TANTALLON CAPITAL

February 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
February 2018:	-7.58%	-6.93%	-0.65%
2018 YTD:	-9.31%	-3.67%	-5.64%
2017:	+59.14%	+36.84%	+22.30%
2016:	-5.79%	-2.90%	-2.89%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+36.29%	+27.04%	+9.25%

Compound Returns	+13.18%	Volatility	+20.38%
3 month US T-bill	+1.61%	Sharpe Ratio	0.568

FUND DETAILS

The Tantallon India Fund

AUM USD 36,000,000

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 -7.58% in February, after expenses. Heightened interest rate, currency and equity market volatility (as global central banks signal the normalization of monetary policy) is being exacerbated by a spate of geo-political 'bad news' with a protectionist, anti-globalization, and anti-immigration wave overwhelming the centrists in the US and in Europe. *What does one really worry about?* Trump's bombast, and the looming threat of retaliatory protectionist tariffs, even as the revolving door with senior advisors plays havoc with the market's ability to calibrate the rhetoric? Xi's audacious play for 'all the marbles' in doing away with term limits? A patchy coalition in Germany, the re-militarization of Russia and China, or the worrisome shift to the Eurosceptic right in Italy, even as the simmering Brexit angst seems to be coming to a boil? *As reality TV goes, you simply cannot possibly script the 'headline' chaos…*

India has not been immune to the global sell-off.

- The 'risk-off' is being magnified in the small and mid-cap space with domestic interest rates and risk premiums having backed-up about 100bp in the last six months.
- The financial services stocks in particular, have been sold down following the massive fraud 'discovered' at Punjab National Bank, with the markets extrapolating systemic collateral damage.
- The imposition of a 10% long-term capital gains tax in the February budget has further weighed on domestic investor sentiment.

However, having just returned from 10 days visiting companies in multiple cities, we would actually make the case that the long-term tailwinds are intact, and we would be looking for opportunities in the current sell-off to intentionally increase exposure to Indian equities.

- *Modi's anti-corruption/pro-reform policy platform continues to be validated at the polls (most recently, in the elections in the three North Eastern frontier states), and his commitment to remain fiscally responsible has set the stage for robust economic growth.* **We expect the Indian economy to grow at a 7%+ CAGR over the next 5 years.**
    - *Recent high-frequency data (from commercial vehicle sales and electricity consumption, to banking credit growth, steel and cement output, and capital goods production) would suggest that we are at the start of a strong industrial recovery.*
- It is fact that our meetings were focused on a sub-set of the investment universe that is not in financial distress, and is broadly indifferent to capital markets as a source of funding. **It was positively refreshing to *NOT* be talking with managements about their share prices.**
    - *Without exception, the companies we met were laser focused on the nascent industrial and consumption recovery, the opportunity to grow market share and revenues, articulating a path to margin uplift, and compounding earnings/free cash flows.*
- The earnings season continues to surprise positively, **revalidating our conviction in our portfolio companies being able to deliver on earnings compounding at a 15%+ run-rate over the next three years.**
    - *We would highlight the continued shift from the unorganized sector to the organized, higher utilization rates, visibility on volume/revenue growth,*

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+36.29%												
2018	-9.31%	-1.87%	-7.58%										
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%	+6.37%	+1.66%	-0.74%	-1.69%	-9.26%	-2.83%
2015	+0.24%									-0.14%	+1.36%	-2.09%	+1.14%

sector consolidation and pricing discipline, margin uplift, strong free cash flow generation, and increasingly, the willingness to re-invest into the business.

- **Continued flows into domestic equity mutual funds will remain supportive of multiples** for companies that deliver on sustained earnings/cash flow growth.
    - *Foreign equity investors net sold US$1.9bn in February; in contrast, domestic institutions bought US$2.3bn of stock, the 22nd consecutive month of positive flows into domestic equity markets.*

Given the pattern of 'shocking' election outcomes globally, **there is growing anxiety, especially with foreign investors, over the next General Elections in India.**

- Our expectations are for the next General Elections to be held in December 2018.
- *The market is most concerned over a re-invigorated opposition and BJP's regional alliances starting to fray. In contrast, our primary concern is actually the monsoons, and the risk of a bad harvest, which would likely translate to an anti-incumbency bias at the polls.*
- **Our view is that Modi remains in firm control of the narrative, and the electorate continues to respond positively to his focus on job creation, infrastructure development, affordable housing, rural incomes, and education and healthcare** – *most recently evidenced by the stellar showing of the BJP in the recent State elections in Tripura, Nagaland, and Meghalaya.*
    - ***We expect a renewed Parliamentary majority for the BJP that will allow Modi to continue to pursue a path of structural reforms, industrialization, and job creation.***

The stock we would like to highlight this month is ***Finolex Industries,*** an entrepreneur-driven, fully integrated Indian PVC company. Finolex has the highest brand recall in the market, and with 800 dealers and 18,000 touch points across the country, is poised to benefit disproportionately from the growth in both urban and rural housing, as well as rural irrigation projects. We anticipate a substantial re-rating of the stock as the market starts to (re)calibrate the ability to leverage brand and national distribution to deliver on sustained volume growth, and vertical integration, richer mix, and operating leverage to drive profitability.

We expect consolidated revenues to conservatively compound at 20%+ annually over the next 3 years; astonishingly, the market is currently projecting an anaemic 5% CAGR in revenues.

- India's agricultural sector currently consumes 1.2m tons of pipes annually, accounting for close to 70% of total industry demand for plastic pipes. On the back of the government's keen focus on increasing irrigated farmland, we expect a significant kicker to demand across Finolex's pan India distribution network for plastic pipes from the agricultural sector over the next 3-4 years.
- The Finolex JV with Lubrizol now provides a complete suite of home indoor and outdoor PVC/CPVC products. With the smaller pipe manufacturers in the unorganized space having been marginalized by GST, we expect Finolex's national presence, brand recognition, and strong product slate to be one of the most significant beneficiaries of the revival in housing and construction activity across the country.

We expect profits to compound at 25% annually over the next three years versus the market's muted expectations of a 10% CAGR in profits.

- No question, on the back of the brand, product suite, and the distribution network, we are much more comfortable with projecting significant volume/revenue traction relative to the market.
- However, what we are most excited about is the opportunity to drive significant mix-improvement as the higher margin housing fixtures business grows from 30% of consolidated revenues currently, to over half consolidated revenues in the next three years.
- In addition, we expect strong operating leverage as capacity utilization ramps up, and backward integration into PVC resin to drive an additional 150bp of margin uplift over the next three years.

To conclude:

- Modi's strong political mandate and commitment to further structural reforms and fiscal discipline, and the growing evidence of an industrial revival, anchor **our expectation of sustained economic growth, and a positive re-set in market expectations/multiples.**
- Post the recent correction in stock prices, we believe that **current valuations are compelling given 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.
- We have strong **conviction in our portfolio delivering on earnings and cash flows compounding at 15%+ annually over the next three 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
Titan Co Ltd	Financials:	32%	Financials:	-1.23%
Kotak Mahindra Bank Ltd	Consumer Discretionary:	13%	Consumer Discretionary:	-1.09%
Kolte-Patil Developers Ltd	Materials:	13%	Materials:	-0.68%
HDFC Bank Ltd ADR	Industrials:	11%	Industrials:	-0.78%
Bajaj Finance Ltd	Consumer Staples:	9%	Consumer Staples:	+0.05%
	Health Care:	7%	Health Care:	-1.15%
	Real Estate:	5%	Real Estate:	-0.35%
	Utilities:	3%	Utilities:	-0.25%
	Energy:	3%	Energy:	-0.02%
	Technology:	2%	Technology:	-0.07%
	Retail:	2%	Retail	-2.01%