

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.

At the outset, Happy New Year! *All our very best for a Peaceful, Healthy, Joyous 2019!*

The Tantallon India Fund closed +0.46% in December, a quiet close in the face of substantial market volatility, affirming the underlying strength in Indian business fundamentals, nudging investors to take the long view as lower crude prices and attractive valuations allow for a re-set in the risk/reward equilibrium in Indian equities.

We would simply re-affirm our conviction in India's secular fundamentals: *high frequency economic data continue to confirm the strength in domestic demand and a nascent capex cycle; we continue to be impressed by transparent policy making, credible inflation-targeting monetary policy, and fiscal restraint despite the obvious temptations to loosen the purse strings significantly in the lead-up to the elections; and we remain encouraged by sustained domestic investor equity flows in the face of foreign institutional selling pressure.*

- The market's concerns are centered around (1) **the direction of crude prices** (and the implications for the current/fiscal deficit and the rupee), and (2) **the outcome of the next General Elections** (which need to be held by May 2019) and whether Modi retains a Parliamentary majority.
- In contrast, buoyed by crude prices around \$60/barrel and sustained demand, **the Indian business community is building intentionally towards a new capex cycle** (evidenced by credit growth tracking in the +15% range) as industry capacity utilization rates nudge over 75%.

General Election Year Rally: Will mid and small cap stocks surge again?

- **The last 12 months have been particularly painful for our portfolio's small and mid-cap tilt**, as higher crude prices and the fear of significantly tighter monetary policy to contain inflationary expectations and to support the rupee, triggered a bout of extreme risk aversion towards the small and mid-cap universe.
 - *While the top 10 stocks by market capitalization saw a median correction of about 12% from their 52-week highs, the sharpest correction was in the small and mid-cap space, where the median correction was in excess of 40%.*
- **Historically, in the 12 months following the General Elections, small and mid cap stocks have significantly outperformed the positive returns from the broad market.**

Performance, in USD

(Inception on September 1, 2015)

	Tantallon India Fund	MSCI India(\$)	Over/Under Full Performance
December 2018:	+0.46 %	-0.28%	+0.74%
2018 YTD:	-22.79%	-8.63%	-14.16%
2017:	+59.14%	+36.84%	+22.30%
2016:	-5.79%	-2.90%	-2.89%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+16.03%	+20.50%	-4.47%
Compound Returns	+4.56%	Volatility	+20.39%
3 month US T-bill	+2.45%	Sharpe Ratio	+0.103

FUND DETAILS

The Tantallon India Fund

AUM USD 32,000,000

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)

- In 2004, 2009, and 2014, in the 12 months following the General Elections, the NIFTY (i.e., the top 50 stocks by market capitalization) posted returns of + 39%, +20%, and +19% respectively.
- **In comparison, in the 12 months following the elections in 2004, 2009, and 2014, the Mid-Cap universe delivered returns of +61%, +68%, and +40% respectively.**

Identifying the key thematics driving our stock selection:

- The strong (i.e., strong brands, strong balance sheets, and effective distribution channels) are getting stronger, while the poorly capitalized, and the unorganized sectors are being marginalized – thanks to the implementation of GST, the government's efforts to reduce the size of the cash economy, financial intermediation, digitization, and significant sector consolidation.
- The upcoming General Elections will hone the focus on the rural economy, job creation, discretionary consumption, universal healthcare, and mass housing.
- Rising industrial capex as industry utilization rates surpass 75%.

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+16.03%												
2018	-22.79%	-1.87%	-7.58%	-1.07%	+3.20%	-4.66%	-5.58%	+1.29%	-2.30%	-12.87%	-2.31%	+9.47%	+0.46%
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%

- Lower crude prices will allow for lower inflationary expectations, a more stable rupee, and for the Reserve Bank of India to ease system-wide liquidity.
- Domestic equity flows to sustain market multiples and valuations for companies that actually deliver on sustained earnings and cash flow growth.

Elsewhere (!), a snap-shot of the external variables that are likely to impacts markets / sentiment over the next few months:

- **Crude prices do keep us on an edge.** The Saudi and the Russian budget deficits would look a lot 'healthier' with crude at US\$80/barrel. Conversely, from an India perspective, a 10% fall in crude prices shaves 20bp off headline inflation, while a \$10/barrel correction in crude prices narrows the current account deficit by 0.5% of GDP.
 - *With crude prices under \$70/barrel, fair value for the rupee on a real effective exchange rate basis is in the Rs.68-Rs.70/US\$ range – for reference, the rupee traded as low as Rs.74.39 when crude surpassed US\$80/ barrel.*
- **Whither the US\$?** A dysfunctional administration, Congressional gridlock, real estate prices starting to roll over, and Powell seemingly re-setting expectations on 'neutral' policy rates would point towards a weaker US\$. *Potentially, very good news for non-US assets, and EM in particular.*
- **The trade wild card remains an overhang.** Even prior to Apple's 'shock' announcement, it was clear that the increasingly blurred fault lines between genuine national security concerns, IP theft/transfer, protectionism, industrial subsidies, and commerce, would weigh heavily on growth/earnings outlooks. *Perhaps, the sharp volatility in stock markets have an impact where, hitherto, 'grown-up' advice has been ignored.*
- **China will demand its share of the headlines.** There is growing recognition by Chinese policy makers that the measures to 'de-leverage' and to 're-balance' the Chinese economy away from debt-funded manufacturing have seen the economy slow significantly, exacerbating the pressure points being brought to bear by US tariff action/proposals. *Given Xi's focus on maintaining political stability domestically, we should expect (i) fiscal and credit stimulus measures to buffer the domestic economy; (ii) further reductions in the banks' required reserve requirements; and (iii) unfortunately, more rhetoric along the lines of Xi's recent exhortation to maintain 'combat preparedness' for conflict in the South China Sea.*

The stock we would like to highlight this month is **Zee Entertainment Limited**, India's largest media company with a vast library of original, multi-lingual television serial and movie content, a genuinely pan-India distribution footprint, and an enviable brand. The library, the tested and proven content creation capacity, and the domestic distribution platform makes Zee a compelling partner for a global media company looking to invest in the Indian OTT space. Given management's very specific criterion for an incoming strategic investor (technology to facilitate the OTT offering, international content to be bundled with Zee's Hindi and vernacular content, access to global distribution for Zee's content library, and the willingness to invest for the long term), we believe that a strategic investor coming into Zee is a high probability event, and will under-pin valuations given good visibility on revenues/margins/earnings.

We expect consolidated revenues to compound at close to 20% annually over the next 3 years, well ahead of the consensus expectation of revenues compounding at sub-15%.

- We are comfortable projecting advertising revenues compounding at 20%+ annually on the back of sustained GDP growth and . Zee continues to gain viewership share across key regional markets, in addition to being the #1 broadcaster in the largest, most profitable,

Portfolio Overview

Top 5 Positions	Sectoral Break-down:	As % NAV	Sector Performance	MTD Performance
Bajaj Finance Ltd	Financials:	38%	Financials:	+0.28%
Kotak Mahindra Bank Ltd	Consumer Discretionary:	18%	Consumer Discretionary:	-0.20%
HDFC Bank Ltd	Materials:	10%	Materials:	+0.17%
Titan Co Ltd	Consumer Staples:	10%	Consumer Staples:	+0.34%
Zee Entertainment Enterprise	Technology:	7%	Technology:	+0.01%
	Industrials:	6%	Industrials:	+0.25%
	Health Care:	4%	Health Care:	-0.40%
	Real Estate:	4%	Real Estate:	+0.09%
	Energy:	3%	Energy:	-0.09%
	Retail:	0%	Retail:	+0.01%
	Utilities:	0%	Utilities:	+0.00%

The Fund has appointed Hugo Fund Services SA, 6 Cours de Rive, 1204 Geneva, Switzerland, as its Swiss Representative. Banque Heritage SA, 61 Route de Chêne, CH-1208 Geneva, Switzerland is the Swiss Paying Agent. In Switzerland shares shall be distributed exclusively to qualified investors. The fund offering documents, articles of association and audited financial statements can be obtained free of charge from the Representative. The place of performance with respect to shares distributed in or from Switzerland is the registered office of the Representative.

Hindi language General Entertainment segment.

- The recent TRAI Tariff Order enforcing pricing parity across offerings will benefit leading broadcasters like Zee. The continued roll-out of digitization in Tier 2 and Tier 3 cities, coupled with the systematic launch of new regional channels will underpin subscription revenues compounding at 15%+ annually.
- Over the next three years, as global satellite television platforms target the Indian diaspora in South Asia, the Middle East, Europe, and the US, we expect international subscription and advertising revenues to account for close to 10% of consolidated revenues.
- At this point, we are building in no assumptions on the potential opportunity to monetize the content on the OTT platform, Zee 5.

We expect earnings to compound at 20% + annually over the next 3 years, substantially ahead of consensus expectations projecting an earnings CAGR of 12%.

- The revenue upside that we are modeling clearly differentiates us from consensus.
- In addition, given the opportunities for in-content branding/advertising, and the upside that we are modeling for subscription revenues, we expect EBITDA margins to be sustained at around 30% despite the significant new investments in content and the OTT platform, Zee5.
- With ROE and ROCE tracking in excess of 20%, and free cash flows compounding in excess of 30% annually, we expect meaningful improvement from the current dividend payout ratio of 27%.

To conclude:

- Looking back on 2018, we are sorely reminded that our conviction in smaller and medium sized companies was over-whelmed by the market's short-term concerns on higher crude prices and tightening global/domestic liquidity.
- Looking ahead, buoyed by lower crude prices and easing liquidity concerns, fundamentals are starting to re-asset themselves; we would urge investors to take advantage of any uncertainty in the lead-up to the General Elections to increase allocations to Indian equities.
 - In a growth challenged world, particularly given the concerns on a slowdown in both the US and in China, **India's structural reforms and domestic economy stand poised to deliver on sustained real GDP growth compounding at 7%+ annually over the next 3-5 years.**
 - Corporate confidence in sustained volume/revenue growth, and upside inherent in strong operating leverage, drives our conviction on **our portfolio holdings delivering on earnings and cash flows compounding at 15%+ annually over the next three years.**
 - **Valuations have corrected significantly over the last few months, and the risk/reward is compelling** in the long runway opportunities in industrialization, urbanization, consolidation, financial intermediation, digitization of the real economy, enhanced agricultural productivity rural incomes, and in discretionary spending.

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