TANTALLON CAPITAL

October 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
October 2018:	-2.31%	-7.11%	+4.80%
2018 YTD:	-29.80%	-17.03%	-12.77%
2017:	+59.14%	+36.84%	+22.30%
2016:	-5.79%	-2.90%	-2.89%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+5.50%	+9.43%	-3.93%

Compound Returns	+1.71%	Volatility	+20.24%
3 month US T-bill	+2.31%	Sharpe Ratio	-0.03

FUND DETAILS

The Tantallon India Fund

AUM USD 30,000,000

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 -2.31% in October, after expenses, with the rupee depreciating 2% versus the US$. Given the extent of the sell-off in global equities over the course of the month, it did feel like a small victory to see the portfolio recover strongly into month-end on the back of our portfolio holdings starting to report strong September quarter earnings, well ahead of consensus expectations. *Fundamentals are starting to re-assert themselves, and the sell-off in crude has certainly helped buoy local investor sentiment.*

Fragile global investor sentiment notwithstanding, we remain steadfast in our conviction on India's secular tailwinds: continued strength in high frequency data, credible inflation-targeting monetary policy, transparent policy-making encouraging the commitment of risk-capital, and sustained domestic investor flows as a back-stop for valuations. **<u>We would continue to make the case for investors to take advantage of the sell-off, to invest in Indian equities on a structural, longer-term view.</u>**

Taking a step back for a moment to reflect on some of the market anomalies setting prices currently:

- **Khashoggi's murder, and the subsequent sell-off in crude prices:** Trump would finally seem to have the leverage to 'encourage' the Saudis to increase output, off-setting any supply shortfalls from the sanctions imposed on Iran. *It IS a breather for the beleaguered Indian rupee, especially given that India seems to have received a 'waiver' to continue to import Iranian crude.*
- **US Congressional gridlock is now official.** The wry commentary suggesting that we are now past the 'smoothest' part of the Trump Presidency does portend a more challenging outlook for the US$, despite the Fed staying firm on its tightening course. *Good news perhaps, for emerging markets, and emerging market currencies.*
- **The trade wild card looms uncomfortably in front of us.** As national security concerns blur the lines between defense and commerce, and given the inherent propensity for 'strong man' posturing on both sides, a protracted US-China face-off would seem to be on the cards. Perhaps Xi and Trump will signal a truce of sorts at the G-20. *Realistically, we should expect more volatility as markets are forced to digest unpredictable policy rhetoric/behavior, exacerbating the myriad (growth) concerns on China.*
- **In India, domestic equity mutual fund net purchases are at a historical high with October inflows into domestic equity mutual funds up 30% month-over-month to US$2bn, half of which were via the monthly systematic investment programs.** (Year-to-date, domestic equity funds have seen close to US$20bn of inflows.) *In contrast, foreign institutional investors net sold US$5.1bn in October in the equity and fixed income markets, the worst monthly sell-off since January 2008.*
- **India equity valuations at 15x forward earnings, and at 2x P/BV, are at March 2014 levels – before Modi was elected!** *Given the real structural reforms put in place over the last five years, the real economy delivering on sustained growth, and the good visibility on corporate earnings/cash flows over the next 2-3 years, it is striking that multiples have compressed so sharply.*

We have sought respite (no, seriously!) from the hyper-volatility on our screens in continuing to pore over dozens of recently released annual reports, triangulating our P&L and Balance Sheet assumptions, with audited financial statements, and management commentary on the short-to-medium term business outlook:

- **Corporate confidence is at a multi-year high:** underpinned by sustained volume growth and rising utilization rates, revenue growth, operating leverage, and profitability are mean-reverting from several years of below-trend growth.

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+5.50%												
2018	-29.80%	-1.87%	-7.58%	-1.07%	+3.20%	-4.66%	-5.58%	+1.29%	-2.30%	-12.87%	-2.31%		
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%

- Despite rising commodity prices, **management commentary is sanguine on margins, and focused on positive tailwinds** from regulatory/tax reforms, industry consolidation, rising rural employment and incomes, and improving export competitiveness.
- **The disruptive regulatory and tax reform measures pushed through by Modi** has broadened the tax net, and allowed the organized sector to (re)invest (and create jobs) with confidence that the non-compliant unorganized sector would have less of an ability to disrupt pricing going forward.
- **The capex cycle has turned.** Rising utilization rates and optimism on the fundamental outlook for consumption, services, industrials, housing and infrastructure, is translating to a strong revival in capital expenditure.
- **The sharp rally in crude prices, and the attendant depreciation of the rupee, and the sharp spike in credit costs followingIL&FS default have been the most significant negative outliers relative to management expectations.**

The stock we would like to highlight this month is ***Kotak Mahindra Bank,*** India's leading, full service financial conglomerate. An entrepreneur controlled bank, Kotak stands out in its ability to genuinely invest for the long term. KMB's brand and digital platform, strong liability franchise, and very well-capitalized balance sheet (with a Tier 1 capital ratio in excess of 18%), puts the bank in pole position to systematically cross-sell product, and to take market share profitably from capital constrained public sector banks and small finance companies.

Over the next three years, we expect KMB to deliver on assets compounding at 20%+ annually *(versus consensus looking for 15%+/- growth).*

- KMB will grow market share at the expense of the capital constrained, cherry-picking opportunities in mortgages, consumer and auto loans, SME loans, infrastructure, and distressed debt.
- On the back of a shrewd acquisition, KMB has built out a national footprint, with a full service branch network dovetailing nicely with the investments into a technology platform allowing for deliberate customer outreach, market segmentation, and cross-sell opportunities.
    - Having doubled its customer base over the last 18 months following the launch of its innovative 811 program (an app-based mobile banking account/digital wallet interface), to 16m customers, we expect KMB to grow its customer base to 27m over the next three years.
    - A full product suite (from commercial and retail loans, to asset management and life and general insurance, credit cards, and the largest private wealth management business in the country) mapped against a scalable, digital platform is primed to aggressively increase the cross-sell within their customer base with minimal incremental expense.

Over the next three years, we expect Kotak to deliver on consolidated profits compounding in excess of 20% annually, with ROA trending in excess of 2.5%, and an 18%+ ROE (*versus the market currently looking for no more than a 15% RoE).*

- The strong liability franchise (CASA ratio is currently in excess of 50%), and the ability to intentionally 'price-for-risk' will allow KMB to deliver on sustainable net interest margins in the 4.3%-4.5% range.
- We expect the investments in building out a comprehensive, scalable digital platform to pay off in spades, delivering on a 500bp+ improvement in the cost-to-income ratio declining to sub-45%.
- The demonstrable credit discipline over the past several cycles, and the conservative provisioning stance management has adhered to, will sustain stable/declining credit costs over the next three years.
- Strong fee income growth and the intrinsic profitability of the asset management and insurance businesses will likely continue to surprise the market on the upside.

To conclude, amidst the inevitable uncertainty in the build-up to the General Elections, we would urge investors to look to structurally increase their allocation to Indian equities.

- **India's domestic economy is structurally accelerating relative to the rest of the world,**
    - *Given significant geo-political uncertainties, the potential collateral damage from a protracted global trade stand-off, and the inherent growth challenges in China and much of the developed world, India does stand-out for its ability to deliver on real GDP growth compounding at 8% annually over the next 3-5 years.*
- **Corporate confidence in India is at a multi-year high.**
    - *A growth-supportive regulatory/policy stance, industry utilization rates trending off decade lows, and corporate profitability inflecting decisively to the upside supports our conviction on our portfolio holdings delivering on earnings and cash flows compounding at 15%+ annually over the next three years.*
- **Given the market correction, and the improving visibility on revenues/earnings, we find valuations compelling.**
    - *We remain focused on 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:	34%	Financials:	-0.69%
HDFC Bank Ltd ADR	Consumer Discretionary:	16%	Consumer Discretionary:	-0.31%
Kotak Mahindra Bank Ltd	Consumer Staples:	13%	Consumer Staples:	-0.12%
Titan Co Ltd	Materials:	9%	Materials:	-1.39%
Kolte-Patil Developers Ltd	Health Care:	8%	Health Care:	-0.22%
	Technology:	7%	Technology:	+0.06%
	Industrials:	6%	Industrials:	-0.12%
	Real Estate:	4%	Real Estate:	+0.35%
	Energy:	3%	Energy:	+0.16%
	Retail:	0%	Retail:	-0.03%
	Utilities:	0%	Utilities:	+0.00%