TANTALLON CAPITAL

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
January 2018:	-1.87%	+3.50%	-5.37%
2018 YTD:	-1.87%	+3.50%	-5.37%
2017:	+59.14%	+36.84%	+22.30%
2016:	-5.79%	-2.90%	-2.89%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+47.48%	+36.50%	+10.98%

Compound Returns	+17.44%	Volatility	+19.99%
3 month US T-bill	+1.46%	Sharpe Ratio	0.799

FUND DETAILS

The Tantallon India Fund

AUM USD 37,000,000

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 -1.87% in January, after expenses. Volatility is back, in spades; the potential for significant interest rate, currency and equity market volatility as global central banks 'normalize' monetary policy is being exaggerated by margin calls and the forced unwinding of leveraged, increasingly complex, supposedly uncorrelated, algorithm-driven trading strategies. *In an India-specific context, the imposition of a 10% long-term capital gains tax in the budget, served to further dampen investor sentiment.*

We would urge investors to look for opportunities in the current volatility to intentionally increase their exposure to Indian equities.

- Modi's anti-corruption/pro-reform policy platform, and the demonstrable commitment to remain fiscally responsible, has set the stage for sustained economic growth. ***We expect the Indian economy to grow at a 7%+ CAGR over the next 5 years.***
- The recent earnings season has surprised positively, and has revalidated our ***conviction in our portfolio companies being able to deliver on earnings compounding at a 15%+ run-rate over the next three years.***
- ***We expect continued flows into domestic equity mutual funds to remain supportive of multiples*** for companies that deliver on sustained earnings/cash flow growth.

Some take-always from having just spent the past week in India visiting companies:

- Despite much media/market fretting over the potential erosion to 'Brand Modi,' our sense is that **Modi is in firm control of the narrative, and remains hugely popular in rural and semi-urban India** thanks to visible improvements in infrastructure, rural incomes, housing, and education and heath care delivery.
  - *Our expectations are for the next General Elections to be held in December 2018.*
  - ***We expect a clear, albeit reduced, Parliamentary majority for the BJP that will allow Modi to continue to pursue a path of structural reforms.***
  - *That said, we should also expect that the markets will be volatile as they convert each of the state elections to be held over the next six months into a mini Modi-referendum to try and handicap the outcome of the General Elections.*
- **Modi and Finance Minster Jaitley delivered on a developmental budget – not a populist one. *We are impressed with the explicit commitment to fiscal discipline, and to avoiding election-related public spending excesses that have historically been the norm.***
  - Continued focus on infrastructure development, urbanization, job creation, affordable housing, and improving rural incomes and standards of living.
  - Continued rationalization of subsidies (in contrast to the market's expectations of a slew of election hand-outs).
  - *The choice to refrain from cutting corporate tax rates, and the imposition of a long-term capital gains tax (in-spite of the market's knee-jerk negative reaction) ought not to have been a surprise;* it was well flagged in the lead-up the budget, and allows the exchequer greater flexibility in funding critical infrastructure, education, healthcare, and affordable housing initiatives.
- **Recent high-frequency data would suggest that we are at the start of a sustained industrial recovery** (from electricity

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+47.48%												
2018	-1.87%	-1.87%											
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%

consumption, and demand for steel and cement, to banking sector credit growth, automobile sales, and core industrial production growth).

   - The shift from the unorganized to the organized sectors is driving higher utilization rates, and given the deleveraging we have seen over the last five years, corporate India now seems poised at the start of a new capex cycle.

- **We are particularly encouraged by the underlying quality of the most recent earnings season, and in particular, for our portfolio companies.**
   - The pain of forced inventory adjustments as a result of demonetization and the implementation of GST are in the rear-view mirror.
   - We would flag higher utilization rates, visibility on volume/revenue growth, sector consolidation and pricing discipline, margin uplift, strong free cash flow generation, and increasingly, the willingness to start to re-invest into the business.
- **The risk of sharply higher commodity prices remains the key risk in the medium term – to inflation, the fiscal deficit, the current account, and ultimately, to the RBI having to raise interest rates:**
   - Assuming sub-$75/barrel oil, we expect the RBI to remain on an "extended hold," explicitly supportive of growth and investments.
   - Given the risk of higher energy prices, we are comfortable with our current expectations of the rupee trading closer to Rs.67/US$ over the next 12 months.
- **Structurally lower nominal and real interest rates, and the government's specific measures to target illicit holdings in real estate and bullion, under-pin the structural shift in retail investors' equity allocations/risk appetite.**
   - In 2017, domestic investors committed US$2bn+/month incrementally to domestic equities; despite the sharp increase in volatility, w*e expect that trend to hold.*

The stock we would like to highlight this month is ***Mahindra & Mahindra Financial Services,*** (MMFS), a non-bank finance company with a well-established, differentiated rural presence, and a diversified portfolio spread across vehicle financing, consumer durables, and mortgages. After five years of reconciling falling rural incomes (drought and collapsing agri-commodity prices), and a spike in rural delinquencies, we are now poised at the start of a robust lending cycle.

The industry backdrop is compelling: given the government's specific measures to drive rural employment and incomes. we expect to see sustained demand for agri-inputs and consumer durables, as well as for commercial and utility vehicles.

- A significant increase in irrigated farm land (new canals, drip irrigation), and the new Crop Insurance program, will reduce the vulnerability of rural incomes to the vagaries of the monsoons, allowing for greater predictability in rural household cashflows.
- The improvements in the rural supply chain and payment systems will allow farmers to directly access commercial agri-markets, leading to lower crop rot/theft, structurally lower food price inflation, and importantly, structurally higher farm incomes.
- The government investments into rural infrastructure and construction (roads, rail, canals, reservoirs, housing and schools) will sustain rural non-farm employment and wages.
- Rural India is a significant beneficiary of the 7th pay commission wage adjustments, as rural and semi-urban areas account for nearly 50% of central government employees.

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

- With a Tier 1 equity capital ratio in excess of 16%, MMFS is well-capitalized to sustain its growth plans over the next three years.
- Through the cyclical slowdown over the last five years, MMFS continued to invest in its network, opening 100 new branches/year, doubling its rural branch presence.
- Expanding beyond the legacy M&M tractor and utility vehicle portfolio to support OEM outreach (Toyota, Hyundai, Renault, Nissan, Ford, Volvo) into rural/semi-urban centers, creates a significant new lending opportunity.
- The Mahindra Rural Housing Finance program will be a meaningful new growth driver.

We expect earnings to compound in excess of 25% annually over the next 3 years, for ROA to substantially expand from 1% to 3%+, and for ROE to track in excess of 20% (versus market consensus looking for ROE to peak around 15%).

- MMFS' stable funding base and low cost funds will allow for 8%+ margins to be sustained.
- Scale economics, and the significant investments in technology to ensure real time connectivity across rural India, mobile payments, and reliable data analytics, will translate to the cost/income ratio improving by 100bp annually over the next three years.
- Credit costs have peaked; over the next three years, we expect credit costs to trend below 2%.

To conclude:

- ➢ **Modi is committed to further structural reforms and fiscal discipline,** anchoring a sustained growth outlook, and a positive re-set in market expectations/multiples.
- ➢ **Current valuations do not reflect the potential upside from a multi-year investment cycle,** and the long runway opportunities thanks to 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:	30%	Financials:	+0.92%
Kolte-Patil Developers Ltd	Consumer Discretionary:	14%	Consumer Discretionary:	+0.05%
Natco Pharma Ltd	Industrials:	11%	Industrials:	-0.41%
Kotak Mahindra Bank Ltd	Health Care:	10%	Health Care:	+0.12%
Zee Entertainment	Materials:	10%	Materials:	-0.25%
	Consumer Staples:	8%	Consumer Staples:	-1.38%
	Real Estate:	6%	Real Estate:	-0.07%
	Retail:	4%	Retail:	-0.56%
	Energy:	3%	Energy:	-0.43%
	Technology:	3%	Technology:	+0.13%
	Utilities:	2%	Utilities	+0.01%