TANTALLON CAPITAL

October 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
October 2016:	-1.69%	-0.50%	-1.19%
2016 YTD:	+6.84%	+5.23%	+1.61%
2015:	+0.24%	-7.53%	+7.77%
2014:	nm	+21.92%	nm
Inception:	+7.09%	+4.44%	+2.65%

Compound Returns	+6.05%	Volatility	+19.12%
3 month US T-bill	+0.34%	Sharpe Ratio	+0.299

The Tantallon India Fund closed down -1.69% in October, after expenses, *with significant intra-month volatility being the stand-out feature as the market absorbed a string of negative global headlines (from prognostication on US Election outcomes and implications for US$ assets, more Fed-speculation as global risk premiums inexorably rise, heightened Brexit antagonism, and very, very high stakes political maneuvering in China), high lined by the very public rift within the Tata Group with the Chairman being summarily 'replaced.'*

India's structural story stays on-course: well thought through executive/legislative reforms, strong policy momentum driving infrastructure spending and risk capital deployment, lower borrowing costs, and a nascent consumption recovery on the back of recovering rural demand.

- *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.*

Some recent positive Indian data points to highlight:

- *Prime Minister Modi take a bow* – the **bold decision to 'shock' the markets and to overnight, scrap and replace high denomination Rs.500 and Rs.1,000 notes in circulation** (representing 85% of the total currency in circulation), *while being a clear short-term negative for discretionary consumption and asset prices (given the store of unaccounted wealth in large denomination bills), will yield significant long-term benefits* in terms of (i) tackling corruption, (ii) removing fake currency in circulation, and (iii) facilitating the government's efforts to bring the grey economy under the formal tax net.
- The **October manufacturing PMI printed at a 22-month high,** led by significant improvement in domestic demand indicators - in particular, the indices for new orders and output saw the largest increases in the month – reinforcing September's strong Core industries data on the back of growth in refining products, cement and electricity production
- Don't look yet…but, it would seem that the September quarter results season has been tracking better than expected: **within the broad BSE200, more than two-thirds of the reporting companies have met/exceeded forecasts.**
- **October inflows into domestic equity mutual funds tracked at US$1.4bn** – the highest level in the past 16 months, and by far the highest amount of net monthly inflows in 2016. Domestic investors are clearly focused in on the changes on the ground…*and given the October inflow into domestic fixed income mutual funds of US$7.8bn, it is clear that the domestic investor will increasingly, set marginal prices.*

FUND DETAILS

The Tantallon India Fund

AUM USD 17,000,000

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)

- …and after weeks of negotiations, India moves a step closer to GST implementation with the **GST council agreeing on a five-slab structure** *(versus the 100+ tax slabs that exist today), for implementation in April 2017.* ***We stand by our view that GST implementation over the next 3 years will be a game-changer – and not just because of a simplistic analysis on lower effective tax rates, but, more on account of the structural cost savings and operational efficiencies that will accrue to the organized sectors.***

A note of caution: global risk premiums are likely to continue to rise – as clearly evidenced in the sharp October moves in the US 10 year, the 10 year bund, and the 10 year JGB.

- The dust has settled on a deeply embittered and divisive US election cycle. ***Even assuming that we will move quickly past the virulence of campaign rhetoric, we should still expect an anti-establishment, unpredictable Trump Presidency*** to challenge the fundamental tenets of US policy-making, (1) starting possibly with more public second guessing of Federal Reserve decisions; (2) calling in question

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+7.09%												
2016	+6.84%	-8.33%	-9.98%	+11.86%	+2.10%	+1.89%	+5.44%	+6.37%	+1.66%	-0.74%	-1.69%		
2015	+0.24%									-0.14%	+1.36%	-2.09%	+1.14%

global trade, manufacturing and business linkages – both historical and prospective; and (3) potentially upending long-standing multi-lateral and bilateral security treaties. *The uncertainty and the unpredictability will make for choppy markets, especially given high levels of foreign ownership of US treasuries and high-end real estate.*

- The ***anti-establishment, isolationist, xenophobic, anti-trade and anti-immigrant narrative*** that has given us Brexit and the Trump run to the White House, will likely have an equally angst-filled sequel – in the Presidential Elections in France and the federal elections in Germany. *Watch this space.*
- ***Xi, no question, is looking to tighten his grip; the 3Q $136bn balance of payments deficit would however suggest that the Chinese stress points are continuing to build.*** Fresh on the heels of Xi being anointed "core" leader (putting paid to any notion of maintaining the norms of power-sharing and institutionalized succession that have characterized leadership transitions post Mao), China unveiled three major decisions that have significant implications: (1) naming a *new finance minister,* replacing the veteran (and outspoken) reformer, Lou Jiwei, with Xiao Jie, a State Council bureaucrat, firmly committed to the Xi narrative; (2) effectively *dis-qualifying two elected Hong Kong "localists"* from taking office; and (3) imposing an intrusive *new cybersecurity law* granting China unprecedented access to the technology of foreign companies operating in China.

The stock we wanted to highlight this month is ***Ahluwalia Contracts.*** Ahluwalia is a leading domestic engineering and construction company focused on civil engineering and construction work for residential, commercial, retail, infrastructure and industrial projects. *The key differentiator is that Ahluwalia is primarily focused on publicly tendered social infrastructure related government projects (schools, universities, hospitals, low cost housing, IT Parks) in Northern India, providing turnkey solutions (i.e., both design and construction), helping rationalize project costs and time to delivery.*

The current order book is tracking at about US$650m *(75% vested in government contracts), providing 3+ years visibility on revenues and margins.* Given the government's commitment to social infrastructure, and in particular, the developments along the dedicated freight corridor, we are enthusiastic about the sustained growth opportunity for the order book:

- ***We expect the order book and revenues to compound in excess of 20% annually over the next five years.***
- *What is not yet in our numbers:* the opportunity to leverage the pre-casting technology that they have brought in-house to bid for, and execute on the government's "Housing for All" program (designed to deliver 50m units over 5 years) could substantially boost the order book over the next 5 years.

Healthy Margin Outlook: Given the capital intensity of the projects and the pre-qualification criterion established by the government (to ensure delivery of the projects on time and on-budget), bidding for these large government projects is rational, and designed to deliver 12%-13% EBITDA margins.

- ***Over the next three years, we expect better pricing and good operating leverage to translate to EBITDA margins improving by 100bp to 13.5%.***

The balance sheet is in excellent shape:

- Having raised equity at the end of the financial crisis, the balance sheet has been substantially deleveraged – with net gearing down to under 10% (versus the peak of 120%).
- Additionally, management's focus on managing receivables and the order book has seen net working capital requirements trending under 100 days (down from the crisis peak of 170 days).

Very strong earnings/cash flow profile:

- On the back of good order book visibility, lower borrowing costs, and economies of scale, ***we expect earnings to compound at close to 30% annually over the next three years.***
- Given the ability to meet capital expenditure and working capital requirements through operating cash flows, and a virtually debt free balance sheet, ***over the next two years, we expect the management to articulate a formal dividend policy, and to start to pay a dividend.***

To conclude:

- ➢ Despite the increasingly acknowledged constraints to global trade and growth, we have confidence in **India delivering on real GDP growth compounding in excess of 7% over the next 3-5 years,** as Modi's pro-reform, pro-growth initiatives start to bear fruit.
- ➢ In the face of significant market volatility and global macro headwinds and uncertainty, we are most enthused by **India's rural recovery,** a **new investment cycle, sustained consumption demand,** and **structurally lower borrowing costs.**
- ➢ 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.**

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
Kotak Mahindra Bank Ltd
Natco Pharma Ltd
HDFC Bank Ltd - ADR
Zee Entertainment Enterprise

Sectoral Break-down:	As % NAV
Agriculture:	4%
Autos:	5%
Building Materials:	14%
Consumer Discretionary:	19%
Financials:	30%
Industrials:	12%
Infra Backbone:	3%
IT Services:	0%
Logistics:	4%
Pharmaceuticals	10%

Sector Performance	MTD Performance
Agriculture:	+0.39%
Autos:	-0.43%
Building Materials:	-1.47%
Consumer Discretionary:	-0.43%
Financials:	+0.45%
Industrials:	-0.01%
Infra Backbone:	-0.28%
IT Services:	0.00%
Logistics:	+0.11%
Pharmaceuticals:	-0.01%