TANTALLON CAPITAL

March 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
March 2017:	+6.73%	+5.86%	+0.87%
2017 YTD:	+25.73%	+16.97%	+8.76%
2016:	-5.79%	-2.90%	-2.89%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+18.72%	+12.73%	+5.99%

Compound Returns	+11.45%	Volatility	+23.04%
3 month US T-bill	+0.752%	Sharpe Ratio	0.464

FUND DETAILS

The Tantallon India Fund

AUM USD 20,000,000

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)

The Tantallon India Fund closed up +6.73% in March, closing the quarter up +25.73% after expenses; US$8.9bn in foreign fund inflows in March into Indian equity and debt markets marked a fifteen year high, *exceeding total foreign inflows for all of calendar 2016,* as investors start to internalize both a positive re-set on earnings expectations *and* real legislative/reform momentum after the BJP's stunning victory in the state elections in UP.

This has been an extraordinary quarter in the markets: reflation trades in the US, Japan, and Europe; multi-billion dollar hostile bids for 100 year old brands; jet-fueled Chinese recovery stories; the 'hope' of production discipline triggering significant energy and commodity stock price moves off the lows; significant asset allocation driven flows into Emerging Markets suggesting some mean reversion after years of serial underperformance; a sharp reversal of the panic selling in India at the end of last year; and even signs of complacency on US Treasuries!

In India specifically, what could play spoil-sport in the short term?

- A bad monsoon triggering concerns on rural incomes, potential short-term earnings dislocations/adjustments as corporate India goes through a GST-reset, fickle ETF flows reacting to negative headlines on geo-politics, trade conflicts, and/or military confrontations.

We would urge you to look through those moments of potential volatility, and to intentionally look for opportunities to increase exposure to Indian equities:

- We retain strong conviction in ***Modi's reform agenda,*** clear legislative mandate, and focus on delivery.
- We expect ***strong policy momentum*** to drive several years of infrastructure build-out, risk-capital deployment, industrialization, job-creation, urbanization, rising rural incomes and improving living standards, and sustained consumption growth – ***the market seems poised to break-out.***
- ***We believe our portfolio holdings are well-positioned to grow markets/market share, under-pinned by the infrastructure build-out nationally, the digitalization of the real economy and growing financial intermediation, rising rural incomes, the focus on mass housing, and strong consumption growth.***

Aggregating feedback across the market cap spectrum, and from an eclectic mix of bankers, brokers, domestic political analysts, and domestic institutional and high net worth investors, we would share the following:

- The ***recovery in domestic SME activity is gathering momentum,*** and as we look ahead into FY2018, our base case expectations of a robust recovery is 'playing out.'
- With the formal passage of the 4 GST Bills in Parliament, GST is now scheduled for national roll-out on July 1, 2017; ***despite the initial teething problems we expect, GST will accelerate the visible shift from the unorganized to the organized sectors.***
- *In the last 15 months, corporate India has completed US$30bn+ in domestic M&A, with another US$60bn+ awaiting final shareholder approval and regulatory clearances.* ***Indian corporates have recognized a 'turn' in the cycle, and are 'acquiring' (as opposed to 'building') capacity in the industrial, telecom, building materials, and energy sectors.***
- At the same time, ***the domestic capex cycle is reviving on the back of committed government infrastructure spending.*** Given the official project-tendering process that is already underway, *we anticipate US$100bn+ in NEW project awards over the next year in infrastructure, power, defense, railways, roads, and oil and gas.*
- With consumer confidence at a 6 year high, and despite the dark clouds over the IT services sector, *we believe that* ***India is on the cusp of a sustained consumption recovery.***

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	18.72%												
2017	25.73%	+8.34%	+8.73%	+6.73%									
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%

- *The potential overhang is the risk of a poor monsoon season – and the risk that developing El Niño conditions augur poorly for rural output and incomes.*

- ***The RBI's caution on system liquidity, and moving its stance from "accommodative" to "neutral" is warranted,*** reflective of an uncertain outlook on inflation (given the risks of poor monsoons leading to a spike in consumer prices, volatile global energy prices, GST implementation, etc.), and underscoring the RBI's inflation-targeting commitment. ***Good news for the rupee that has actually strengthened by 5%+ y-t-d versus the US$!***
- ***Market multiples are likely to continue to be well supported in the medium-to-long term by domestic investors:***
  - In the financial year ended March 2017, aggregate stock buy-backs (US$4.5bn+) were an astounding 60% of all new equity issuance (US$7.5bn) in the same time period. *We expect that buy-backs and acquisitions will continue at an elevated level relative to the new equity issuance calendar.*
  - Despite averaging close to US$1.5bn/month in domestic retail equity fund inflows over the last year, investments in domestic equities currently constitute less than 4% of total domestic household savings (versus property at 55%, and gold at 12%). *Our working assumption is that in the current cycle, given the relative attractiveness of equities (especially given the government's clamping down on illicit flows into bullion and property), we will likely see equity holdings comfortably exceed the prior equity peak of 5% of total household savings.*

The stock we wanted to highlight this month is *Suzlon,* *India's largest integrated manufacturer of wind turbine generators and turnkey contractor with an installed base of 15GW, and incremental capacity of 3.6GW annually.* The new shareholders have brought great discipline and focus to the business, divesting the ill-conceived international forays, and systematically deleveraging the balance sheet. Today, match-fit, with a new product line-up designed to deliver superior plant load factors (PLF), Suzlon is poised to be the key beneficiary of India's focus on renewable energy (the explicit goal is to add 5GW of renewable energy annually over the next 5 years), and the new policy decision on reverse auctions leading to efficient price discovery rewarding the low cost manufacturer.

We expect consolidated revenues to conservatively compound at 20%+ over the next three years versus market consensus suggesting low teens growth.

- The installed base of 15GW, provides a base-line on annuity O&M revenues.
- The key growth driver is Suzlon's market share gains in wind installation in India (management's guidance of 50% market share of new installations by 2020 seem reasonable given execution record, superior product line-up, and balance sheet constrained competitors), and the upside accruing to incremental annuity O&M revenues.
- The new product line-up (S111-120) with a 40% PLF creates an export opportunity – we are currently building in 400MW of exports annually that is currently not in market consensus.
- The wild card is the 1.5GW hybrid Wind and Solar project that Suzlon has just been commissioned in Rajasthan, designed to boost generation productivity per hectare. If Suzlon is successful in establishing proof of concept, it will be a game-changer for the renewable industry, and a significant competitive edge for Suzlon in new bidding.

We expect profits to compound at a 50%+ annual run-rate over the next three years on the back of product mix improvement, strong operating leverage, and further de-leveraging.

- We believe that management has been quite conservative in guiding for 15% sustainable EBITDA margins (while having delivered 18% EBITDA margins in the most recent quarter).
  - *Consensus estimates are currently building in 10% EBITDA margins on concerns over the lower pricing achieved in the reverse auction bids.*
  - *We are significantly more optimistic than the market on margins – we expect significant operating leverage (as utilization rates ramp up), and that Suzlon's higher PLF product line-up will off-set much of the pricing pressure, and are comfortable projecting sustainable EBITDA margins in the 16%-17% range.*
- Additionally, given the commitment to continue to de-leverage, we expect the market will have to upgrade consensus estimates (currently, 50% of EBITDA goes into debt servicing).

To conclude:

- **Modi's mandate and reform agenda will sustain infrastructure build-out, risk-capital deployment, industrialization, urbanization, rising disposable incomes, and improving standards of living.**
- **We retain strong conviction in a portfolio that is clearly differentiated relative to the benchmarks, significantly weighted 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:	4%	Agriculture:	+0.37%
Bajaj Finance Ltd	Autos:	4%	Autos:	+0.34%
Kotak Mahindra Bank Ltd	Building Materials:	12%	Building Materials:	+0.11%
HDFC Bank Ltd - ADR	Consumer Discretionary:	17%	Consumer Discretionary:	+1.35%
Zee Entertainment Enterprise	Financials:	29%	Financials:	+1.20%
	Industrials:	11%	Industrials:	+0.85%
	Infra Backbone:	4%	Infra Backbone:	+0.55%
	IT Services:	0%	IT Services:	0.00%
	Logistics:	4%	Logistics:	-0.04%
	Retail:	3%	Retail	+0.20%
	Healthcare:	12%	Healthcare:	+0.67%