TANTALLON CAPITAL

April 2018

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
April 2018:	+3.20%	+3.95%	-0.75%
2018 YTD:	-7.41%	-3.32%	-4.09%
2017:	+59.14%	+36.84%	+22.30%
2016:	-5.79%	-2.90%	-2.89%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+39.14%	+27.50%	+11.64%

Compound Returns	+13.18%	Volatility	+19.81%
3 month US T-bill	+1.82%	Sharpe Ratio	0.574

FUND DETAILS

The Tantallon India Fund

AUM USD 38,000,000

Investment Advisor: Tantallon Capital

Minimum Investment: USD 1,000,000

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 up +3.20% in April, after expenses.

The headlines remain feverish: from hand-wringing on US$ strength *(or not!)*, to the mind-numbing rhetoric across every conceivable media platform on protectionism, retaliatory tariffs, customs unions, energy prices, non-trade sanctions on corporations/individuals, and potential peace treaties, to the hyper-sensitivity in equity, fixed income and currency markets to data that might *(or not!)* re-enforce views on the 'gradual' tightening of monetary policy globally.

Thankfully, from our perspective, sustained flows into domestic Indian retail equity mutual funds continue to be validated by a very strong earnings season, and in particular, for our portfolio holdings. **We are most "differentiated" from the more cautious market commentaries that are making the rounds in our explicit view on the Indian earnings cycle having decisively inflected.**

Continuing to meet with companies across sectors, and across the market cap spectrum, looking to test/re-validate our assumptions on volume growth, pricing, and margins, we would like to highlight the following:

- Services, private sector financials, cement, steel, passenger and commercial vehicles, tourism, infrastructure, specialty chemicals, logistics, renewables, agriculture, and niche IT Services are seeing strong sequential growth, a sustained recovery in demand, and resilience in pricing/margins.
- Production capacities are stretched, and as utilization rates rise, we believe we are on the cusp of a new, extended investment cycle.
- Domestic consumption and tourism trends are particularly robust, highlighted by the upcoming school holiday travel advance bookings, and very strong volume guidance from the FMCG companies who have reported thus far.
- The private sector financial services companies have transitioned seamlessly to scalable digital platforms, and continue to take market share away from the capital constrained, legacy public sector banks.
- *Potential points of stress: (i) noisy politics and regional elections might make Modi more populist in the lead-up to the national elections (he has been remarkably disciplined thus far); (ii) high crude price impacting the current and fiscal deficits, raising the risks of higher interest rates; (iii) new job creation is still lagging (12m new jobs created over the last 12 months versus 21m kids having just turned 20 this past year).*

Our primary concern at this point is that global energy prices have spiked, reflecting the market's unease with politics/military conflict in the Middle East and Latin America, and the risk of potential supply-side disruptions exaggerating the OPEC production 'discipline.' Our baseline working assumptions incorporated $70/barrel oil as the outlier risk for the markets. A further US$10/barrel increase in crude oil prices to US$80/barrel, would potentially:

- Reduce the GDP run-rate by 10bp relative to our assumptions of GDP growth averaging 7.5% over the next three years.
- Increase the fiscal deficit by 0.1% of GDP relative to our expectations of a fiscal deficit averaging 3% of GDP.
- Increase the current account deficit by 0.75% of GDP relative to our expectations of a current account deficit averaging 2.1% of GDP.

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+39.14%												
2018	-7.41%	-1.87%	-7.58%	-1.07%	+3.20%								
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%

- Boost inflationary expectations beyond the RBI's comfort level of about 4%.

Assuming US$70+/barrel oil:

- *With 10 year US treasuries having breached the 3% mark, underpinning a view on continued US$ strength, and with the current account and inflationary expectations potentially widening beyond the RBI's comfort threshold, we should expect the RBI to bring forward its rate hike cycle: potentially, a 25bp hike in the repo rate to 6.25% in June, and cumulatively, +75bp over the next 24 months as growth accelerates.*
- *The rupee has depreciated by 4.5% y-t-d to Rs.67/US$; we should expect the rupee to trade in a Rs.65-Rs.70/US$ band over the next 12 months.*

We are more sanguine than the market talking heads vis-à-vis Modi being challenged to retain his majority in the next General Elections (that need to be held by May 2019).

- *The lesson from the elections/referendums globally over the last two years would suggest that projecting election outcomes is a mug's game – and especially so, in an election where we could see potentially as many as 100 million (this is not a typo!) first-time voters exercising their prerogative at the polls!*
- That said, Modi has delivered a lot in the last four years, and our expectation is that his focus on anti-corruption, structural reforms, and fiscal discipline will be rewarded at the polls with a comfortable Parliamentary majority, enabling him to press ahead with structural reforms, helping catalyze a sustained investment cycle.

A final point on the Reserve Bank of India enforcing discipline in the due recognition of, and provisioning for non-performing loans.

- It does mean that the public sector banks in particular, will be capital constrained, dampening the velocity of money through the system, and raising the cost of capital.
  - *Having watched the Chinese obfuscate with their non-performing loans for decades, we are convinced that the RBI and Modi are doing the 'right' thing, to prevent the issue festering, and creating a systemic issue several years down the road.*
- Nevertheless, we remain confident that India will deliver on GDP compounding at 7%+ over the next 5 years, and that at the end of the banking 'clean-up,' will reap the benefits of a healthy banking system.

The stock we would like to highlight this month is ***Amber Enterprises,*** an air conditioning original equipment and design manufacturer, supplying both completely built-up air conditioning units, as well as compressor units and spare parts to India's top 10 branded air conditioning companies. The extent of Amber's backward integration, and the capital intensity required by the new energy efficient technologies, is a significant barrier to entry for new competitors.
Given its brand neutral strategy, strong technical know-how, scale and sourcing capabilities, and on the back of the new capacity commissioned, Amber is well-poised to grow its current 60% market share in outsourced air conditioner manufacturing in India without having to compromise its margins.

We expect revenues to compound in excess of 25% over the next 3 years on the back of new customers, the introduction of more energy-efficient products, and a ramp-up in capacity utilization at the new plants; *the markets would seem to be building in a much more modest 15% CAGR.*

- Amber's clear, brand agnostic strategy, its multi-location manufacturing footprint, and its rapidly improving design capabilities, makes it the partner of choice for the branded air conditioner companies.
  - Over the next 5 years, our expectation is that air conditioning penetration in India will more than double from the current level of 4%.
  - Given the advantages of scale and technology accruing to very large manufacturing units, the benefits of GST, and importantly, rapidly rising costs in China, the branded air conditioner companies are increasingly opting for domestic Indian outsourcing (as opposed to setting up manufacturing facilities of their own, or relying on imports from China).
- Improving wallet share with existing clients with brand adjacency revenue opportunities (from outsourced manufacturing of washing machines, ovens, microwave ovens, etc.) representing a significant new growth driver.

We expect profits to compound in excess of 75% over the next 3 years, with ROE/ROCEs nearly tripling to 30; *the markets would seem to be building in a more subdued 30% CAGR in consolidated profits.*

- The improvement in profitability is driven primarily by volume growth, significant mix improvement, and strong operating leverage as capacity utilization ramp-up.
- Amber's size and scale allows it significant bargaining power with its suppliers, allowing for significant cost savings that are shared with the branded companies.
- Currently in pilot mode, Amber is starting to provide after-sales servicing and support for their branded clients; it is early days, but, our sense is that we are likely to be surprised positively as the very high margin after-sales parts and service business scales up.

To conclude: We would urge investors to continue to look for opportunities amidst the volatility in global capital markets to build exposure to Indian equities.

- **We believe that the real economy (underpinned by rural India, and domestic services and industry) is poised to deliver GDP growth compounding at a 7%+ run-rate over the next three years.**
- We have strong **conviction in our portfolio delivering on earnings and cash flows compounding at 15%+ annually over the next three years.**
- **Current valuations are compelling given our benign outlook on inflation/interest rates, the potential upside from a multi-year investment cycle, and the long runway opportunities** in industrialization, urbanization, consolidation, financial intermediation, digitization of the real economy, enhanced agricultural productivity, and growth in rural incomes and discretionary spending.

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:	32%	Financials:	+2.09%
Kotak Mahindra Bank Ltd	Consumer Discretionary:	16%	Consumer Discretionary:	+0.37%
Bajaj Finance Ltd	Materials:	12%	Materials:	+0.64%
HDFC Bank Ltd ADR	Industrials:	8%	Industrials:	+0.17%
Kolte-Patil Developers Ltd	Consumer Staples:	8%	Consumer Staples:	+0.25%
	Health Care:	6%	Health Care:	+0.19%
	Technology:	6%	Technology:	+0.27%
	Real Estate:	5%	Real Estate:	+0.26%
	Energy:	3%	Energy:	+0.23%
	Utilities:	3%	Utilities:	+0.02%
	Retail:	1%	Retail	-1.28%