TANTALLON CAPITAL

May 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
May 2018:	-4.66%	-3.71%	-0.95%
2018 YTD:	-11.73%	-6.91%	-4.82%
2017:	+59.14%	+36.84%	+22.30%
2016:	-5.79%	-2.90%	-2.89%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+32.67%	+22.78%	+9.89%

Compound Returns	+10.83%	Volatility	+19.77%
3 month US T-bill	+1.90%	Sharpe Ratio	0.452

FUND DETAILS

The Tantallon India Fund

AUM USD 37,000,000

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 down -4.66% in May, after expenses. It's been a particularly difficult month for small and medium sized companies that have been sold down rather indiscriminately – despite fundamentals on the ground continuing to improve as evidenced by the strong GDP print, very positive corporate commentary, and a very strong earnings season. We would point specifically to (i) the spike in crude oil prices, and the implications of significantly higher energy prices for inflationary expectations and therefore, for tightening monetary policy, and (ii) US$ strength and the prospects of higher real interest rates, as the primary catalysts for the heightened risk aversion setting the tone for markets broadly.

Our conviction stays intact: with the earnings cycle having inflected, we would urge investors to stay focused on the fundamentals, and to take advantage of the correction in valuations to invest intentionally in India's transformative growth runway.

Having just returned from spending two weeks in India, we are struck by the sharp disconnect between stock market participants and corporate India.

- Almost without exception, asset allocators, fund managers, the sell side, and the media talking heads would seem to be focused on the potential loss of flows/monetary policy support for equity markets broadly, the potential for damaging trade conflicts exacerbating the existential challenges being posed to customs unions globally, and the uncertainty over the outcome of the next General Elections.
- In sharp contrast, is the ***quiet confidence being articulated by companies on the ground (across sectors and the market cap spectrum) on underlying domestic demand, rising utilization rates, credit availability, political and fiscal stability, and importantly, in a nascent industrial capex cycle.***

For the March quarter, India posted real GDP growth of 7.7%, accelerating from the December quarter run-rate of 7% real growth. *Amidst the noise and the panic of stop-loss selling, what seems to have been 'lost' is an economy that is visibly demonstrating resilience, and the prospects of a sustained, demand and capex driven growth cycle.*

- Despite the short-term growth challenges to the real economy posed by demonetization and the implementation of GST, anchored by public spending, investments, and private consumption, **the real economy grew 6.7% for the fiscal year ended March 2018.**
- **We expect India's real economy will compound at a 7.5%+ run-rate over the next three years** on the back of a strong recovery in manufacturing and industrial capex, continued buoyancy in the services sector, recovering exports, and the uplift in rural incomes and consumption.

We retain strong conviction on the Indian earnings cycle having decisively inflected, and in our portfolio companies delivering on earnings growth compounding at 15%+ over the next three years.

- Yes, private corporate capex and profitability as a percentage of GDP is at it lowest level since 1996 – against a backdrop of weak commodity prices, and the disruptions of demonetization and the implementation of GST.
- Yes, a simplistic filter on the index would suggest continued 'earnings disappointments' – primarily on account of anaemic utilization rates at the industrial heavy-weights, and the travails at the public sector banks being forced to recognize and provision for their non-performing loans.

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+32.67%												
2018	-11.73%	-1.87%	-7.58%	-1.07%	+3.20%	-4.66%							
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%

- However, ***going deeper into the markets, what seems clear is that underlying volume growth, rising utilization rates, and strong operating leverage is being reflected in sustained margin uplift and very strong earnings/cash flow growth.***
    - Services, private sector financials, cement, steel, passenger and commercial vehicles, tourism, infrastructure, specialty chemicals, logistics, renewables, agriculture, and niche IT Services are demonstrating strong sequential volume/revenue growth, and importantly, resilient pricing/margins.
    - Production capacities are stretched, and as utilization rates rise, we believe we are on the cusp of a new, extended investment cycle.
- **For the record, for the fiscal year ended March 2018, our portfolio holdings delivered on earnings growth of 26%. *This is not a typo!***

The Reserve Bank of India has preserved its inflation-targeting credentials by hiking repo rates by 25bp to 6.25% at its June 6 Monetary Policy meeting.

- As we had expected, the RBI has chosen to allay market concerns over 'falling behind the curve,' by bringing forward the rate tightening cycle in response to growth accelerating, heightened inflationary expectations following the spike in energy prices, and the back-up in US Treasury yields.
- **In reiterating its 'neutral' policy stance despite the rate increase, our sense is that the RBI is signaling that this will be a shallow, data-dependent, rate hike cycle.**
- Assuming crude prices in a US$70-$80 band, and real GDP growth accelerating to sustain at 7.5%+, **we should expect another 50bp of tightening over the next 12-18 months.**

The company that we would like to highlight this month is ***Cyient Ltd.***, an Engineering and Research & Development software company focusing on specific niche segments: aerospace, defense, transportation, communications, semiconductors, medical devices, and geospatial projects. The opportunity to grow not just their client base, but their customers' share-of-wallet is significant, as Cyient delivers on differentiated, custom solutions to global businesses committed to adopting Artificial Intelligence, the internet of things, and crucially, the imperative to analyze and react/respond in real time to Big Data. We anticipate a substantial re-rating of the stock as the market re-calibrates the business model, and the ability to deliver sustained revenue growth, with improving mix and strong operating leverage driving profitability.

We expect consolidated revenues to compound at 18%+ annually over the next 3 years, *with meaningful risk to the upside* as the investments in people and systems over the last five years, start to bear fruit. Market consensus would seem to be projecting a more sedate 13% CAGR in revenues.

- An enviable client list (UTC, Pratt & Whitney, Boeing) would suggest a step-function increase in the aerospace and defense business opportunity given the upcoming product replacement cycles for the Boeing 737s and the Airbus A-320s, and the recently established joint venture to develop and manufacture unmanned aerial vehicles (UAV).
- The geospatial opportunity is significant, leveraging the decade long relationships with Bombardier, TomTom and Ordinance Survey of the UK to deliver on navigation-based apps and solutions for the shared economy (ie., ride-sharing, food and grocery delivery, package delivery services), signaling, service and safety solutions for mass transit systems, high definition maps and safety over-ride features for autonomous vehicles, and detailed 3D geospatial models for 5G network planning and roll-outs.
- Artificial Intelligence and the Internet of Things will be more than just buzz-words, as Cyient commissions turnkey, custom solutions for the likes of NVIDIA and Bosch, integrating complex firmware designs, with safety and maintenance software that collects, collates, analyzes, and responds to a multitude of data inputs in nano seconds.

We expect profits to compound conservatively at 20%+ annually over the next three years (versus the market consensus that is building in a 15% CAGR). *We believe that we are on the cusp of a structural uplift in mix/margins over the next three years.*

- Our conviction is that the market is yet to fully appreciate the incremental change in the business model from billing of time and material, to fixed price/outcome based pricing models.
- There have been substantial investments made in the last couple of years in new capabilities (semiconductors, medical, defense), and as utilization ramps, we expect the IP being generated by the different verticals to deliver on strong operating leverage and sustained profitability.

To conclude: despite heightened risk aversion, we would urge investors to take advantage of the market sell-off to intentionally build exposure to Indian equities.

- ➢ On the back of Modi's structural reforms and the RBI's explicit inflation targeting discipline, **the real economy is poised to deliver GDP growth compounding at a 7%+ run-rate over the next three years.**
- ➢ Our portfolio holdings are demonstrating good visibility on accelerating revenue growth, margin uplift, and on **earnings and cash flows compounding at 15%+ annually over the next three years.**
- ➢ **The recent correction in valuations would suggest a compelling risk/reward** 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
Kotak Mahindra Bank Ltd
Bajaj Finance Ltd
HDFC Bank Ltd ADR
Titan Co Ltd
Kolte-Patil Developers Ltd

Sectoral Break-down:	As % NAV
Financials:	35%
Consumer Discretionary:	16%
Consumer Staples:	11%
Materials:	10%
Technology:	6%
Industrials:	6%
Health Care:	5%
Real Estate:	5%
Energy:	3%
Utilities:	2%
Retail:	0%

Sector Performance	MTD Performance
Financials:	+0.41%
Consumer Discretionary:	-1.09%
Consumer Staples:	-0.56%
Materials:	-0.87%
Technology:	-0.04%
Industrials:	-0.79%
Health Care:	-0.19%
Real Estate:	-0.35%
Energy:	-0.20%
Utilities:	-0.33%
Retail:	-0.64%

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