November 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
November 2016:	-9.26%	-7.49%	-1.76%
2016 YTD:	-3.05%	-2.65%	-0.40%
2015:	+0.24%	-7.53%	+7.77%
2014:	nm	+21.92%	nm
Inception:	-2.82%	-3.38%	+0.56%

Compound Returns	-2.26%	Volatility	+20.43%
3 month US T-bill	+0.47%	Sharpe Ratio	-0.134

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)

The Tantallon India Fund closed down -9.26% in November, after expenses; *a perfect storm given the 'surprise' US Presidential Election outcome, rising US bond yields, a strengthening US$, and returning Emerging Market risk aversion, exacerbated by the 'shocked' system-wide adjustment to India's demonetization program, and the short-term hit to domestic consumption and corporate earnings.*

Despite the uncertainty and the noise (from Trump-anomics and demonetization, to Chinese capital flight, Brexit, and policy unpredictability globally), **we would reiterate our conviction to deliberately increase exposure to Indian equities:**

1) **valuations** have meaningfully corrected *(at under 16x forward earnings, market multiples are now back to where they were in June 2013 in the midst of the taper-tantrum)*, and especially with regards to the domestic fixed income alternatives *(attested to by the US$4.5bn of inflows into domestic equity funds in November)*;
2) **sustained growth and earnings visibility;**
3) a shift in funding mix to FDI (as opposed to debt and equity funding), and improving terms of trade making the case for **relative rupee stability** *in the face of higher interest rates globally and a potentially stronger US$;*
4) **structurally falling borrowing costs;** and
5) a government committed to a path of **intentional structural reforms.**

The key risks that we would highlight: 1) the near term growth uncertainty arising from demonetization; 2) a sharp increase in crude (in particular) and other commodity prices; and 3) a sharp spike in US treasury yields which in the short term, are likely to contribute to much higher risk aversion for emerging markets assets.

On demonetization, to reiterate what we wrote in our special update two weeks ago: **despite the significant execution challenges, and the short-term hit to growth/earnings, we are unambiguously positive on Modi's demonetization program and the forced digitalization of the Indian economy.**

- ***Earnings for the December quarter are a complete "wash-out,'*** reflected in the very sharp sell-off in our portfolio given its intentional consumer-facing tilt.
- ***Demonetization will broaden the tax net,*** and as it forces digital conversion and greater transparency on India's massive parallel economy, it tees up the real economy for more effective GST implementation in the middle of 2017.
- ***Demonetization allows for inflation, interest rates, and borrowing costs to structurally trend lower*** – in part due to a lower fiscal deficit, in part, due to the forced reduction in money in circulation, and in part due to the flood of deposits into the formal banking system.
- ***Demonetization is the first step on Modi's ideological commitment to fight corruption – and yes, this is going to be a protracted battle;*** we would anticipate further restrictions targeting properties owned under nominee accounts, and on un-documented bullion purchases. There will be an impact on psyche, and the hitherto, brazen trading of access and patronage – and India will benefit.
- ***We expect that the markets will price the economic re-set and the earnings decline relatively efficiently:*** *Over the next 3-4 months, we expect that the focus will switch to the significant tailwinds accruing post demonetization, and that the markets will start to anticipate the re-set in the real economy and the positive uplift to tax collection and to corporate earnings post GST implementation in the first half of 2017.*

Walking through the re-sets on our expectations:

- **The anticipation of growth accelerating in the second half has been stymied,** as India's ubiquitous cash economy is forced into significant adjustments.
    - ***We expect real GDP growth for the fiscal year ended March 2017 of about 6.5% (down from 7%), accelerating***

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	-2.82%												
2016	-3.05%	-8.33%	-9.98%	+11.86%	+2.10%	+1.89%	+5.44%	+6.37%	+1.66%	-0.74%	-1.69%	-9.26%	
2015	+0.24%									-0.14%	+1.36%	-2.09%	+1.14%

to a 7.5%-8% compound annual run-rate over the next 3-4 years on the back of GST implementation, a surge in fixed asset investments and in employment, and sustained consumption growth post the re-set.
    - ***We do expect regulatory forbearance, and more monetary policy easing*** by the Reserve Bank, ***as well as significant non-monetary stimulus*** (we are already hearing of lower direct taxes and a fiscal spending package in the February budget).
- **Earnings for the December quarter for the consumer facing companies are a wash-out** with retail sales having collapsed.
    - ***Our sense is that we are likely to see the 'worst' of the data by the middle of December, when the second derivative will probably start to improve.***
- **The perfect storm with the rupee at Rs.68.5/US$ testing its all-time lows:** over US$4bn in foreign institutional selling in the equity and fixed income markets on the back of concerns over the US Elections *and* demonetization, coupled with the markets pricing-in the near-certainty of Fed rate hikes over the next 12 months, suggesting a stronger US$, and collateral damage in currencies across Asia.
    - ***Our base case assumption now is for the rupee to settle around Rs.72/US$ over the next 12 months.***

The stock we wanted to highlight this month is ***Vakrangee.*** Vakrangee (VKI) started out in early 1990s as a sub-contractor for TCS, implementing eGovernance projects, fully funded by multi-lateral agencies, independent of government patronage, and project managed by the Big 4 accounting firms. Its franchisee model ensures as asset light business, and as VKI scales its brick and mortar presence, technology backbone, and a bouquet of financial and e-fulfillment services across rural and semi-urban India, it is a unique beneficiary of government's focus on financial inclusion, and the massive pent-up demand for financial services, e-commerce, and logistics, from the urban poor and the vastly underserved swath of population in rural India.

VKI's primary growth driver will be the opportunity to scale the current footprint of 20,000 Vakrangee Kendras (basically, 200 square foot store fronts equipped with a white label ATM, computers, and staff), with five distinct service verticals: (1) **Government Services offering UID registration, registration for Aadhar cards, Voter Identification cards, and utility payments; (2) basic banking on the back of the correspondent banking relationships with 35 public sector banks (account openings, deposits, withdrawals, and remittances); (3) Insurance, offering customers** life, general, term, and micro insurance policies through tie-ups with LIC, HDFC Life, Bajaj Allianz, , Reliance GIC, TATA AIG, Religare Healthcare;(4) **eCommerce Services**, including re-charging of SIM cards and satellite services (Vodafone, Tata Sky, Airtel, Idea, Dish, Videocon), and long-distance Bus Ticket purchases (RedBus); and (5) the **exclusive tie-up with Amazon India,** where dedicated VKI staff provide the bottom-of-the-pyramid in rural and semi-urban with unique, assisted eCommerce access.

The Amazon relationship is a game-changer: a 5 year exclusive relationship during which VKI effectively becomes Amazon's last mile connectivity in India, allowing customers to not only 'search and shop' on-line on VKI's dedicated terminals on-premise, but to make purchases on-line, and then arrange for parcel collection and charge-on-delivery on-premise, and potentially, to arrange for parcel returns as well. After a year of due-diligence on VKI's stores, and systems/processes, Amazon has opened 500 dedicated outlets in Vakrangee Kendras, and our expectation is that over the next three years, Amazon will commission close to 5,000 dedicated outlets, while building fulfillment centers in close proximity, allowing for outreach and penetration on a scale that is, quite frankly, unheard of.

Over the next three years, management's vision is to scale revenues to US$2bn, touching 200m customers (half of whom would be in rural India), and generating a 17%-18% EBITDA margin.
- On the revenue front, we have conservatively modeled 40%+ CAGR to US$1.8bn.
- We are modeling a 35% CAGR in EBITDA given the evolving profit share mix with the franchisees.
- We are modeling a 45%+ CAGR on our EPS estimates, and a minimum of a 20% dividend payout ratio.

To conclude:
- ***Discretionary consumption, building materials, autos, real estate, jewelry, and consumer finance companies will be quite negatively impacted over the next few weeks, as India's cash economy re-sets.***
- However, as Modi's pro-reform, pro-growth, and anti-corruption initiatives start to bear fruit, we will be invested in **India's rural recovery,** a **new investment cycle, sustained consumption demand,** and **structurally lower borrowing costs.**
    - *Our strongest convictions are in cement, industrials, the financials, and consumer discretionary stocks.*
    - *We continue to have no exposure to IT Services and telecom, and limited exposure to energy and consumer staples.*
- We expect borrowing costs to trend lower providing **valuation support for our portfolio companies compounding earnings at a 15%+ CAGR over the next 3 years.**

On a final note, from our families to yours: Happy Holidays! Much Joy, Good Health, Peace, and a Prosperous New Year!

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

Portfolio Overview

Top 5 Positions
Natco Pharma Ltd
Kotak Mahindra Bank Ltd
Bajaj Finance Ltd
HDFC Bank Ltd - ADR
Zee Entertainment Enterprise

Sectoral Break-down:	As % NAV
Agriculture:	4%
Autos:	5%
Building Materials:	13%
Consumer Discretionary:	15%
Financials:	30%
Industrials:	12%
Infra Backbone:	3%
IT Services:	0%
Logistics:	4%
Pharmaceuticals	10%
Retail	4%

Sector Performance	MTD Performance
Agriculture:	-0.12%
Autos:	-0.55%
Building Materials:	-2.06%
Consumer Discretionary:	-2.01%
Financials:	-3.31%
Industrials:	-0.21%
Infra Backbone:	-0.54%
IT Services:	0.00%
Logistics:	-0.31%
Pharmaceuticals:	-0.30%
Retail:	+0.15%