *Our conviction is that GST will become a reality, and will be a significant positive catalyst, not just for the real economy, but, in re-setting market expectations on earnings and potentially, the market multiple.*
- **Corruption has been visibly reined-in** thanks to Modi committing to and enforcing the transparent tendering for public projects, and the transparent auctioning of spectrum, mineral and natural resources, and land use rights.
- **The corporate tax rate being reduced to 25% is a significant positive** *– not just as an incentive to corporate India and re-investments, but, importantly, as a dis-incentive to systematic tax evasion*.
- **The government's investment focus remains on "rural" India and on infrastructure:** *we are particularly encouraged by the visible investment decisions being made on roads, power, irrigation, defence, ports and railways, and importantly, on the intensive adoption of technology to drive financial inclusion and to minimize subsidy leakages.*

The key issues on our mind:

- ***Has the Indian Profit Cycle bottomed?*** *Our conviction is that after a prolonged 5 year down-shift in corporate earnings, we are on the cusp of an earnings recovery thanks to commodity prices stabilizing, accelerating real growth, and improving operating leverage.*
- ***Will he, won't he* - will Rajan's tenure as Reserve Bank Governor be extended?** Rajan's hard-won inflation-fighting credentials, and his independent and balanced approach on fiscal and monetary stimulus, the currency, and importantly, cleaning up the banking system, has created a credible, stable macro framework for India – in the face of mediocre global growth, volatile capital markets, and the threat of competitive devaluations.
- **Government capital expenditure and urban consumption are the key growth drivers currently - exports and rural demand remain tepid.**
  - *Exports have contracted for 8 consecutive quarters,* mirroring global trade patterns, and it is clear that the manufacturing sector has absorbed the brunt given the continued strength in services exports into the US.
  - *However, we are hopeful that with agri-commodity prices having staged a smart recover over the last few months, and the prospects of a 'good' monsoon, rural incomes and demand will re-bound strongly into the new financial year.*
- **A revival in Private Sector Capital Expenditure is over-due** – and it has to start with a revival in stalled projects (in the commodity, power, and housing sectors), more than a third of which are currently held up in bureaucratic limbo. Investments at 32% of GDP simply cannot sustain

Performance, in USD

(*Inception on September 1, 2015*)

	Tantallon India Fund	MSCI India($)	Over/Under Full Performance
May 2016:	+1.89%	+1.80%	+0.09%
2016 YTD:	-3.98%	-0.69%	-3.29%
2015:	+0.24%	-7.53%	+7.77%
2014:	nm	+21.92%	nm
Inception:	-3.75%	-1.43%	-2.32%

Compound Returns	-4.97%	Volatility	+22.07%
3 month US T-bill	+0.34%	Sharpe Ratio	-0.241

FUND DETAILS
The Tantallon India Fund

AUM USD 14,000,000

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	-3.75%												
2016	-3.98%	-8.33%	-9.98%	+11.86%	+2.10%	+1.89%							
2015	+0.24%									-0.14%	+1.36%	-2.09%	+1.14%

7%+ real GDP growth and adequate job-creation. *Our expectation is that with real deposit growth inching higher, and Modi's focus on reviving stalled project and creating employment, we are on the cusp of a strong recovery in industrial capex.*

- **Spending on consumer durables remains robust,** and *our expectation is that in addition to the positive consumption tailwinds from a better monsoon, the pay commission increases will filter through in terms of a significant boost to consumption demand over the next 3 years.*
- **Is the much touted restructuring at State Bank of India, consolidating its subsidiaries, and recognizing and providing for delinquent loans, a harbinger of a genuinely healthier banking system?**
- **Crude prices edging higher creates a drag for India** – *both in terms of the current account deficit, as well as for inflationary expectations.*

The stock we wanted to highlight this month is ***Aegis Logistics Limited***, India's largest third party oil, gas and chemicals logistic company. Aegis operates a bi-coastal network of bulk liquid terminals, liquefied petroleum gas (LPG) terminals, filling plants, and pipelines on a "build, own, operate" basis to service the national oil companies and other local industrial companies. The nascent investments to develop a retail LPG distribution network branded Aegis Auto, and a joint venture with Itochu Corporation to develop the sourcing and transportation capabilities to meet their customer requirements, are interesting, longer-term growth opportunities.

- *Aegis thus offers us exposure to a unique combination of strong, annuity-type cash flows (from long-term storage and terminalling rental contracts), and the visible high-growth opportunity to significantly expand the LPG business (sourcing, terminalling, and downstream distribution).*

The Liquid Chemicals Logistics Division generates 10% of consolidated revenues, and 50% of consolidated EBITDA.

- Given a stable outlook on rental rates, the real upside is in the operational efficiencies in evacuating product and hence, the ability to increase utilization rates of the existing facilities.
- The increasingly stringent safety and environmental clearances required to build new terminal capacity at the ports, and the (in)ability to secure adequate contiguous property to expand existing port capacity, are effective entry barriers, making the case for high utilization and rental rates.
- The goal is to scale from 500,000 to 1.2m cubic meters, at an investment of Rs. 350cr, over the next 3-4 years.
- On average, assuming 75% utilization, Aegis earns EBITDA margins of 63%-65%, and post-tax IRR of 25%.

The Gas Division generates 90% of consolidated revenues and 50% of profits.

- LPG is the key growth driver for the company: given the government's push to make LPG the fuel of choice in rural India (replacing kerosene and wood burning stores), we expect India's LPG demand to compound at 10% annually over the next decade, almost all of which will be met with imports.
- Aegis currently enjoys an 8% market share of all LPG imports into the country, and the intent is to grow share to 25% by 2020, with operating efficiencies (greater automation, and terminal in deep water ports) and scale economics translating to meaningful industry cost leadership.
- Aegis plans to increase capacity 4x to 100,000 metric tones over the next 3 years, at an investment of Rs.500cr.
- On average, at an 85% utilization rate, Aegis earns EBITDA margins of 75%, and post-tax IRR of 40%.

The company is currently in a net cash position, and is poised to more than double its EBITDA over the next two years, while meetings all its capex requirements through internal accruals.

- We expect EPSe to compound at 30%+ over the next 3 years on the back of the new capacity being commissioned, and significant operating leverage.
- Given the growth opportunity through the LPG value-chain (from sourcing to downstream distribution), we expect that the current dividend payout of 30% will likely be maintained.

To conclude:

- ➢ We continue to have strong conviction in Indian ***demographics and consumption***; ***lower inflation and lower borrowing costs;*** and government spending on urban and rural infrastructure, and mass-housing, as catalysts for a ***new investment cycle.***
- ➢ Against a back-drop of demand recovery and good operating leverage, our ***portfolio companies are poised to grow earnings at a 15%+ CAGR over the next 3 years.***
- ➢ The recent State elections in Assam, West Bengal, Tamil Nadu, and Kerala, are a net positive for Modi's pro-reform legislative agenda, and ***we expect equity multiples to be sustained by the revival in the investment cycle, and visible earnings/cash flow growth.***

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
Asian Paints Ltd
ZEE Entertainment Enterprise
Natco Pharma Ltd
Kotak Mahindra Bank Ltd

Sectoral Break-down:	As % NAV
Agriculture:	4%
Autos:	7%
Building Materials:	13%
Consumer Discretionary:	19%
Financials:	22%
Industrials:	11%
Infra Backbone:	11%
IT Services:	2%
Logistics:	3%
Pharmaceuticals	8%

Sector Performance	MTD Performance
Agriculture:	+0.87%
Autos:	-0.53%
Building Materials:	+0.93%
Consumer Discretionary:	+1.00%
Financials:	+0.79%
Industrials:	-0.43%
Infra Backbone:	-0.25%
IT Services:	-0.04%
Logistics:	+0.06%
Pharmaceuticals:	+0.38%