TANTALLON CAPITAL

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
January 2019:	-6.16%	-2.00%	-4.16%
2019 YTD:	-6.16%	-2.00%	-4.16%
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:	+8.88%	+18.09%	-9.21%

Compound Returns	+2.52%	Volatility	+20.43%
3 month US T-bill	+2.38%	Sharpe Ratio	+0.007

FUND DETAILS
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)

The Tantallon India Fund closed -6.16% in January; the volatility in global markets and rising risk aversion has served to aggravate fragile investor sentiment over the outcome of the upcoming General Elections, towards smaller and medium sized companies, and in particular, over loans made to major shareholders with pledged shares as collateral.

The irony of course is that the recent sell-off has had very little to do with business fundamentals – consistent high frequency data-points and the December quarter earnings releases would affirm that we are at the start of a new investment up-cycle, credit growth and profit margins are inflecting higher, the correction in energy prices would seem to have nudged inflation (and inflationary expectations) lower, and valuations are increasingly attractive relative to our benign outlook on inflation, and on the prospects for sustained growth.

What has changed in the public markets narrative over the last six months?

Politics: The BJP's poor performance in the State Elections in November and December has encouraged the Opposition to look to create alliances ahead of the next General Elections (that need to be held by May 2019). **The various talking heads project (loudly, and with great conviction of course!) any number of potential outcomes; what we are certain of at this point is that no one really knows!**

- ***Our working assumption is that Modi will retain a functional majority in Parliament*** – despite his well-publicized mis-steps with the introduction of GST and demonetization, and the failure to deliver on his stated goal of creating 20 million new jobs a year (the economy is currently tracking at +12m-14m new jobs per year versus the historical run-rate closer to +3m annually).
    - There is no doubt that Modi remains a polarizing figure for the media, and within the business community; you really like him, or you really don't. *The recent articles in the international press in particular, have stridently proclaimed Modi's imminent political demise, while demonstrating limited depth and texture in the analysis. Go figure.*
    - Additionally, to be fair, we are probably at one end of the spectrum in viewing with significant cynicism the myriad pre-poll alliances being touted by ideologically deeply conflicted opposition parties. *A virulently anti-Modi platform, with little thought to realistic alternatives or detail, is hardly sustainable.*
    - Our view is that the Indian electorate has always been relatively thoughtful and nuanced – and takes its electoral responsibilities seriously. *Despite the natural anti-incumbency bias, the fatigue in rural India over stagnating rural incomes, and millennial disenchantment at the pace of job creation, our sense is that Modi's street credentials and personal integrity is intact, and that the recent budgetary measures to reduce taxes, and to boost rural incomes and consumption will be positively received.*

Bottom-line, in four decades, this is the first Indian Administration that has not been swamped over allegations of corruption and crony-capitalism. Modi's reforms are transformational, and the impact on the bottom-of-the-pyramid is real. ***Given the lack of credible alternatives at the national level, we believe that Modi will be re-elected Prime Minister, albeit with a reduced majority.***

- ***What if we are wrong, and the BJP does not come back to power in May 2019?***

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+8.88%												
2019	-6.16%	-6.16%											
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%

- If history is any guide, the market's initially negative reaction will devolve quickly to an assessment of (i) the strength of the institutions, (ii) whether or not the reform process would stall, or worse, be reversed, and (iii) the outlook/sustainability for growth.
- Our absolute conviction is that **Modi's reform measures have been thoroughly institutionalized and will not be reversed** – from GST implementation, to the Real Estate Regulation Act, the new Bankruptcy code, the Debt Resolution Tribunal, the transparent Public Auctions of state assets, and importantly, the direct transfer of subsidies to the bottom of the pyramid (as opposed to the debilitating subsidy programs over the past 5 decades).

Bottom-line, yes, we should expect more stock market volatility over the next three months. However, ***over the next twelve months, as in previous election cycles, as India's growth cycle unfolds, we should also expect the market to explicitly focus on, and reward strengthening business fundamentals, and for small and mid cap stocks to significantly outperform the positive returns from the broad market.***

- In 2004, 2009, and 2014, in the 12 months following the General Elections, the NIFTY (i.e., the top 50 stocks by market capitalization) posted returns of + 39%, +20%, and +19% respectively.
- ***In comparison, in the 12 months following the elections in 2004, 2009, and 2014, the Mid-Cap universe delivered returns of +61%, +68%, and +40% respectively.***

Domestic Liquidity / Interest Rates.

- The correction in crude prices has translated to a significant pull-back in headline inflation and inflationary expectations. ***With headline inflation now tracking and projected well below the Reserve Bank of India's inflation targeting band, the RBI is in a position to reduce interest rates – and actually, did, in Monetary Policy Committee Meeting last week.***
- Yes, the struggling, lower-quality, non-bank finance companies claim the headlines in the popular press; but, from our perspective, visiting companies on the ground, ***system liquidity has clearly stabilized, as evidenced by improving credit disbursement and stable domestic bond yields.***

The key now is whether or not the outlook for energy prices / headline inflation / inflationary expectations remain benign…and if they do, we would not be surprised to the RBI cut rates further.

The stock we would like to highlight this month is ***Thermax Limited,*** a professionally-managed capital goods company focused on Industrial Heating and Cooling, Captive and Co-Generation Plants, Water System Management, Air Pollution Control, and Speciality Chemicals. Thermax has significantly revamped the business model during the current down-cycle, diversifying geographical and product mix, emphasizing short-cycle products that will smoothen order book volatility going forward. *Thermax stands out as an early-cycle industrial, strongly leveraged to the recovery in industrial capital expenditure, conservatively run with a net cash balance sheet, robust free cash flow generation, and a consistent 30% dividend payout policy.*

We expect consolidated revenues to compound at 20%+ annually over the next 3 years, versus consensus expectation of revenues compounding at ~15% annually.

- The current 1.3x book-to-bill ratio and a strong pipe-line of new order bids gives us excellent visibility on the next 18 months of orders, revenues, and margins. *As in past election cycles, we expect a significant ramp-up in domestic-order inflows post the May 2019 General Elections.*
- The *new Indonesian manufacturing plant opens up a significant opportunity in the ASEAN* for the Captive/Co-Generation vertical; the early feedback from ASEAN customers would suggest significant upside to consensus expectations.
- In addition, we expect the industrial heating business to deliver sustained growth over the next 5 years as management's investments into sales and marketing, leveraging its low cost engineering capacity in India, start to show results in other emerging markets in Asia, Latin America, Africa and Eastern Europe.

We expect earnings to compound 30% annually over the next three years; consensus expectations are anchored in the 18%-20% range.

- Through the most recent downturn (with revenues falling as much as 30% at one point) management has continued to invest in upgrading, and in new capacity in its industrials, steel, cement, and specialty chemicals verticals: gross fixed assets have increased by 50% since the last peak. *We believe the market is significantly underestimating the inherent operating leverage as capacity utilization ramps-up.*
- On the back of the recovery in domestic industrial capex, and higher export volumes driving mix improvement, we expect operating margins to improve by 50bp-75bp annually over the next three years.

To conclude: Buoyed by lower crude prices and easing liquidity concerns, and recovering consumer demand, fundamentals are starting to re-assert themselves; **we would urge investors to take advantage of the uncertainty in the lead-up to the General Elections to increase allocations to Indian equities.**

- ***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.***
- Our view on sustained volume/revenue growth, and upside inherent in strong operating leverage underpins our conviction on ***our portfolio holdings delivering on earnings and cash flows compounding at 15%+ annually over the next three years.***
- ***Valuations have corrected significantly over the last few months, and 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
Bajaj Finance Ltd
Kotak Mahindra Bank Ltd
Titan Co Ltd
HDFC Bank Ltd
Kolte-Patil Developers Ltd

Sectoral Break-down:	As % NAV
Financials:	37%
Consumer Discretionary:	19%
Materials:	11%
Consumer Staples:	10%
Industrials:	7%
Technology:	7%
Real Estate:	5%
Energy:	3%
Retail:	1%
Health Care:	0%
Utilities:	0%

Sector Performance	MTD Performance
Financials:	-1.95%
Consumer Discretionary:	-1.55%
Materials:	-0.57%
Consumer Staples:	-0.48%
Industrials:	-0.91%
Technology:	-0.81%
Real Estate:	+0.34%
Energy:	-0.22%
Retail:	+0.09%
Health Care:	-0.10%
Utilities:	+0.00%

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