

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 flat (+0.23%) in June (+5.5% for the quarter), after expenses. The volatility over this past month is certainly reminiscent of the 'taper tantrum' from 4 years ago, as hypersensitive markets look to (re)calibrate the Fed's, the ECB's, and the Bank of England's respectively muddled messages on 'normalization' and an exit from prolonged monetary accommodation. We would also make the point that the significantly heightened volatility would suggest that the markets seem to be poorly positioned for 1) the extent of the Chinese crack-down on on-shore liquidity and leverage, 2) the forced unwinding of the long technology/short energy trade, and 3) Central Bankers who seem to be signaling an intent to look-through 'transitory' declines in key inflation measures given their concerns on tight labor markets and elevated asset prices.

Our simple message stays on point: amidst the volatility, intentionally look for opportunities to increase exposure to Indian equities: *Modi's pro-reform/anti-corruption/pro-growth agenda is transformational; the investment thematic driving infrastructure development, job creation, rising disposable incomes, mass housing, discretionary consumption, and the digitalization of the real economy, are durable, and provide us an opportunity to invest in genuinely idiosyncratic growth.*

To be absolutely clear, we are not anticipating a market 'meltdown' in India. But, we do want to make sure we are addressing the concerns that we have heard being articulated over the last few weeks - *and, yes, almost exactly twenty years after the handover in Hong Kong, AND the devaluation of the Thai baht that triggered the Asian crisis (does anyone remember 'that' crisis anymore??!!), it does seem appropriate to address the potential near-term headwinds:*

- **India cannot completely decouple from global capital flows.** Geo-political risks, investors (over) reacting to central bankers trying to reframe their stance on monetary accommodation, forced unwinding of leveraged momentum trades, the (unintended) consequences of 'negotiated' common market dislocations, embedded China uncertainty, and populist protectionism will create periodic over-hangs over global growth, and global equity risk appetite, and by extension, on flows and market sentiment in India.
 - *Our conviction is that as India's growth cycle reasserts itself (after eight years of pain), and with structurally lower bank fixed deposit rates, **domestic equity risk appetite, and sustained flows into domestic equity mutual funds, will put a strong, sustained bid under Indian equities.***

Performance, in USD

(Inception on September 1, 2015)

	Tantallon India Fund	MSCI India(\$)	Over/Under Full Performance
June 2017:	+0.23%	-1.00%	+1.23%
2017 YTD:	+32.64%	+19.80%	+12.84%
2016:	-5.79%	-2.90%	-2.89%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+25.26%	+15.46%	+9.80%
Compound Returns	+13.07%	Volatility	+21.85%
3 month US T-bill	+1.01%	Sharpe Ratio	0.55

FUND DETAILS

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)

- **Does persistent oil price weakness portend contagion risk?**
 - Yes, India is actually a significant beneficiary of lower energy prices!
 - We would make the case that the **weakness in energy equities and energy high yield has not spread to Industrials, Materials, Financials, or to Emerging Markets!**
 - **Importantly too, we are encouraged by recovering economic activity in China, signs of a sustained recovery in global trade, and the positive implications for emerging market currencies and commodity economies generally, from a weaker US\$.**
- **GST implementation will be disruptive to reported earnings over the next two quarters.** India's GST moment (at midnight, on July 1, 2017) is transformational, and is arguably the most significant reform measure in the past 25 years, broadening the tax-base, and catalyzing the continued shift to the organized sector, and the opportunity to rationalize both the tax and the cost base.

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+25.26%												
2017	+32.64%	+8.34%	+8.73%	+6.73%	+6.54%	-1.20%	+0.23%						
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%

- Given the inevitable inventory and working capital adjustments, and the investments required to ramp-up systems and processes, **we do expect noisy earnings comps – and are poised to take advantage of any meaningful market corrections.**
- **Job losses in the Indian IT Services sector will likely continue to weigh on consumer sentiment and headlines over the next 2-3 quarters.**
 - We believe that the rural recovery will more than off-set any weakness from the IT sector lay-offs.
 - We also believe that IT outsourcing to India is just as relevant to global companies as it ever was, and that the broad sectoral adjustments underway provide us a **window to identify and invest, at very attractive valuations, in niche specialization, and/or a unique set of customer relationships, that will allow for an effective and speedy re-set on volume growth, pricing, and margins.**
- **In the near term, the banking system is probably constrained in its ability to support rapid credit expansion and a strong capex-driven recovery** thanks to the Reserve Bank of India enforcing the recognition of, and the adequate provisioning against, legacy non performing loans.
 - Despite the short-term pain, the government and the RBI is consciously ensuring that the banking system is adequately recapitalized, and a proper credit culture installed – exactly what needs to happen to avoid a lingering malaise.
 - **We are particularly encouraged by domestic M&A, and the visible green shoots in investments in telecoms, infrastructure, housing, industrials, financials, and renewable energy, reflecting both government incentives, as well rising utilization levels.**
- The **Indian rupee has appreciated** against the US\$ and most other EM currencies (on the back of the RBI's commitment to deliver on its inflation targets, a sharply narrowing current account deficit, and sustained capital inflows into both fixed income and equity markets), creating a headwind for IT/Pharma/Export sectors.
 - Given inflation differentials and the messaging from central bankers looking to 'normalize' monetary policy globally, our contention is that rupee strength has probably run its course.

The stock we wanted to highlight this month is **Housing Development Finance Corporation (HDFC)**, India's largest mortgage finance company. Despite its size, we believe that **HDFC is the best positioned financial institution to take advantage of the extraordinary opportunity in affordable housing catalyzed by the government's explicit tax incentives to affordable housing projects, and the upfront government subsidies being made available to salaried, first-time house buyers.** HDFC boasts a truly enviable 25 year+ track-record in terms of sustained loans growth, a deeply embedded credit culture and capital allocation discipline, and an operational efficiency/cost advantage that more than off-sets the funding

Portfolio Overview

Top 5 Positions	Sectoral Break-down:	As % NAV	Sector Performance	MTD Performance
Natco Pharma Ltd	Consumer Discretionary:	18%	Consumer Discretionary:	+0.10%
Bajaj Finance Ltd	Consumer Staples:	3%	Consumer Staples:	-0.05%
Kotak Mahindra Bank Ltd	Energy:	3%	Energy:	-0.42%
HDFC Bank Ltd - ADR	Financials:	28%	Financials:	+0.53%
Vakrangee Ltd	Health Care:	13%	Health Care:	+0.57%
	Industrials:	14%	Industrials:	-0.64%
	Materials:	14%	Materials:	-0.56%
	Retail:	5%	Retail:	+0.61%
	Utilities:	2%	Utilities:	+0.10%

cost edge enjoyed by the highest quality deposit-taking banks.

We expect HDFC to compound its loan book at a 25% CAGR over the next three years (versus consensus estimates modeling a much more modest 15% run-rate).

- Given the brand, the branch network, the strong credit culture, and the sustained investments in distribution, processes, and technology, we believe that HDFC is primed to significantly scale its presence in the affordable housing segment, and to systematically take market share from the capital constrained public sector banks.
- Additionally, thanks to their decades old relationship with developers across the country, we believe that HDFC is uniquely positioned to grow substantially ahead of the peer group by offering finance to credible, affordable housing development projects.

We expect earnings to compound in excess of 25% annually over the next 3 years, for ROA (return on assets) to track in a 2.5%-2.6% band (versus consensus estimates looking for ROA to compress), and for ROE (return on equity) to trend towards 22%+ (versus market consensus looking for ROE to plateau around 20%):

- With a Tier 1 ratio of 12%, total CAR of 15%, HDFC is sufficiently well-capitalized to support the next 3 years of aggressive loans growth.
- Given our expectations of HDFC's funding costs falling faster than lending rates, we expect net interest margins to actually expand by 20bp (as opposed to the market projecting competitive pricing pressure).
- We expect scale benefits to translate into the cost-income ratio falling by another 50bp, even as credit costs trend in-line with its historical average of about 20bp.
- The opportunity to monetize its highly profitable holdings in insurance and asset management via dividends and a potential IPO will be an additional boost.

To conclude:

- Despite bouts of headline volatility, the continued **strong inflows into domestic equity funds** (anticipating a revival in industrial investments, discretionary spending, and domestic demand) are visibly supportive of market valuation multiples.
- Domestic M&A in telecoms, infrastructure, cement, property, light industrials, and financial services would make a clear case for **sector consolidation and pricing discipline, improving utilization rates, and strong operating leverage.**
- Looking through the short-term GST-implantation related drag on corporate earnings, **we retain strong (well-differentiated) conviction in our concentrated holdings in financials, industrials, healthcare, building materials, and consumer discretionary stocks, and in their ability to idiosyncratically grow markets/market share/earnings.**

Please do let us know if you would like a follow-up conversation, or a catch-up in the next few days.