TANTALLON CAPITAL

September 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 down -0.74% in September, after expenses; *a choppy month where the market sold off sharply in the last two trading sessions after India announced a punitive military incursion onto Pakistani soil, surgically targeting and destroying several terrorist camps set up beyond the Kashmir Line of Control.*

We remain extremely positive on India's structural tailwinds: significant executive/legislative reforms, visible policy momentum, falling borrowing costs, the re-engaging of private risk capital to leverage the infrastructure being built, sustained job creation and wage growth, and consumption underpinned by improving rural demand.

- *Our convictions are anchored in our exposure to cement, industrials, the financials, and consumer discretionary stocks.*
- *We have no exposure to IT Services, telecom, and limited exposure to energy and consumer staples.*

First, on the border tensions:
After the mid-month terrorist attack on a military base in Uri, in Kashmir, where 18 Indian soldiers were killed, Modi signaled an assertiveness, and a clarity of thought and purpose that quite frankly, we have not *ever* seen before from an Indian politician. *In a pre-dawn raid on the morning of September 29th, Indian forces crossed the border (a "first" in the history of independent India), and carried out co-ordinated 'surgical strikes' inside Pakistan Occupied Kashmir, targeting and destroying several terrorist camps.*

Despite the sensational headlines and breathless rhetoric in both the local and the international press, our sense is that the situation will be contained – and the risk of escalating military action is quite low.

- Modi has decisively made his point – India has no territorial aspirations; Pakistan needs to accept responsibility for the terrorist staging camps on Pakistani soil; and the ongoing efforts to isolate Pakistan diplomatically in various international forums will maintain pressure on the Pakistani army to rein-in the terrorist camps.
- With Pakistan rejecting outright the possibility of an Indian incursion across the border, we would simply highlight the continued, highly dysfunctional relationship between the Pakistani politicians and its military, and that the US is weighing in very heavily behind the scenes to pre-empt any retaliation by the Pakistani Army.
- *The marker we have our eyes on is if Pakistan's Chief of Army Staff, General Raheel Sharif (no relation to Pakistan PM Nawaz Sharif), retires as scheduled, at the end of November. If he does not, the odds of another military coup in Pakistan would rise significantly, while increasing the likelihood of more terrorist strikes in India, and potentially, some border skirmishes, with an eye on 'managing' headlines in the Pakistani media.*

Performance, in USD
(*Inception on September 1, 2015*)

	Tantallon India Fund	MSCI India($)	Over/Under Full Performance
September 2016:	-0.74%	-1.02%	+0.29%
2016 YTD:	+8.67%	+5.76%	+2.91%
2015:	+0.24%	-7.53%	+7.77%
2014:	nm	+21.92%	nm
Inception:	+8.93%	+4.97%	+3.96%

Compound Returns	+8.22%	Volatility	+19.75%
3 month US T-bill	+0.27%	Sharpe Ratio	+0.402

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)

Looking back on past 'conflicts:'

- In the summer of 1999, a limited scale conflict took place when the Pakistani Army crossed the Line of Control and occupied Kargil on May 3, and held their positions until July 14. Over this period, interestingly, the Sensex actually moved up by 25%+ and the rupee depreciated by 1%. *BUT … in 1999, India was a relatively small market (total market cap under US$150bn), with relatively low foreign ownership, and no ETF investments to speak off to be spooked by a New York Times headline.*
- It is also worth reflecting on the political brinksmanship and heated rhetoric between the two countries after the 2001 terrorist attack on the Indian Parliament, and the 2008 terrorist attacks on the Mumbai hotels, where India underperformed the MSCI EM benchmark 450-500bp over the following six weeks.

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+8.93%												
2016	+8.67%	-8.33%	-9.98%	+11.86%	+2.10%	+1.89%	+5.44%	+6.37%	+1.66%	-0.74%			
2015	+0.24%									-0.14%	+1.36%	-2.09%	+1.14%

More meaningful from a market perspective was the first RBI Policy meeting after Patel took over as RBI Governor – *the policy rate was cut by 25bp to 6.25%, and for better or worse, the messaging is unambiguously "accommodative."*

Welcome to the post-Rajan world!

- *Rajan's advocacy of a 150bp-200bp real interest rate band has been 'moderated' to 125bp* – reflecting in part, an environment of falling yields globally, but also, the concerted focus by Indian policy-makers to be explicitly growth-supportive.
- *The 4% CPI inflation target for March 2018 is not sacrosanct.* Reading between the lines it seems that the new Monetary Policy Committee is comfortable keeping inflation within a band – as opposed to focusing on *a* number.

Quite frankly, we would not be surprised to see the 'new' inflation band anchored around the 4.5% mark, suggesting further room for rate cuts if inflation continues to trend lower.

- In a world starting to come to terms with the "normalization" of monetary policy globally, and the reality of global interest rates likely headed higher over the next 12 months, *provided the inflation data remains well-behaved, the RBI actually has the ability to potentially ease by another 50bp over the next six months.*

The stock we wanted to highlight this month is ***PVR Ltd,*** India's largest chain of cinema multiplexes with a national footprint of 550 screens (accounting for 25% of the organized sector). *PVR is a key beneficiary of a rising propensity to consume, and a growing willingness to "pay-up" for a quality entertainment experience.* Having signed-up ~500 screens in key locations (50% in Tier 1 cities, and the balance, in Tier 2 and Tier 3 cities with a clear first-mover advantage), PVR is set to maintain their historical run-rate of opening 70+ new screens annually, providing excellent visibility on growth over the 7-8 years.

The growth run-way ahead for Indian multiplexes is substantial, with the key constraint being the slow pace of integrated mall roll-outs by Indian property developers.

- As a point of reference, India currently has 9 screens/m people, versus the US at 123 screens/m, and China at 23 screens/m.
- China opens 5,000 new screens annually; India with 8,000 screens nationally (of which just 2,200 are in modern multiplexes), is currently on track to open 250 screens annually.

The primary barrier to entry is location in the 'right' catchment areas – not all mall locations are created equal. The fact that we are already seeing industry consolidation is a reflection of the fact that the top 3 operators (thanks to their balance sheets) have secured and locked-in favorable long-term leases in the key catchment areas, forcing a significant cash flow crunch at the smaller operators with limited scale, and limited bargaining power with the developers and the content providers.

We expect that growing customer appetite for regional content (currently 25% of revenues) and Hollywood content (currently 20% of revenues), and strong growth in non-ticket revenue (advertising and F&B revenues) will drive both top-line and mix improvements.

- Ticket sales (growing at 4%-6% annually) is 60% of revenues, F&B (growing at 10%-12% annually) is 25% of revenues, and advertising (growing at 10%-12% annually) is about 15% of revenues. *On the back of the visibility on new screen openings, we expect the top-line to compound at 15%+ over the next 5 years.*
- With higher utilization rates (driving strong operating leverage) and the upside from GST, we expect to see a 450bp uplift in EBITDA margins over the next three years from the current run-rate of about 18%. *The real upside surprise could come from a strong pick-up in advertising revenues – the strong brand and the prime locations in key catchment areas give advertisers the ability to reach-out to a target audience with highly customized high-impact marketing material.*
- The current fiscal year (FY16) will see the company turn FCF positive, and our expectation is that FCF will rise substantially over the next three years. *Over the next two years, as new screens mature, driving margins and FCF, we expect that the Board will be in a position to frame a formal dividend policy.*

To conclude:

- A ***pro-reform, pro-growth Modi government*** is focused on sustained job creation and real income growth: **India is poised to deliver on real GDP growth compounding at a 7%+ CAGR.**
- Our portfolio is invested in beneficiaries of a strong ***rural recovery;*** a ***new investment cycle; sustained consumption demand;*** and ***structurally lower borrowing costs.***
- In an environment where borrowing costs are likely to continue to trend lower, ***we expect strong 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
HDFC Bank Ltd - ADR
Kotak Mahindra Bank Ltd
Orient Cement Ltd
Natco Pharma Ltd

Sectoral Break-down:	As % NAV
Agriculture:	3%
Autos:	8%
Building Materials:	14%
Consumer Discretionary:	18%
Financials:	27%
Industrials:	11%
Infra Backbone:	6%
IT Services:	0%
Logistics:	4%
Pharmaceuticals	9%

Sector Performance	MTD Performance
Agriculture:	+0.15%
Autos:	+0.38%
Building Materials:	+0.59%
Consumer Discretionary:	-0.26%
Financials:	-0.67%
Industrials:	-0.21%
Infra Backbone:	-0.22%
IT Services:	0.00%
Logistics:	+0.48%
Pharmaceuticals:	-0.97%

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