TANTALLON CAPITAL

April 2017

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 April up +6.54% after expenses; the underlying policy momentum is palpable, anchored by Modi's strong legislative mandate, and the continued flows into domestic equity funds are anticipating a decisive revival in demand with nominal growth at a multi-month high, and with broad market revenue/earnings growth at a 3 year high.

We do not want to sound/be complacent in the least; given the market move off the de-monetization lows last December, we should be prepared for some volatility in the next few months. *In the near term, the key risks to highlight include (i) a potential spike in global commodity prices (will the 'real' China please stand up??!) and underlying inflation, (ii) a poor monsoon with potentially negative implications for rural incomes and demand, (iii) potential dislocations to supply chains and unexpectedly painful inventory adjustments with GST implementation, and (iv) the reality of fickle global risk appetite and capital flows.*

That said, having just spent ten days on the ground, meeting with a cross-section of companies in multiple cities, across multiple sectors and the market cap spectrum, ***we remain enthused about (1) Modi's legislative mandate, and the pro-reform, pro-growth policy momentum we anticipate over the next two years heading into the next General Elections; (2) the first tangible signs of risk-capital deployment in a series of M&A transactions (in telecoms, infrastructure, cement, property, light industrials, and financial services) to acquire (as opposed to build) incremental capacity; and (3) an increasingly visible revival in discretionary consumer sentiment/demand.***

<u>We would urge investors to take advantage of any potential market volatility to intentionally increase exposure to Indian equities:</u>

- ***Structural tailwinds and Modi's pro-reform/anti-corruption agenda will sustain several years of infrastructure development, job creation, and rising disposable incomes/discretionary consumption.***
- ***We believe our portfolio holdings are poised to deliver on idiosyncratic growth, to disproportionately grow markets/market share, fully vested in the digitalization of the real economy, growing financial intermediation, the policy commitment to mass housing, and sustained consumption growth and premiumization.***

Some thoughts to share after our meetings in India last week:

<u>Performance,</u> <u>in USD</u>
(*Inception on September 1, 2015*)

	Tantallon India Fund	MSCI India($)	Over/Under Full Performance
April 2017:	+6.54%	+1.86%	+4.68%
2017 YTD:	+33.95%	+19.14%	+14.81%
2016:	-5.79%	-2.90%	-2.89%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+26.49%	+14.82%	+11.67%

Compound Returns	+15.14%	Volatility	+22.92%
3 month US T-bill	+0.803%	Sharpe Ratio	0.626

<u>FUND DETAILS</u>
The Tantallon India Fund

AUM USD 23,000,000

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% US$ hurdle rate compounding annually

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)

- **<u>The Modi government is at the start of the final two years of its first term in office.</u>** As we have observed with every government post India's 1991 liberalization program, we should expect:
  - **an acceleration in government expenditure and a commensurate pick-up in capital goods production;**
    - Having assessed the official projects-under-tender, *we have growing confidence in the government delivering on its goal of US$100bn+ in NEW project awards over the next year in infrastructure, power, defense, railways, roads, and oil and gas.*
  - the **government's unabashedly pro-growth stance and the focus on job creation to translate to strong out-performance by the Indian equity markets;** and
  - **sharp out-performance by capex-linked sectors and discretionary consumer stocks.**
- **<u>The government's keen focus on mass housing is transformational.</u>** On the back of urbanization, improving affordability (stabilizing real estate prices, mortgage rates having fallen 250bp over the last three years, and per capita incomes having compounded at about 10% a year over the last

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	26.49%												
2017	33.95%	+8.34%	+8.73%	+6.73%	+6.54%								
2016	-5.79%	-8.33%	-9.98%	+11.86%	+2.10%	+1.89%	+5.44%	+6.37%	+1.66%	-0.74%	-1.69%	-9.26%	-2.83%
2015	+0.24%									-0.14%	+1.36%	-2.09%	+1.14%

three years), and explicit government subsidies for low-cost housing, *we expect the housing stock to grow by 8m-9m units annually over the next 5 years, creating 2m new jobs, sustaining 12m tons of incremental cement demand annually, and an annual US$100bn mortgage opportunity.*

- The recovery in domestic SME confidence/activity is increasingly visible, and while there are obvious concerns over the implementation of GST, and in particular as it relates to potential inventory adjustments, **we anticipate a significant shift from the unorganized to the organized sectors.**
- We are encouraged by the **government's non-performing asset resolution framework,** and in particular, by the recent government ordinance empowering the Reserve Bank of India to more effectively deal with willful defaulters, while ensuring the banks appropriately provision for bad loan exposure.
- **Market multiples are likely to continue to be well supported in the medium-to-long term by domestic investors:** we expect corporate buy-backs and domestic fund flows into equity mutual funds and insurance products to sustain market multiples, underpinned by greater retail optimism on growth and reforms, and 'encouraged' by Modi's deliberate measures to curb corruption and rein-in nominee holdings in real estate and bullion.

The stock we wanted to highlight this month is *HealthCare Global (HCG),* *a speciality healthcare group focused on oncology (diagnostics, radiology, chemotherapy, and surgery drive 90% of the current revenue base) and fertility treatments.* With 19 established oncology centers across the country, and an IVF business (currently 8 IVF centers) that is ramping much faster than expected, HCG is poised to benefit disproportionately from greater patient awareness and education, brand acceptance, and a growing reputation for good patient care and successful clinical outcomes.

HCG's runway is substantial:

- India currently reports just 93 cancer diagnoses per 10,000 pop (in contrast, the US reports 318 per 10,000 pop, and China reports 174 per 10,000 pop). Our view is that the actual incidence of cancer in India is much higher – but undiagnosed, given poor education/awareness in both the medical as well as the patient communities. *With rising disposable incomes and greater levels of patient awareness and education, and physicians becoming more pro-active with health screenings and follow-up testing, we expect significant growth in the incidence of diagnosed and treated oncology patients, and hence, sustained volume/revenue growth/operating leverage to drive profitability and cash flows.*
- The IVF market in India remains incredibly fragmented with the largest treatment center performing just 5,000 IVF cycles out of a current market of about 100,000 IVF cycles annually (vs. 500,000 annually in the US). *HCG currently performs 2,000 cycles annually, and on the back of branding and demonstrably superior clinical outcomes and patient care, is ramping volumes/profitability substantially faster than expected.*

We expect consolidated revenues to conservatively compound at a 25%+ run-rate over the next three years (versus consensus estimates penciling in 18%-20% growth).

- Base case, our expectation is for the existing 19 oncology centers to deliver on volume growth compounding at 15% annually over the next three years, with, conservatively, a modest 5% annual uplift in realized pricing.
- We expect the 7 new oncology centers to be commissioned over the next two years to ramp faster on the back of the brand recognition and the well-defined catchment areas.
- In addition, we expect the IVF business to double revenues over the next two years, largely volume-driven.
- The wild card that is simply 'not in the numbers,' is the partnership with CDC UK, expanding systematically into Africa, creating a basic front-end to (re)direct more complex oncology procedures to the oncology centers in India.

We expect profits to compound at close to 60% annually over the next three years on the back of the strong operating leverage in the oncology centers, and the 2-4 month break-even in the IVF centers.

- Despite capex having peaked, management has guided consensus expectations towards a 15% consolidated EBITDA margin; we are significantly more constructive, and are comfortable projecting EBITDA margins tracking around 18% by FY2019 as the new centers establish break-even levels in 12 months, and demonstrate the strong operating leverage in the business.
- Additionally, we believe that the Street is currently underestimating the hockey stick ramp-up in the IVF vertical, and given the short break-even period, the positive impact on earnings and cash flows over the next 3-4 years.

To conclude, we retain strong conviction in Modi's mandate and reform agenda, and the substantial runway for growth ahead of us under-pinned by the infrastructure build-out nationally, the digitalization of the real economy, growing financial intermediation, rising rural incomes, the focus on mass housing, and strong consumption growth.

- ➢ *The portfolio is well differentiated relative to the benchmarks, with conviction in financials, industrials, healthcare, building materials, and consumer discretionary stocks.*
- ➢ *We expect lower borrowing costs and sustained flows into domestic equity funds to provide strong valuation support for our portfolio, with earnings compounding 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 in the next few days.

Portfolio Overview

Top 5 Positions	Sectoral Break-down:	As % NAV	Sector Performance	MTD Performance
Natco Pharma Ltd	Agriculture:	3%	Agriculture:	+0.11%
Bajaj Finance Ltd	Autos:	4%	Autos:	+0.10%
Kotak Mahindra Bank Ltd	Building Materials:	13%	Building Materials:	+1.57%
HDFC Bank Ltd - ADR	Consumer Discretionary:	16%	Consumer Discretionary:	+0.59%
PVR Ltd	Financials:	29%	Financials:	+1.73%
	Industrials:	11%	Industrials:	+0.96%
	Infra Backbone:	5%	Infra Backbone:	+0.48%
	IT Services:	0%	IT Services:	0.00%
	Logistics:	4%	Logistics:	-0.03%
	Retail:	3%	Retail	+0.14%
	Healthcare:	12%	Healthcare:	+0.84%