TANTALLON CAPITAL

December 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.

Performance, in USD

(*Inception on September 1, 2015*)

	Tantallon India Fund	MSCI India($)	Over/Under Full Performance
December 2017:	+4.21%	+4.77%	-0.56%
2017 YTD:	+59.14%	+36.84%	+22.30%
2016:	-5.79%	-2.90%	-2.89%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+50.28%	+31.89%	+18.39%

Compound Returns	+19.07%	Volatility	+20.26%
3 month US T-bill	+1.40%	Sharpe Ratio	0.872

FUND DETAILS

The Tantallon India Fund

AUM USD 37,000,000

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)

At the outset, a very Happy, Healthy, and Prosperous New Year to you, and your families!

The Tantallon India Fund closed +4.21% in December, after expenses. For the year, the Fund was up +59.14% versus MSCI India posting +36.84%.

It's been a good year, with the markets responding positively to the BJP continuing to strengthen its hand politically, Modi's steadfast anti-corruption/pro-reform agenda, the real economy absorbing, and then rebounding from the disruptions from demonetization and GST implementation, the recapitalization of the government banks, the surprise Moody's sovereign upgrade, sustained flows into domestic equity funds, and importantly, our portfolio companies delivering on top-line growth, margin uplift, and earnings growth.

Looking out over the next 2-3 years, no question, we should **expect volatile markets** - *multiple geo-political flash-points; ongoing Brexit angst; China 'slowing' to deal with its banking sector challenges; the potential for significant interest rate, currency and equity market volatility as global central banks 'normalize' monetary policy; trade wars; spiking crude prices…the list is long!*

Amidst that expected volatility, we would continue to **urge investors to look for opportunities to intentionally increase exposure to Indian equities.**

- Empowered by electoral mandates, ***Modi remains committed to a path of structural economic and policy reforms, and is setting the country on a sustained growth path.***
- Having rigorously re-visited our assumptions and earnings estimates, ***we retain strong conviction in our portfolio companies, and in our expectations of sustained revenue growth, margin accretion, and earnings growth.***
- ***We expect continued flows into domestic equity mutual funds to remain supportive of multiples*** for companies that deliver on earnings/cash flow growth.

Framing our broad-brush expectations for the next 2 years in the lead-up to the next General Elections in 2019:

- ***We expect further policy/reform initiatives*** to drive rural incomes, industrialization, housing, infrastructure development, job creation, and the ongoing digitalization of the real economy.
- ***Thanks to the Reserve Bank of India's explicit inflation-targeting discipline, and Modi's commitment to fiscal discipline, we expect a stable macro framework to sustain:*** structurally low(er) inflation in the 4%-4.5% range, growth-supportive real interest rates (+150bp), continued fiscal consolidation with the fiscal deficit being contained to ~3% of GDP, FX reserves in excess of US$400bn, a current account deficit under 2% despite the risk of higher energy prices, a stable rupee, and a broadly positive investment/growth outlook.
- ***The risk of sharply higher energy prices remains the significant outlier risk – to inflation, the fiscal deficit, the current account, and the RBI having to raise interest rates:***
    - Assuming sub-$75/barrel oil, we expect the RBI to remain on an "extended hold," explicitly supportive of growth and investments.
    - Given the risk of higher energy prices, we are comfortable with our current expectations of the rupee trading closer to Rs.67/US$ over the next 12 months.
- ***We expect domestic retail investors to continue to increase their allocation to domestic equities.***
    - Lower nominal and real interest rates, and the government's specific measures to target illicit holdings in real estate and gold, have seen a structural shift in retail investors' equity allocations/risk appetite.

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+50.28%												
2017	+59.14%	+8.34%	+8.73%	+6.73%	+6.54%	-1.20%	+0.23%	+4.30%	-1.47%	-0.69%	+5.64%	+6.79%	+4.21%
2016	-5.79%	-8.33%	-9.98%	+11.86%	+2.10%	+1.89%	+5.44%	+6.40%	+1.66%	-0.74%	-1.69%	-9.26%	-2.83%
2015	+0.24%									-0.14%	+1.36%	-2.09%	+1.14%

- Calendar 2017 saw domestic investors commit US$2.5bn/month to domestic equities; foreign institutional investors significantly lagged, with US$8bn of net inflows for the year. *We expect that trend to hold, with domestic investors now being the price-setters in the market.*

In terms of portfolio positioning, we would highlight the following:

- ***Financials:*** we continue to have very high conviction in the well-capitalized private sector banks and finance companies who have prioritized (a) strong credit discipline and under-writing standards, (b) digital outreach and analytics to increase cross-sell and profitability, and (c) mortgages, and who are poised to structurally grow market share at the expense of the government owned banks, while improving margins/profitability.
- ***Consumer Discretionary, Retail and Consumer Staples:*** given the underlying strength in the economy, Modi's focus on job creation and rural spending, *and* GST implementation, our continued expectation is for the consumer-facing stocks in our portfolio to grow market share at the expense of the unorganized sector, while structurally improving profitability.
- ***Healthcare:*** our conviction is in complex generic pharmaceuticals where portfolios of limited competition products protect profitability, and in the branded specialty hospital chains driving industry consolidation and quality healthcare delivery, and leveraging brand and scale economics to improve profitability.
- ***Industrials:*** the government's focus on infrastructure development and industrialization, on "Make in India," and specific policy initiatives to reduce pollution and carbon emissions, have facilitated a durable investment thematic that we are developing strong conviction in.

The stock we would like to highlight this month is ***HDFC Standard Life Insurance,*** one of India's leading, and most profitable life insurance companies. Set-up in 2000 as a joint venture between HDFC (who currently owns 52% of the listed entity), and Standard Life (with a 29% stake), HDFC Standard Life ***sits in an enviable sweet spot*** of a strong demographic tailwind, growing financial literacy translating to awareness of/demand for insurance 'protection' products, and digitalization and more sophisticated data analytics allowing for deliberate customer out-reach and acquisition.

With total industry premiums of US$62bn, India's premium/GDP ratio of 2.7% in among the lowest in the world, and the insurance sector is poised to grow sustainably for years to come.

- Total insurance products currently only account for 25% of India's financial savings, which, in turn, only account for ~45% of India's household savings.
- Even more striking is India's low per-capita expenditure on life insurance premiums – currently tracking at US$47 per capita, versus US$190 per capita in China, US$616 per capita in South Africa, US$1,725 in the US, and US$3,033 in the UK.

We expect HDFC Life's differentiated distribution platform, and innovative product suite to translate to a 30% CAGR in new premiums over the next three years (versus the market looking for growth in the 20% or so range).

- HDFC Standard Life has built a very high quality book of business thanks to prioritizing customer retention and 'protection' products (as opposed to the more volatile investment products that the competitors have focused on), and the ability to leverage the brand/bancassurance channel (through sister company HDFC Bank).
- Over the next decade, we expect HDFC Standard Life to post sustained market share gains (building on its current market share of 7%) at the expense of the erstwhile government monopoly, Life Insurance Corporation of India (who currently has a 55% market share), on the back of the significant investments in building out its digital platform, the establishment of several new bancassurance partnerships, and the systematic scale-up of its agency channel.

We expect new business margins to average 25% over the next 5 years (currently tracking at 22%) supporting a 20%+ CAGR in embedded value (versus the market's expectations of 15% growth).

- Despite competition and the risk of higher tax rates, we have built significant conviction in the quality of the book (emphasizing protection products), the improving product mix and persistency ratios, and importantly, the significant operating leverage that will accrue to the digital initiatives and the vastly improved agency productivity.
- Additionally, we are significantly more positive than the market on the the two new business initiatives (in reinsurance and as a licensed manager for the National Pension System).

To conclude:

- **We believe that Modi is committed to further structural reforms and fiscal discipline,** anchoring a strong growth outlook, and a positive re-set in market expectations/multiples in the lead-up to the next General Elections.
- **We believe that current valuations do not reflect the potential upside from a multi-year growth cycle** on the back of industrialization, urbanization, consolidation, financial intermediation, digitization of the real economy, enhanced agricultural productivity, and growth in rural incomes and discretionary spending.
- We have strong **conviction in our portfolio delivering on earnings and cash flows compounding at 15%+ annually over the next three years.**

Again, all our very best to you and your families, for a successful 2018!

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
Titan Co Ltd	Financials:	29%	Financials:	+1.08%
Natco Pharma Ltd	Consumer Discretionary:	18%	Consumer Discretionary:	+0.75%
Vakrangee Ltd	Materials:	10%	Materials:	+0.09%
Bajaj Finance Ltd	Consumer Staples:	10%	Consumer Staples:	+0.64%
Zee Entertainment	Health Care:	10%	Health Care:	-0.14%
	Industrials:	8%	Industrials:	+0.30%
	Retail:	5%	Retail:	+0.84%
	Real Estate:	5%	Real Estate:	+0.03%
	Energy:	3%	Energy:	+0.58%
	Utilities:	2%	Utilities:	+0.04%