TANTALLON CAPITAL

November 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.

The Tantallon India Fund closed +9.47% in November, after expenses, with the rupee staging a smart recovery versus the US$ on the back of lower crude prices.

In a year where uncertainty regarding geo-politics, trade conflicts, the future of customs unions, spiking energy prices, and importantly, trending US$ strength (anticipating further Fed tightening), set the table for significant market volatility and investors being whipsawed, **we have remained steadfast in our conviction on India's secular fundamentals:** *consistent, high frequency economic data affirming the strength in domestic consumption and a nascent capex cycle, credible inflation-targeting monetary policy and fiscal discipline, transparent policy-making encouraging the commitment of risk-capital, and sustained domestic investor equity flows as a back-stop for valuations.*

On the back of lower energy prices, fundamentals are starting to re-assert themselves. We would make the case for investors to take advantage of any market uncertainty ahead of the General Elections to invest in Indian equities on a structural, longer-term view.

Putting a spot-light on the key variables that are likely to impact the markets over the next 12 months:

- **The sell-off in crude is a BIG deal for India, and the rupee.** Crude prices are down ~30% from the recent peak: a 10% fall in crude prices shaves 20bp off headline inflation, while a $10/barrel correction in crude prices narrows the current account deficit by 0.5% of GDP. *Importantly, on our estimates, with crude prices under $70/barrel, fair value for the rupee on a real effective exchange rate basis is in the Rs.68-Rs.70/US$ range.*
- **The trade wild card remains an overhang.** Perhaps, the temporary truce over steaks in Buenos Aires sets the stage for rational negotiations and measured actions to 'right' the trade imbalances, and to start to address the blurred fault lines between national security concerns, IP theft/transfer, protectionism, industrial subsidies, and commerce. *Will the grown-up's in the room prevail?*
- **Whither the US$?** US Congressional gridlock, US real estate prices starting to roll over, and the Fed seemingly re-setting expectations on 'neutral' policy rates would suggest that we are likely to see a reversal in the US$ strength we have seen over the last 18 months. *If so, it is definitely good news for emerging markets, and emerging market currencies.*

Performance, in USD

(Inception on September 1, 2015)

	Tantallon India Fund	MSCI India($)	Over/Under Full Performance
November 2018:	+9.47%	+10.43%	-0.96%
2018 YTD:	-23.14%	-8.37%	-14.77%
2017:	+59.14%	+36.84%	+22.30%
2016:	-5.79%	-2.90%	-2.89%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+15.50%	+20.84%	-5.34%

Compound Returns	+4.53%	Volatility	+20.66%
3 month US T-bill	+2.34%	Sharpe Ratio	+0.106

FUND DETAILS
The Tantallon India Fund

AUM USD 32,000,000

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

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- **China remains an enigma.** The data on credit disbursement, railway cargo volumes, and electricity consumption (i.e., the most reliable data points we can consistently track) attest to the challenges of trying to 'de-leverage' and to 're-balance' the Chinese economy away from debt-funded manufacturing, while maintaining political stability. *Will the Chinese have no choice but to resort to massive fiscal and credit stimulus as they did in 2008 and 2014?*

Having just returned from two weeks in India in multiple cities, we wanted to pass on the following observations:

- The **stand-out positive surprises** were: *surging peak power demand over the last six months (attesting to a sustained revival in capex and industrial production), the resilience in rural demand, sustained e-commerce growth, improving entry-level housing affordability, and the banks and finance companies credibly articulating a peak in non-performing loans.*

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+15.50%												
2018	-23.14%	-1.87%	-7.58%	-1.07%	+3.20%	-4.66%	-5.58%	+1.29%	-2.30%	-12.87%	-2.31%	+9.47%	
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%

- Given the RBI's commitment to maintaining an adequate real rate buffer in the face of tighter liquidity conditions globally, Modi remaining fiscally prudent, and the pick-up in corporate capex, **our conviction stands that the cycle is intact, and that India will sustain GDP growth tracking at an 8% CAGR.**
- There is a natural anti-incumbency over-hang, and amidst the grand aspirations projected by potential Opposition coalition rhetoric, we should expect that **the lead-up to the General Elections will likely be a source of market volatility.**
    - *Our electoral math would point to Modi being re-elected, albeit with a reduced majority, allowing for his pro-reform and anti-corruption agenda to be sustained.*
- **Corporate confidence is at a multi-year high.**
    - The (disruptive) reform measures pushed through by Modi (specifically, GST, the Real Estate Regulation Act, and the Insolvency and Bankruptcy code accelerating non-performing loan resolution) has allowed the **organized sector to (re)invest (and create jobs) with confidence** that the non-compliant and unorganized sectors would have less of an ability to disrupt pricing going forward.
    - **Rising utilization rates and optimism on consumption, services, industrials, housing and infrastructure**, is translating to a sustained capital cycle.
    - **Managements remain sanguine on margins** thanks to the positive tailwinds from regulatory/tax reforms, industry consolidation, rising rural employment and incomes, and improving export competitiveness.
    - **The spike in credit costs following the IL&FS default has not created systemic stress.** Funding is available, albeit at a higher rate for the balance sheet challenged.

The stock we would like to highlight this month is ***Titan Co Ltd***, India's largest organized jewelry (80% revenues) and watch retailer with 2m+ square feet of retail space spread over 1,600 stand-alone stores, and over 11,000 multi-brand outlets. Titan's deliberate focus on advertising to, and for young women professionals and entrepreneurs, and the expansion into Tier 2 and Tier 3 cities with an enviable product portfolio ranging from mid-market to premium jewelry, watches, fragrances, eyewear and ethnic wear, addresses the core wedding and diamond jewelry segment, as well as the aspirations of a burgeoning middle-class. Titan is directly leveraged to Indian discretionary spending and consumption patterns and is arguably, the most significant beneficiary of the marginalization of the mom-and-pop jewelry stores post the implementation of GST.

We expect consolidated revenues to compound at a 25%+ annual run-rate over the next three years, while the market would seem to be projecting growth in the 15%-18% range.

- Titan is a key beneficiary of the industry-shakeout post-GST implementation, with the mom-and-pop local jewelers (who still account for about 70% of the Indian jewelry market) being forced into regulatory and tax compliance, and hence, no longer able to compete with Titan on product quality, range, and pricing. Titan's established brands, *Tanishq, Zoya, Mia* and *Caratlane,* are uniquely positioned across the jewelry value chain to structurally grow presence and market share over the next decade.
- The systematic investments into watch and eyewear retailing, and mass market gold retailing, are starting to bear fruit, and will provide sustained revenue opportunities thanks to Titan's brand/quality/pricing advantages.

We expect profits to compound at 30%+ annually over the next three years (versus the market's expectation of a more muted 20% +/- growth trajectory).

- Structural market share gains, scale, and the evolution of the franchisee model will deliver strong operating leverage, and a 75-100bp annual expansion in operating margins over each of the next 3 years to 13.5%.
- Management is even more constructive on the margin outlook, projecting a meaningful improvement in profitability in the watches and studded jewelry segments.
- With ROE and ROCE tracking in excess of 30%, and free cash flows compounding in excess of 30%, we expect the dividend payout ratio to potentially double from the current level of 25% over the next three years.

To conclude: this has been a very challenging year; we have not protected capital, and our conviction in smaller and medium sized companies has been sorely tested by the market's concerns on higher crude prices and tightening global/domestic liquidity. However, our conviction on the structural opportunity in Indian equities is intact, and as fundamentals start to re-asset themselves, we would urge investors to take advantage of any uncertainty in the lead-up to the General Elections to increase their allocation to Indian equities.

- Despite the inherent growth challenges in China, and the risks of protracted trade and geo-political conflicts, ***India's structural reforms and domestic economy is poised to deliver on real GDP growth compounding at 8% annually over the next 3-5 years.***
- Buoyed by corporate confidence in sustained volume/revenue growth, and operating leverage, 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 compelling*** in the long runway opportunities in industrialization, urbanization, consolidation, financial intermediation, digitization of the real economy, enhanced agricultural productivity rural incomes, and in discretionary spending.

A final note, from our families to yours. Happy Holidays! We wish you Peace, Good Health, and Much Joy in the New Year!

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
Bajaj Finance Ltd
Kotak Mahindra Bank Ltd
HDFC Bank Ltd
Titan Co Ltd
Zee Entertainment Enterprise

Sectoral Break-down:	As % NAV
Financials:	37%
Consumer Discretionary:	18%
Consumer Staples:	11%
Materials:	10%
Technology:	6%
Health Care:	6%
Industrials:	5%
Real Estate:	4%
Energy:	3%
Retail:	0%
Utilities:	0%

Sector Performance	MTD Performance
Financials:	+5.03%
Consumer Discretionary:	+2.26%
Consumer Staples:	+0.61%
Materials:	+1.33%
Technology:	-0.04%
Health Care:	-0.26%
Industrials:	+0.36%
Real Estate:	+0.02%
Energy:	+0.08%
Retail:	+0.09%
Utilities:	+0.00%