TANTALLON CAPITAL

August 2019

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 -4.58% in August, almost all of it on account of the rupee depreciating by -3.7% against the US$, in-line with the 4% depreciation of the renminbi.

The world is significantly more complicated than just six months ago. The specter of an increasingly aggressive response to the mass demonstrations in Hong Kong, the risk-off/risk-on market schizophrenia to off-again/on-again, trade-talk carrots and sticks, a liquidity constrained and slowing China and an inverted yield curve foreshadowing a potential global recession, the bleak prospects of a no-deal Brexit, saber rattling over the Kashmir Valley, rolling conflicts in the Middle East…the list goes on and on and on, paralyzing actual investment decision-making, and encouraging myopic portfolio duration and positioning.

In India, investors have been spooked by the deceleration in GDP growth to 5% (monsoon deficits and the credit crunch in rural India being the primary culprits), the vulnerability of the export economy (now, accounting for 20% of GDP) to the global slowdown, the stock market over-hang from pledged shares being held as collateral, and the government's self-inflicted wounds (specifically, the tax surcharge on high net worth and foreign portfolio investors, and the heavy-footed response to the credit squeeze on the smaller non bank finance companies).

At the risk of sounding like a cracked record, this is the time to acknowledge the risks, but, to take the long view, focus on fundamentals, and to intentionally invest in companies that are structurally growing share at the expense of weaker competitors in a <u>growing</u> economy.

- The fear and uncertainty in public markets is palpable, as is the frustration at significantly heightened volatility, and numerous short-term trading strategies failing to preserve capital.
- The irony of course is that ***the last six months have seen a significant uptick in both foreign direct and strategic investments into India*** as multinationals and venture funds (from Walmart, Amazon, Duracell, Ali Baba, Tencent, Saudi Aramco, and British Petroleum, to SoftBank, Blackstone, CDC, Invesco, Steadview, and Wellington) have looked to opportunistically take advantage of the sell-off in publicly listed assets.
- Even more striking, ***in the last four weeks, controlling shareholders have increased their stakes in 134 of the listed BSE500 companies.***

<u>We believe that growth troughed at 5% in the June quarter.</u> *We expect the government to continue to introduce targeted fiscal and monetary stimulus, specific relief measures for the agrarian economy, and the recapitalization of the public sector banks.*

- Government expenditure bottomed at 2% of GDP during the June quarter: we expect government expenditure to normalize at 8% of GDP over the next 12 months, providing a significant impetus to the real economy.
- The Reserve Bank of India has delivered four consecutive rate cuts - given the surplus inter-bank liquidity and the new guidelines on benchmark base lending rates, we expect the

<u>Performance, in USD</u>
(Inception on September 1, 2015)

	Tantallon <u>India Fund</u>	MSCI <u>India($)</u>	<u>Over/Under</u> <u>Full Performance</u>
Aug 2019:	-4.58%	-3.13%	-1.45%
2019 YTD:	-4.87%	-2.08%	-2.79%
2018:	-22.79%	-8.63%	-14.15%
2017:	+59.14%	+36.84%	+22.30%
2016:	-5.79%	-2.90%	-2.89%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+10.37%	+18.00%	-7.63%

Compound Returns	+2.50%	Volatility	+19.76%
3 month US T-bill	+1.95%	Sharpe Ratio	+0.028

<u>FUND DETAILS</u>
The Tantallon India Fund

AUM USD 29,000,000

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)

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+10.37%												
2019	-4.87%	-6.16%	+1.05%	+9.08%	-1.89%	+3.14%	-0.19%	-4.58%	-4.58%				
2018	-22.79%	-1.87%	-7.58%	-1.07%	+3.20%	-4.66%	-5.58%	+1.29%	-2.30%	-12.87%	-2.31%	+9.47%	+0.46%
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%

RBI's messaging and rate actions to be more effectively transmitted over the next 12 months.

- The recently announced merger of 10 public sector banks, and their effective re-capitalization is a clear statement of intent to avoid the 'walking dead' syndrome, and to allow the public sector banks to start to lend again.
- The rolling back of the retrograde tax surcharge on capital gains, proposed in the July budget, was an acknowledgment of a mis-step, and the willingness to 'fix' the mistake.
- Further easing of FDI norms in contract manufacturing, coal mining, Digital Media, and single brand retail - clear recognition of the opportunity to continue to attract manufacturing sector FDI (and jobs!) as a viable alternative to China.
- The commitment to streamline the GST refund process, with outstanding GST refunds to be paid within 30 days will significantly ease the working capital constraints from small and medium sized businesses.
- Allowance for accelerated depreciation benefits and the deferral of auto registration fees will hopefully jump-start a new commercial vehicle replacement cycle.
- Further simplification of the KYC norms for the issuance/renewal of foreign portfolio investor (FPI) licenses.

The rupee is trading cheap relative to our Real Effective Exchange Rate fair value estimates of about Rs.70/US$.

- Yes, we have seen a sharp growth slowdown, regulatory indecisiveness, policy mid-steps, and earnings disappointments in some of the large index constituents.
- The primary risks: (i) further competitive devaluations (our base case is for the RMb to trade closer to 7.3/US$ with increased two-way volatility); and (ii) a sharp spike in crude prices in the event of a deterioration in geo-politics in the Middle East.
- Our base-case assumptions are supported by our expectation of growth having troughed in the June 2019 quarter, US$430bn in foreign currency reserves, a modest sub-2% current account deficit, inflation well in-check, the demand/supply driven pull-back in global energy prices, and importantly, the recent growth-restorative measures announced by the government.

The stock we would like to highlight this month is **Max Financials Services,** the controlling shareholder of Max Life, India's largest independent (i.e, non-bank owned) private life insurance company. After almost two decades of investments, the private Indian insurance sector has established scale (at the expense of the erstwhile government monopoly), and is on the the cusp of multi-year profitable growth. Max Life has systematically developed the highest quality insurance book in the country, with high persistency ratios across the board, and a strong network leveraging both banc assurance as well as independent agent distribution.

The stock has underperformed the market and its peers over the last 12 months on the back of concerns over the changes in holding company structure (with Mitsubishi Sumitomo swapping its stake in the operating business, Max Life, into the listed company, Max Financial), concerns over pledged shares by the founding shareholders, and the uncertainty over the banc -assurance tie-up with Axis Bank. This temporary over-hang has, quite frankly, diluted the market's appreciation of the strong growth fundamentals, systematic market share gains, and structurally superior profitability of the operating business.

With the regulators enforcing open architecture in the distribution channels, **we expect Max Life to grow its gross premiums at 25%+ annually over the next three years versus the market's more muted expectations of ~15% growth.**

- The sector growth dynamics are compelling on the back of rising awareness/penetration levels.
- Management's focus on traditional protection products, deliberately limiting the equity-linked business, has paid rich dividends, allowing the company to grow their book of business through periods of weak/volatile equity markets.
- We expect to see Max Life's gross premium growth tracking substantially above the market, allowing sustained market share gains.

We expect new business premiums to improve by 500bp over the next three years to 25% - the market is currently projecting flat margins.

- Over the past decade, Max Life has deliberately eschewed flashy top-line growth, to emphasize the selling of higher margin protection products.
- Improving persistency rations, operating leverage, and conservative actuarial assumptions make us comfortable projecting returns on embedded value at 20%+ (*management's goal is to actually deliver on a 25% return on embedded value).*

Bottom-line, our conviction is that as growth troughs, as in prior cycles *(this is the fourth 'slowdown' in the last two decades: March 2000-December 2002; June 2008-March 2009; September 2011-March 2014; June 2018-???),* **the Indian market is poised for meaningful outperformance in absolute and relative terms.**

- We expect a revival in government spending, and on infrastructure and rural development in particular, the recapitalization of the public sector banks, and a further rationalization of the GST tax slabs.
- We expect a more efficient transmission of the RBI's clear messaging on easing rates over the next 12 months.
- Sustained FDI flows, corporate M&A, and creeping acquisitions by controlling shareholders attest to increasingly attractive valuations for listed equities, and in particular, in the small and mid-cap universe.

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
HDFC Bank Ltd
Kotak Mahindra Bank Ltd
Bajaj Finance Ltd
Titan Co Ltd
Housing Development Finance

Fund's Sectoral Break-down	As % NAV
Financials:	39%
Consumer Discretionary:	24%
Materials:	12%
Industrials:	9%
Consumer Staples:	8%
Technology:	3%
Energy:	3%
Retail:	2%
Health Care:	0%
Utilities:	0%
Real Estate:	0%

Sector Contribution to Monthly Performance	
Financials:	-1.61%
Consumer Discretionary:	-0.43%
Materials:	-0.52%
Industrials	-0.50%
Consumer Staples	+0.01%
Technology:	-0.50%
Energy:	-0.06%
Retail:	-0.19%
Health Care:	+0.00%
Utilities:	+0.00%
Real Estate:	-0.78%

TANTALLON CAPITAL, 137 TELOK AYER ST #03-05, SINGAPORE 068602. T: +65 6327 3920 F: +65 6327 3924
www.tantalloncapital.com