TANTALLON CAPITAL

February 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.

Performance, in USD

(Inception on September 1, 2015)

	Tantallon India Fund	MSCI India($)	Over/Under Full Performance
February 2019:	+1.05%	+0.39%	+0.66%
2019 YTD:	-5.17%	-1.62%	-3.55%
2018:	-22.79%	-8.63%	-14.16%
2017:	+59.14%	+36.84%	+22.30%
2016:	-5.79%	-2.90%	-2.89%
2015:	+0.24%	-7.53%	+7.77%
Inception:	+10.02%	+18.55%	-8.53%

Compound Returns	+2.77%	Volatility	+20.18%
3 month US T-bill	+2.42%	Sharpe Ratio	+0.017

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 up +1.05% in February, the markets impressively shrugging-off the high stakes drama over Kashmir, with India conducting a bombing sortie on terrorist camps across the line of control in response to the suicide bombing that killed 40 soldiers, and Pakistan, in turn, retaliating by downing a couple of Indian MiG 21's. The focus now seems squarely upon the prospects of Modi being re-elected in the next General Elections *(slated for April 11-May 19, 2019),* and on the increasingly visible recovery in rural India, fixed asset investments, and private sector capital expenditure.

- High frequency data-points, and robust volume earnings growth for the December quarter would affirm that **we are on the cusp of a new investment/consumption up-cycle.**
- **We see credit growth and profit margins inflecting higher.**
- **We find valuations increasingly attractive** – especially in the small and mid-cap space – given the prospects of sustained revenue and earnings growth, and the likelihood of further easing by the Reserve Bank of India.

Having just returned from several days in India visiting companies, we wanted to pass on some of our take-always:

- Tight liquidity and risk aversion in October and November last year pushed India into a growth air-pocket of sorts – with **the real economy *only* expanding by 6.6% in the December quarter,** boosted by strong exports, recovering fixed asset investments, and robust manufacturing output. *With system liquidity having meaningfully improved, and given our growing confidence in the capex cycle ahead of us, we remain comfortable with our expectations of real GDP growth compounding at 7%+ over the next 3 years.*
- That growth soft-spot and inflation trending below the RBI's inflation-targeting framework reinforces the **RBI's accommodative policy bias,** in accord with central banks globally signaling a collective 'pause.' *We now expect another 75bp-100bp of policy easing in the next 12 months – and this is definitely not consensus.*
- **Rural India continues to surprise positively,** thanks to stabilizing farm-gate prices, and the government's specific rural policy initiatives, targeted incentives, building out rural connectivity, infrastructure, and rural housing. *Sustained rural demand is the clear bright-spot for corporate India.*
- **Politics** – *and yes, everyone has an opinion!* – dominates the airwaves. *However, mind-numbing permutations on pre-and-post-poll alliances by a host of psephologists and media pundits would suggest that no one really has a clue as 900 million Indians prepare to vote!*
    - Our expectations remain that Modi will be re-elected, albeit with a smaller majority.
    - We are equally clear in our view that if Modi is not re-elected, as in previous election cycles, the market's initially negative reaction will devolve quickly to an assessment of (i) stability and the strength of the institutions, (ii) underlying reform momentum, and (iii) the outlook/sustainability for growth.
    - ***Bottom-line, irrespective of the election outcome, we believe that Modi's structural reforms have been institutionalized, and will***

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+10.02%												
2019	-5.17%	-6.16%	+1.05%										
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%

sustain a new investment cycle, and our growth outlook.

- The **key risks** to assess are (i) the *external pressure points* (energy prices, geo-politics, trade conflicts, etc.) impacting global risk appetite/flows, creating a potential drag for Indian risk assets and in particular, for the rupee; (ii) *fiscal constraints* in an election year limiting government spending; and (iii) *delayed/impaired transmission of the RBI's easing bias* given a moribund public banking sector, and the risk of government borrowing crowding out the private sector.

Our portfolio remains significantly exposed to the idiosyncratic growth opportunity in domestic consumption through our investments in financials, as well as in consumer discretionary and staples. *We expect our exposure to the Indian consumer to continue to increase over time.*

- ***Aspirational discretionary spending constitutes a sustainable investment thematic*** thanks to demographics, urbanization, increasing education levels, job creation, and rising disposable incomes.
- We see our portfolio companies investing dis-proportionately in ***branding, distribution*** (both direct access and through organized retail), and ***product innovation,*** to drive category awareness/penetration, product differentiation, and market share gains.
- Despite the liquidity crunch ***in the December quarter, the household and personal care companies posted a 130bp quarter-over-quarter growth in volumes, suggesting that we are potentially on the cusp of a sustained consumption recovery.***
    - Given the focus of this government on driving rural incomes, rural spending will likely continue to outpace urban consumption.
    - Importantly, discretionary spending continues to exceed staples growth, suggesting that urbanization and aspirational consumption will likely sustain both volume growth and mix improvements.
- ***Operating leverage and mix improvement have sustained margins*** despite the spike in raw material input costs.
- ***Big data analytics and increasingly sophisticated predictive algorithms*** feeding off on-line consumer behavior is re-casting the e-commerce landscape, and potential winners/losers.
- ***The key risk to assess is whether or not the wave of multi-national and private equity investments into both listed and unlisted consumer-facing vehicles will ultimately, increase competitive intensity at the expense of margins.***

The stock we would like to highlight this month is ***HDFC Bank,*** India's leading full service bank with a pan-India footprint of 5,000 branches and 13,000+ ATMs across 2,800 cities. As it leverages its investments in brand, distribution reach, customer service, and digital platform, HDFC Bank's liability franchise is poised to be the significant beneficiary of the capital constraints at the public sector banks and the weaker finance companies.

Over the next three years, we expect HDFC Bank to compound its loan book at a 20%+ CAGR; consensus is looking for 15%-18% growth.

- We expect continued market share gains in both the corporate and the retail loan book at the expense of the impaired public sector banks and finance companies.
- There is a significant opportunity to grow working capital loans for small-and medium-enterprises, credit cards, and consumer lending to the salaried class on the back of its brand, brick-and-mortar expansion into second and third tier cities.
- The careful investments into semi-rural and rural India will represent the next generation of growth opportunities, and we are just scratching the surface at this point.

Over the next three years, we expect HDFC Bank to deliver on consolidated profits compounding at 25% annually, with RoA trending in excess of 2.0%, and an 18%+ RoE.

- Operating leverage as the deliberate investments into brick-and mortar in the smaller cities and in semi-rural India start to deliver on strong customer acquisition and new loans growth.
- The stellar liability franchise (with a current-and-savings-account ratio currently at 41%) and the ability to price-for-risk in an environment where competitive intensity has eased, will allow the bank to deliver on sustainable net interest margins in the 4.3%-4.5% range.
- The investments in technology and its digital outreach has seen the cost/income ratio decline by 100bp in the last 12 months; we expect 70bp of further margin improvement annually over the next three years.
- We expect credit costs to remain sub-100bp thanks to management's discipline and prioritizing an enviable credit culture.

To conclude: we do expect the markets to remain choppy in the build-up to the General Elections in May; however, on the ground, strong rural consumption dynamics and a new capex cycle would suggest that India's idiosyncratic growth opportunity is intact. We would urge investors to look through the temporary uncertainty, and to continue to increase their allocation to Indian equities.

- ***Irrespective of the election outcome, India's structural reforms and domestic economy stand poised to deliver on sustained real GDP growth compounding at 7%+ annually over the next 3-5 years.***
- We retain strong conviction in our ***portfolio companies delivering on earnings and cash flows compounding at 15%+ annually over the next three years.***
- ***Given the correction in markets/multiples over the last six months, the risk/reward is compelling.***

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:	37%	Financials:	+0.05%
Titan Co Ltd	Consumer Discretionary:	21%	Consumer Discretionary:	+1.48%
HDFC Bank Ltd	Materials:	12%	Materials:	+0.17%
Kotak Mahindra Bank Ltd	Consumer Staples:	10%	Consumer Staples:	-0.14%
Zee Entertainment Enterprise	Technology:	6%	Technology:	+0.19%
	Industrials:	5%	Industrials:	-0.29%
	Real Estate:	5%	Real Estate:	-0.52%
	Energy:	3%	Energy:	+0.10%
	Retail:	1%	Retail:	+0.01%
	Health Care:	0%	Health Care:	+0.00%
	Utilities:	0%	Utilities:	+0.00%