TANTALLON CAPITAL

May 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
May 2017:	-1.20%	+1.57%	-2.77%
2017 YTD:	+32.33%	+21.01%	+11.32%
2016:	-5.79%	-2.90%	-2.89%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+24.97%	+16.62%	+8.34%

Compound Returns	+13.58%	Volatility	+22.39%
3 month US T-bill	+0.971%	Sharpe Ratio	0.563

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)

The Tantallon India Fund closed down -1.2 % in May, after expenses; *the Fund's relatively sedate performance for the month did mask some significant intra-month volatility as the markets looked to balance, on the one hand, negative headlines on global terrorism, uncertainty over Trump's socio-economic and tax-reform agenda, and uncertainty over the geo-political and economic implications of Brexit and the US withdrawal from the Paris climate accord, against, on the other hand, a perceptible improvement in global equity risk appetite, relief over the outcome of the French Presidential elections, recovering economic activity in China, signs of a sustained recovery in global trade, and the positive implications for emerging market currencies and commodity economies from a potentially weaker US$.*

We are grateful that we have stayed focused on company fundamentals!

Despite the likelihood of intermittent market volatility, we would urge investors to take the long view, and to intentionally look for opportunities to increase exposure to Indian equities:

- ***We expect Modi's pro-reform/anti-corruption agenda will sustain the tailwinds for infrastructure development, job creation, and rising disposable incomes/discretionary consumption.***
- ***We expect Modi's unambiguously pro-growth stance and focus on job creation to translate to strong out-performance for Indian equities, and in particular, for capex-linked sectors and discretionary consumer stocks.***
- ***We have strong conviction in our portfolio holdings, and in their positioning to sustainably and profitably grow markets/market share on the back of the digitalization of the real economy, growing financial intermediation, the policy commitment to mass housing, and sustained consumption growth.***

Having met with over a dozen companies in the last month, and looking beyond short-term, noisy market dynamics, we would make the following points:

- Modi's hard-won electoral mandate has translated to an ***acceleration in policy momentum and government spending,*** and is reflected in ***broad market revenues/earnings growth tracking at a three year high, and nominal GDP growth at a multi-month high.***
- The continued ***strong inflows into domestic equity funds*** would seem to be anticipating a revival in industrial investments, discretionary spending, and domestic demand.
- The price of oil matters – and at sub-$60/barrel, falling government subsidies and positively trending fiscal and current accounts would make the case for a ***stable rupee,*** and for ***sustained government spending in infrastructure, job creation, and social welfare.***
- Domestic M&A in telecoms, infrastructure, cement, property, light industrials, and financial services to acquire (as opposed to building) incremental capacity augurs well for ***sector consolidation and pricing discipline, improving utilization rates, and improving operating leverage.***
- GST implementation will no doubt, be disruptive in the short-term to volumes, working capital requirements, potential inventory write-downs, and reported earnings; longer-term, ***GST implementation will catalyze the continued shift towards the organized sector, and the opportunity to rationalize both the tax and the cost base.***
- On the back of urbanization, improving affordability, and direct government subsidies for low-cost housing, ***we expect domestic housing stock to grow by 8m-9m units annually over the next 5 years, creating 2m new jobs, sustaining 12m tons of***

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+24.97%												
2017	+32.33%	+8.34%	+8.73%	+6.73%	+6.54%	-1.20%							
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%

incremental cement demand annually, and an annual US$100bn mortgage opportunity.

We are not complacent, or oblivious to the inherent risks; we would highlight the following:

- *GST implementation* will be disruptive to domestic supply chains, and potentially painful inventory adjustments could see negative surprises in reported earnings over the next 1-2 quarters.
- *A poor monsoon,* and its negative implications for growth, inflation, and rural incomes/consumption, remains an over-hang.
- We remain wary of the *potential of domestic politics to spring negative surprises* – the Opposition's efforts to field a consensus candidate for Presidential Elections in July, and the alliance implications that it carries for the next General Elections, bears close watching.
- Fickle global capital flows, and the potentially negative impact on *domestic investor risk appetite.*
- A *sharp spike in global commodity prices, and in particular, energy prices,* and the negative implications for inflation, the fiscal/current account deficits, and the rupee.

The stock we wanted to highlight this month is *Cholamandalam Investment and Finance Company (CIFC),* a consumer finance company with a well diversified portfolio spread across commercial vehicles, automobiles, used vehicles, tractors, and property. The post de-monetization re-set is behind us, as is the drag from the slow-down in loans approvals/ disbursement, and an increase in delinquencies. The opportunity in rural / semi-urban communities which are structurally under-banked, is significant, and given management's disciplined track-record, and their focus on profitability and maintaining asset quality, *we expect strong loans growth to translate into 25%+ CAGR in earnings, and 20%+ ROEs over the next three years.*

We expect CIFC to compound its loan book at a 20%+ CAGR over the next three years (versus consensus estimates modeling a more sedate 12%-15% run-rate).

- Over the next 24 months, we expect CIFC to open 300 new branches (on the current base of 700 branches), focusing primarily on Eastern and rural India where they have virtually no presence.
- In addition, GST adoption and the investments in national highway infrastructure, will see a significant rationalization of local logistics networks, and substantial fleet optimization, translating to sustained demand for used and new commercial vehicles.
- Given the investments in distribution and technology, and a number of new products, CIFC is poised to realize market share gains at the expense of local money-lenders and capital constrained public sector banks, and to grow disproportionately on the back of a revival in demand for both new and used construction equipment and commercial vehicles, for agricultural products, and for mortgage products in rural and semi-urban centers.

We expect earnings to compound in excess of 25% annually over the next 3 years, for ROAs (return on assets) to sustainably expand from 2.5% to 3%+ (versus consensus estimates looking for ROAs to remain flat), and for ROE (return on equity) to track in excess of 20% (versus market consensus looking for ROE to plateau around around 17%):

- With Tier 1 Capital Adequacy Ratio of 13.6% and a total CAR of 18%, CIFC is sufficiently well-capitalized to support the next 2-3 years of aggressive loans growth.
- Given the strength of the funding base, and our expectation of a ratings agency upgrade of CIFC's commercial paper and non-convertible debentures, and despite our expectation of a more competitive lending environment for mortgages and for commercial vehicles, we are comfortable projecting net interest margins remaining stable at 8.5%.
- Having already moved to the RBI's new standard on 90 day recognition of delinquent loans, we expect that credits costs have peaked at 1.1%, and over the next three years, expect credit costs to track closer to the historical run-rate of about 70bp.
- We expect a 150bp-200bp improvement in the cost/income ratio (currently at 41%) over the next three years on the back of the investments in the digital platform, and the significant scale benefits as productivity ramps in the new branches.

To conclude, we maintain our strong conviction in Modi's election mandate, and his anti-corruption and structural reforms agenda.

- ➢ *We would continue to highlight India's substantial runway for growth, 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.*
- ➢ *Our portfolio is clearly differentiated relative to the benchmarks, with strong conviction in financials, industrials, healthcare, building materials, and consumer discretionary stocks.*
- ➢ *We expect flows into domestic equity funds and lower borrowing costs 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:	-0.07%
Bajaj Finance Ltd	Autos:	4%	Autos:	+0.29%
Kotak Mahindra Bank Ltd	Building Materials:	12%	Building Materials:	-0.75%
HDFC Bank Ltd - ADR	Consumer Discretionary:	17%	Consumer Discretionary:	-1.10%
Asian Paints Ltd	Financials:	27%	Financials:	+0.41%
	Industrials:	11%	Industrials:	-0.39%
	Infra Backbone:	6%	Infra Backbone:	+0.08%
	IT Services:	0%	IT Services:	0.00%
	Logistics:	4%	Logistics:	+0.27%
	Retail:	4%	Retail	+0.19%
	Healthcare:	12%	Healthcare:	-0.14%