

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 up +8.34% in January, erasing much of the angst from the sell-down in November and December last year; yes, corporate India seems to have absorbed demonetization rather well; yes, the budget delivered on discipline, a commitment to jump-start the rural economy, investments, and consumption, and to simplify the tax structure; and yes, opportunistic shorts that were loaded-on towards year-end anticipating a protracted demonetization-related slowdown, have been forced to cover positions.

It's been a breathless start to the year, highlighted by the Executive Pronouncements out of the White House. Trying to remain dispassionately focused on just the implications for the markets, we would make the following points:

- *Up to this point, most of our investment careers have celebrated the benefits and beneficiaries of globalization, and the margin uplift from global supply chains.*
- Given the increasingly isolationist and protectionist rhetoric globally, *it is probably fair to say that the pendulum on globalization is now definitively swinging the 'other' way.*
 - That said, *globalization is NOT dead; Executive Fiat cannot arbitrarily force the well-entrenched global supply chains to relocate – especially if the local labor force lacks the pre-requisite skills.*
 - However, *global manufacturing and distribution margins will likely be under pressure as tariff/non-tariff barriers (and of course, retaliatory measures) are hastily cobbled together. Yes, expectations on margins and stock price multiples will need to be re-set; but, not necessarily, catastrophically so.*
- *Of greater concern is the element of randomness that will likely characterize geo-politics and multi-national/bi-lateral agreements for a period of time.* There is a vacuum in the global world order as radical(ized) domestic agendas (re)establish the rules of engagement; beware the elevated risks of regional conflicts and military stand-offs.
- *Importantly too, global capital markets will likely be forced to take a view on reflation and the correlation between US\$ strength AND the timing/extent of US\$ interest rates trending higher.* There is an inherent conflict between the White House's 'views' on the US\$ being 'over-valued,' and the promise of debt-funded infrastructure spending, job-creation, and trending inflationary expectations arguing for higher US\$ interest rates. *Which algorithm is going to figure that one out??!!*

In the Indian budget announced on February 1, Finance Minister Jaitley was appropriately nuanced, balancing fiscal prudence with a clear growth imperative, with a specific focus on reviving the rural economy and the SME sector, and boosting infrastructure investments and affordable housing.

Performance, in USD

(Inception on September 1, 2015)

	Tantallon India Fund	MSCI India(\$)	Over/Under Full Performance
January 2017:	+8.34%	+4.39%	+3.95%
2017 YTD:	+8.34%	+4.39%	+3.95%
2016:	-5.79%	-2.90%	-2.90%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+2.31%	+0.61%	+1.70%
Compound Returns	+1.62%	Volatility	+23.20%
3 month US T-bill	+0.513%	Sharpe Ratio	0.048

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:
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- **Fiscal consolidation remains the key focus:** the government's revenue targets are achievable, and despite intentionally boosting social spending and the rural employment guarantee program, the budget resists the impulse to be populist.
 - *With the government committed to not crowding-out the private sector, inflation data remaining benign, and the influx of deposits into the banking system, we continue to expect domestic borrowing costs to trend lower – in the face of rising US bond yields.*
- **Most transformational (and unexpected!): the proposal to abolish the FIPB,** the Foreign Investment Promotion Board, while setting up a transparent, (semi) automatic mechanism to approve foreign investments into the country.
- **Market participants were also positively surprised by the government choosing to refrain from 'changing the rules' on taxation on long-term equity capital gains for both domestic as well as Foreign Portfolio Investors** (going a long way towards moderating the disappointment that corporate tax rates were not reduced across the board!).
- *On the specifics, we would highlight:*

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+2.31%												
2017	+8.34%	+8.34%											
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%

- The **focus on government driven capital expenditure and infrastructure spending: +10% to US\$58bn**, with significant new investments in railways, roads, waterways and other transport infrastructure.
- **Specific measures to encourage accelerated non-performing loan recognition** (and in particular, confronting 'willful' defaulters), the **cut in SME tax rates** (improving SME cash flows and boosting employment), and measures to rein-in unorganized deposit-taking institutions, will be quite positive for the banking sector.
- The **specific measures to boost the digitalization of the payments infrastructure** (no cash payments over US\$4,500, doubling the POS terminals for card payments to 3m units in the next 12 months, and empowering the RBI to regulate the fees charged on digital transactions) will provide a structural boost to tax compliance.

All eyes now on the specifics and the modalities of GST implementation over the next 12 months!

Half way through the 3Q reporting season, we would make the following observations:

- *Simplistically, top-down, in the immediate aftermath of demonetization (November, December 2016), we saw consensus market earnings expectations for FY2017 being cut by about -7%; six weeks later, half way through earning season, consensus earnings has actually seen a +2% increase - so much for consensus!*
- The high frequency data that we have studied closely would suggest that economic activity post-demonetization is trending better than initially feared, while manufacturing PMI data and management commentary for the financials, staples, autos, cement, and durables would suggest that *demand conditions are 'normalizing.'*
- *The 'drag' from demonetization was highest in the rural and northern parts of the country where penetration of bank networks is lower, and where the cash economy is the most prevalent. In contrast, the demand re-set and consumption revival was most visible in the urban and southern parts of the country where financial inclusion is the highest.*
- *The key negative to reflect on is the moderation of the margin uplift we have enjoyed over the last seven quarters given rising commodity and input costs, and higher fuel and transportation costs.*

The stock we wanted to highlight this month is Thomas Cook India (TCIL), a holding company acquired from Thomas Cook Group (UK) by Canada's Fairfax Financial Holdings in 2012, with three stand-alone business verticals: financial services, Human Resources/staffing, and travel/holiday resorts. *No question, this is an a-typical investment for us, with limited synergies across the three verticals; however, we are enthused by the distinct growth prospects of the three verticals, and a deeply discounted sum-of-the-parts valuation framework that would suggest significant valuation upside over the next 3-4 years.*

The key growth driver is the controlling stake in Qess Corp, India's largest Human Resources/staffing/facilities management company.

- Conservatively, given a market in its very infancy, we are projecting Qess' revenues to triple over the next five years to US\$2bn, under-

pinned by the burgeoning demand for temporary staffing, and integrated facilities management in e-commerce, telecom, retail, financial services, warehousing, and healthcare sectors.

- The key constraint is in ensuring discipline in systems and processes, given the pace of the scale-up, and the acquisitions made over the last five years.
- The under-appreciated opportunity is in improved pricing, scale economies, and turning-around loss-making acquisitions: the market is currently projecting EBITDA margins to improve by 70bp over the next three years; our conviction is that the margin uplift could be closer to 200bp.

We are similarly convinced of the substantial margin expansion potential in the travel/forex/holiday resorts business: we expect earnings for the travel division to double over the next two years.

- The Kuoni acquisition has significantly moderated destructive industry pricing dynamics.
- A substantial cost rationalization initiative is in its final stages of implementation.
- The resort renovations at several Sterling properties are complete, and occupancy levels are now poised to surprise on the upside.

We expect consolidated revenues to compound at close to 45% annually over the next three years, and for profits to go up 3x.

- GST implementation could see a very substantial *additional* boost to earnings given the current effective tax rate of 33%.
- A net cash balance sheet will be bolstered by extremely strong FCF generation suggesting significant upside to the current 10% payout ratio.
- Management is clearly aware too, of the deeply discounted valuation framework.

In conclusion, we would reiterate our conviction to deliberately increase exposure to Indian equities.

Staying focused on the long runway ahead of us in India, our portfolio is significantly differentiated relative to headline benchmarks; we remain overweight financials, industrials, building materials, healthcare, and consumer discretionary, while having limited/no exposure to IT Services, energy, and telecommunications.

- Modi's government remains reassuringly committed to a path of **intentional structural reform and to addressing chronic corruption.**
- **In a growth challenged world, we are excited about the sustained growth and earnings uplift in our portfolio, with earnings compounding at a 15%+ CAGR;**
- **Structurally falling domestic borrowing costs will boost infrastructure spending and domestic consumption; and will be supportive of stock price multiples.**

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:	4%	Agriculture:	+0.14%
Bajaj Finance Ltd	Autos:	4%	Autos:	+0.23%
HDFC Bank Ltd - ADR	Building Materials:	13%	Building Materials:	+0.97%
Kotak Mahindra Bank Ltd	Consumer Discretionary:	15%	Consumer Discretionary:	+1.26%
Zee Entertainment Enterprise	Financials:	32%	Financials:	+2.89%
	Industrials:	11%	Industrials:	+1.15%
	Infra Backbone:	3%	Infra Backbone:	+0.18%
	IT Services:	0%	IT Services:	0.00%
	Logistics:	3%	Logistics:	0.00%
	Pharmaceuticals	10%	Pharmaceuticals:	+1.14%
	Retail	4%	Retail:	+0.37%