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
July 2018:	+1.29%	+6.22%	-4.93%
2018 YTD:	-15.58%	-2.41%	-13.17%
2017:	+59.14%	+36.84%	+22.30%
2016:	-5.79%	-2.90%	-2.89%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+26.87%	+28.71%	-1.84%

Compound Returns	+8.50%	Volatility	+19.52%
3 month US T-bill	+2.02%	Sharpe Ratio	0.332

FUND DETAILS
The Tantallon India Fund

AUM USD 36,000,000

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 +1.29% in July, after expenses. The broad market recovery and the rotation into large cap stocks does mask the continued risk-off in the smaller and medium sized companies. However, the nascent earnings season affirms that the recovery in the real economy is under-way, and as operating leverage kicks-in, revenue growth and margin uplift would appear set to surprise positively to the upside.

The Pros and the Cons:

- **Largely insulated from the risk of damaging trade restrictions and punitive retaliatory tariffs, India's domestic economy is structurally accelerating relative to the rest of the world.** Having just returned from three weeks of company visits, it is clear that corporate confidence is at a multi-year high as real GDP growth sustains at a 7%+ run-rate, as policy making is geared to incentivize risk capital being deployed, as industry utilization rates improve off decade lows, and as top-and-bottom-line growth inflects to the upside.
- **Having front-loaded two rounds of rate hikes in June and in August, the Reserve Bank of India is committed to maintaining its hard-won inflation targeting credentials.** We would specifically point to the recent steepening of the yield curve (which is currently at post-2010 highs), and its historical correlation with positive equity returns.
- **Domestic retails flows into equities have sustained at around US$2.5bn per month creating a good base for the market/valuations** – despite the sustained foreign institutional selling through the first half of the year (foreign institutional ownership in the market is back to 2011 levels).
- **The risk of higher energy prices** and the stress it potentially implies for the current account/fiscal deficit, inflationary expectations/monetary policy, and the currency.
  - *Yes, higher energy prices are inherently inflationary, and a potential drag for the rupee (currently trading down -7% on the year, close to its all-time low), and for Indian equities.That said, Modi's deliberate efforts to cut back energy subsidies, and a stable current/fiscal account, would suggest that we are well positioned to avoid the the damaging boom/bust cycles of the past.*
- **The attendant uncertainties of the upcoming General Elections** *(which need to be held by May 2019),* both in terms of potentially populist policy actions in the near term, as well as whether or not Modi will retain a Parliamentary majority to sustain his reformist agenda.
  - *We are more sanguine than the market pundits on both Modi's commitment to fiscal discipline and ongoing reforms, AND his retaining a Parliamentary majority.*
- **Domestic equity valuations (on consensus estimates) would seem to be at the top of their historical trading range relative to bonds,** suggesting that the market is starting to price in some of the re-set in earnings expectations.
  - *We would reiterate that we are substantially more constructive than consensus on sustained top-line growth, margin uplift, and very strong earnings/cash flow growth.*

The RBI's Monetary Policy Committee raised the repo rate by another 25bp to 6.50%, while explicitly maintaining its neutral stance.

- As we expected, by front-loading successive rate hikes in June and August, the RBI has preserved its inflation-targeting

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+26.87%												
2018	-15.58%	-1.87%	-7.58%	-1.07%	+3.20%	-4.66%	-5.58%	+1.29%					
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%

credentials, while signaling (again) that this is likely to be a shallow tightening cycle.
- Given the underlying (benign) trends on domestic inflation, *our expectation is for the RBI to opt for an extended pause over the next 6-9 months* (to better assess the cumulative impact of geo-political fault lines, potentially higher energy prices and trade tariffs, global supply chain disruptions, and more tepid global growth).
- *Over the course of the next 12 months, our expectations are for another 25-50bp of potential tightening,* responding appropriately to the closing of the output gap, higher utilization rates, and the underlying momentum in the domestic economy.

We are increasingly constructive on the Small and Mid-cap (SMID) Universe. Despite visibly improving fundamentals, there remains the obvious risk of retail 'panic,' and more forced selling in small and mid-cap (SMID) stocks. Given heightened risk aversion broadly, it is also probably unrealistic to expect a quick snap-back in stock prices. However, given fundamentals, the underlying earnings resilience and the visibility on sustained growth, and the correction in valuations, we are actively sharpening our pencils.

- In US$ terms, the SMID indices are down almost 20% year-to-date, well into recession territory, despite having delivered on earnings substantially ahead of market expectations. The drawdown in the broad SMID indices matches the worst period of under-performance in absolute terms over the last decade, and the SMID indices are now trading at levels last seen in early 2016.
- The relative under-performance over the last six months of the SMID indices relative to the large cap indices would seem to suggest that the SMID indices are close to the bottom of their historical trading/valuation ranges relative to the larger cap stocks.

The stock we want to highlight this month is **GlaxoSmithKline Consumer Healthcare India** (GSK), the leader in the malted food drinks category in India with brands like Horlicks (a 100 year old brand in India), Boost, Cardia, and Protein Plus. The category has been dormant over the last 5 years, as growth in urban India plateaued with the greater availability of fresh milk. However, significant recent new product innovation (by GSK, Nestle, Abbott and Mondelez), and the expansion of the distribution networks into rural India, has seen the category 'return to growth.' The fundamental case for being invested in GSK is further bolstered by our expectation that minorities will benefit from a take-out premium when Glaxo's stated intent to exit the consumer products business globally does come to fruition.

We expect consolidated revenues to compound at a minimum of 12% annually over the next three years, ahead of market consensus anticipating top-line growth in the 7%-8% range.

- We believe that the market is structurally under-estimating the recent commitment by the multi-nationals to improve consumer awareness, and to intentionally 'grow' the malted drinks category.
- We expect that rising disposable incomes, improving affordability, and GSK's re-invigorated marketing and distribution outreach (after years of being an after-thought in the Glaxo eco-system) into semi-urban and rural India will sustain good volume momentum over the next 3-4 years.

We expect earnings to compound at 18%+ annually over next three years, well ahead of consensus estimates projecting a more modest 10%-12% run-rate.

- On the back of sustained volume growth and strong operating leverage, we expect operating margins to improve by 300bp over the next three years.
- The thoughtful brand extensions for both Horlicks and Boost into new categories (biscuits and noodles), and the commitment to ongoing product innovation (sachets, women's and children's drinks, low calorie/meal-substitute alternatives, breakfast alternatives, etc.) will translate to richer mix, and potentially, further margin upside.

To conclude, we would urge investors to look through the geo-political flash-points and the current market volatility, and to stay focused on the idiosyncratic structural opportunity in Indian equities.

- **Largely insulated from the risk of damaging global trade restrictions and punitive retaliatory tariffs, India's domestic economy is structurally accelerating relative to the rest of the world.** *On the back of Modi's structural reforms, India will deliver on GDP growth compounding at a 7%+ run-rate over the next three years.*
- *Corporate confidence in India is at a multi-year high* given the policy framework and access to capital encouraging a multi-year investment cycle, industry utilization rates trending off decade lows, and revenue growth and profitability inflecting meaningfully to the upside. **We have strong conviction on our portfolio holdings delivering on earnings and cash flows compounding at 15%+ annually over the next three years.**
- **Valuations are attractive** given our benign outlook on Indian inflation/interest rates, 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
Bajaj Finance Ltd	Financials:	38%	Financials:	+1.87%
Kotak Mahindra Bank Ltd	Consumer Discretionary:	16%	Consumer Discretionary:	-0.73%
HDFC Bank Ltd ADR	Consumer Staples:	11%	Consumer Staples:	+0.09%
Titan Co Ltd	Materials:	10%	Materials:	+0.52%
Zee Entertainment Enterprise	Technology:	6%	Technology:	-0.08%
	Health Care:	5%	Health Care:	-0.17%
	Industrials:	5%	Industrials:	+0.03%
	Real Estate:	4%	Real Estate:	-0.15%
	Energy:	3%	Energy:	+0.25%
	Utilities:	2%	Utilities:	-0.16%
	Retail:	0%	Retail:	-0.20%