TANTALLON CAPITAL

March 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
March 2018:	-1.07%	-3.45%	+2.38%
2018 YTD:	-10.28%	-7.00%	-3.28%
2017:	+59.14%	+36.84%	+22.30%
2016:	-5.79%	-2.90%	-2.89%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+34.82%	+22.66%	+12.16%

Compound Returns	+12.26%	Volatility	+20.07%
3 month US T-bill	+1.73%	Sharpe Ratio	0.525

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 -1.07% in March, after expenses, bringing a challenging quarter to a close with protectionist, retaliatory rhetoric and bellicose brinksmanship certainly claiming the headlines, exacerbating the hyper-sensitivity in equity, fixed income and currency markets to global central banks signaling the 'gradual' tightening of monetary policy. In India specifically, despite sustained flows into retail equity mutual funds, and earnings continuing to surprise positively on the upside, the 'risk-off' was accentuated in the small and mid-cap space, anticipating a reversion to the mean after several quarters of significant out-performance.

From our perspective, while acknowledging a fragile global investor psyche, and a manifest tendency to 'sell first, ask questions later,' **we would urge investors to continue to look for opportunities amidst the volatility in global capital markets to build exposure to Indian equities.**

- *The Indian economy has inflected:* the green shoots are being re-enforced by recent high frequency economic indicators (automobile and commercial vehicle sales, passenger air traffic and railway freight growth, petroleum product and electricity consumption data, steel and cement output, and accelerating credit growth). **On the back of Modi's structural reforms, 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.**

- **Corporate earnings have also inflected positively, supporting our view of sustainable earnings growth in the mid-teens, over the next three years.** There is, no question, a base-effect from demonetization and GST implementation; but, the robust trends in volume growth, margin uplift, and free cash flow generation, are finally finding voice in industry consolidation, the intentional shift in favor of the organized sector, and importantly, new capacity additions, auguring well for the outlook on sustained earnings and cash flow growth.

- Modi's anti-corruption/pro-reform agenda, and the fiscal discipline he has imposed (despite it being an 'election year'), allows the Reserve Bank of India to keep monetary policy on an 'extended pause,' and to demonstrate adequate regulatory forbearance to cushion the enforcement of the timely recognition of non-performing loans. **Our view is that as the economy recovers, domestic interest rates and borrowing costs will trend higher by 50-75bp over the next two years, providing a stable/positive backdrop for equity markets/multiples.**

To reiterate our thoughts on domestic politics:

Despite the unexpected success of the BJP in the February polls in the North Eastern states of Tripura, Nagaland, and Meghalaya, *the market remains pre-occupied with the political calendar (state elections in Karnataka in April, and Rajasthan and Madhya Pradesh in December), and the potential ramifications of regional parties attempting to stitch together 'coalitions of convenience' to challenge the BJP in the next General Elections.*

- Given the markets' poor record with election prognosis globally over the last two years, we are convinced that trying to project an election outcome at this point, is a mug's game. Instead, we have committed ourselves to filtering out the noise being generated by a plethora of pre-election 'polls' of dubious

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+34.82%												
2018	-10.28%	-1.87%	-7.58%	-1.07%									
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%

quality being conducted by various political and media platforms.

- We do expect a certain level of anti-incumbency, and that the proposed coalitions in Uttar Pradesh and the Southern Indian states will likely erode the BJP's current absolute majority in the Lower House.
- *That said,* ***we do expect that Modi will (i) retain firm control over the narrative, (ii) retain a clear Parliamentary majority, and (iii) remain committed to his anti-corruption / pro-reform / pro-infrastructure and manufacturing / pro-rural agenda.***

In terms of portfolio positioning, we would highlight the following:

- ***Financials:*** we have very high conviction in the well-capitalized private sector banks and finance companies with demonstrable credit discipline and under-writing standards, and intentional digital outreach and analytics to increase cross-sell and profitability at the expense of the capital constrained government owned banks.
- ***Consumer Discretionary, Retail, Consumer Staples, Real Estate:*** given the underlying strength in the economy, Modi's focus on job creation, rural spending, and affordable housing, *and* GST implementation, our expectation is for the consumer-facing stocks in our portfolio to grow market share at the expense of the unorganized sector, while structurally improving profitability.
- ***Industrials:*** the government's focus on infrastructure development and industrialization, on "Make in India," and specific policy initiatives to reduce pollution and carbon emissions, underpin a durable investment thematic.

The stock we would like to highlight this month is ***Sudarshan Chemicals,*** an entrepreneur-driven, niche speciality manufacturer of high performance pigments (from iron oxide based inorganic pigments to organic high performance and effect pigments) and an A-list customer base. Sudarshan is differentiated from the peer group by strong process chemistry skills, manufacturing/technical complexity, strict environmental compliance, and scale economics. Management is committed to building on its current 35% market share in India, to develop a global footprint with marketing subsidiaries in North America, Europe, China and South America, and to an ambitious vision of quintupling revenues and profits over the next five years.

We expect consolidated revenues to conservatively compound at 25%+ annual run-rate over the next three years, while the market would seem to be projecting a much more sedate 11% CAGR in revenues.

- New product innovation in digital ink, and augmented distribution capabilities (in new geographies, and to new sectors), will see a step-function increase in revenue opportunities over the next five years.
- Given its R&D driven, non-commodity product portfolio (i.e., the ability to deliver on color, luster, and strict environmental compliance), there is a significant opportunity to break into the global supply chains of the major global paints and coating companies who are looking to diversify their respective supplier risks given the spate of M&A in the sector, and the increased constraints on Chinese capacity growth.
- Unlike their global competitors, Sudarshan does have the ability to process small(er) batch, customized production for low(er) volume demand from South East Asia and the Middle East.

We expect profits to compound at 40%+ annually over the next three years (versus the market's expectations of a 15% CAGR in profits), and for ROE/ROCE to track north of 30%.

- Sudarshan has embarked on a Rs.10bn capex program to augment their capacity in high performance pigments and specialty chemicals. As the new capacity comes on-line, we expect to see significant mix improvement and strong operating leverage.
- We expect that the commitment to backward integration and pigment adjacencies, and to increasingly automate manufacturing, will see a structural uplift in profitability, with EBITDA margins improving by 400bp over the next three years.

To conclude:

- **On the back of Modi's structural reforms and fiscal discipline, 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.**
- Corporate earnings have also inflected positively. We have strong **conviction in our portfolio delivering on earnings and cash flows compounding at 15%+ annually over the next three years.**
- Post the recent correction in stock prices, we find **current valuations to be 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
Titan Co Ltd
Bajaj Finance Ltd
Kotak Mahindra Bank Ltd
HDFC Bank Ltd ADR
Zee Entertainment Enterprises

Sectoral Break-down:	As % NAV
Financials:	32%
Consumer Discretionary:	14%
Materials:	13%
Industrials:	10%
Consumer Staples:	8%
Health Care:	7%
Real Estate:	5%
Energy:	3%
Technology:	3%
Utilities:	3%
Retail:	2%

Sector Performance	MTD Performance
Financials:	+0.13%
Consumer Discretionary:	+0.72%
Materials:	-0.07%
Industrials:	-0.60%
Consumer Staples:	-0.67%
Health Care:	-0.36%
Real Estate:	-0.78%
Energy:	+0.08%
Technology:	+0.23%
Utilities:	-0.32%
Retail	+0.57%