TANTALLON CAPITAL

July 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
Jul 2019:	-4.58%	-5.51%	+0.93%
2019 YTD:	-0.31%	+1.08%	-1.39%
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:	+15.67%	+21.81%	-6.14%

Compound Returns	+3.79%	Volatility	+19.83%
3 month US T-bill	+2.04%	Sharpe Ratio	+0.088

FUND DETAILS

The Tantallon India Fund

AUM USD 31,000,000

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:
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The Tantallon India Fund closed -4.58% in July. The fault lines between tweets have finally been exposed with the yuan breaking its RMb7:US$1 floor. The harsh economic costs of a protracted trade conflict, the unprecedented mass demonstrations in Hong Kong challenging China's hegemony, the rolling conflicts in the Middle East, and the uncertainty posed by Johnson-ian bluster and bravado would suggest that geo-politics will likely further erode fragile investor confidence. In India, the proposal to scrap Article 370, rescinding the special rights and privileges of 'permanent residents' in the disputed border state of Kashmir, while transformative and bold, and in-line with Modi's explicit election agenda, has been a 'surprise' at a time when the slow-down in the real economy has already generated significant investor angst. *It's certainly been another challenging summer!*

Reflecting on the extreme volatility in the markets over the last few weeks:

First, the negatives:

- Volatility is up – in spades! There has been US$3bn in 'foreign selling,' in July alone.
- Global growth is challenged, and with exports now tracking at 20% of GDP, India (and the rupee) is not completely immune to the risks posed by trade conflicts, competitive devaluations, and geo-politics.
- Smaller banks and non-bank finance companies are being forced to 'clean-up;' however, given their capital and liquidity constraints, funding for small and medium sized enterprises, for the agrarian economy, and for marginal consumption, has been significantly cut-back.
- The over-hang from entrepreneurs having pledged their shareholdings as collateral to fund 'other' businesses has come home to roost, and the markets have been particularly severe with small and medium sized companies – *not* because of the fundamentals, but on account of the risk of entrepreneurs being forced to divest stock at distressed prices.

The positives:

- Cognizant of a slowing economy and weak consumer sentiment, and the negative feedback loop to the budgetary proposals increasing the effective tax burden for the 'wealthy,' and in particular, for equity investors, we expect the government to introduce targeted fiscal and monetary stimulus to drive fixed asset capital formation, specific relief measures for the agrarian economy, and the recapitalization of the public sector banks.
- The Reserve Bank of India cut repo rates by another 35bp at the policy meeting on August 7 – the fourth rate cut in a row. Given the surplus inter-bank liquidity, we expect the RBI's messaging and rate actions to be more effectively transmitted over the next 12 months.
- Government expenditure troughed at 2% of GDP during the June quarter, held back by the Elections. We expect government expenditure to normalize at 8% of GDP over the next 12 months, providing a significant impetus to the real economy.
- Strong FDI flows and overseas inflows into rupee fixed income instruments have helped alleviate the foreign equity outflows.

What on earth is Article 370?

Article 370 is the constitutional provision (inserted by Presidential decree in 1954 – as opposed to being a formal Parliamentary amendment) underpinning India's emotive, complex relationship with Kashmir, the only Muslim-majority region on the sub-continent to join India at the time of partition in 1947.

- For 65 years, Article 370 has reluctantly allowed the state of Kashmir a certain amount of autonomy - its own constitution, a separate flag, and freedom to make laws impacting local

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+15.67%												
2019	-0.31%	-6.16%	+1.05%	+9.08%	-1.89%	+3.14%	-0.19%	-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%

citizenship, including restricting ownership of property, and government employment and grants to deemed Kashmiri citizens.

- Stung by the continued insurgency in Kashmir (with over 300 people being killed in the last six months alone), and Pakistan's inability/unwillingness to rein-in terrorist activity in Kashmir (operating from 'safe' camps immediately across the Line of Control), Modi made revoking Article 370 a central plank in the BJP's 2019 election manifesto.
- Scrapping Article 370 therefore does away with Kashmir's semi-autonomous status; and the introduction of the plan to break-up the current state of Jammu and Kashmir (J&K) into two separate "Union Territories" (Jammu and Kashmir which will retain its legislature, and Ladakh, a sparsely-populated region to be ruled directly by India's central government), will explicitly increase the Central Government's control over the Valley.

Modi's decision to revoke Article 370 has provoked much consternation, support, and outright opposition, almost in equal measure – domestically and internationally.

- Modi's mandate and his penchant for calibrated risk-taking should have suggested that fulfilling his campaign pledge on Kashmir would be a priority.
    - *To be fair though, we are surprised that he acted so early in his term, when, addressing the slow-down in the real economy would appear to have been of the highest priority.*
- The flip side is that with the credibility of J&K's 'mainstream' political parties having severely eroded in the face of mounting violence, and evidence of significant state-level corruption, with Pakistan desperately looking for substantial debt relief and financial aid packages from the IMF and the US, and with China focused on its trade-tiff with Trump and the demonstrations in Hong Kong, it is *the* opportune time to 'change' the status quo.

Bottom-line, it is too soon to hazard even an 'educated guess' as to how the history books will ultimately judge Modi's decision to abrogate Article 370 – and there are simply too many moving parts to even pretend other-wise.

- *That said, in the weeks ahead, we should (i) expect more violent insurgency in J&K,(ii) a robust challenge in the Supreme Court questioning the constitutional validity of Modi's decision to abrogate Article 370, and (iii) significant criticism in the international media/ forums as Pakistan and China look to marshal opposition to Modi's determination to re-frame the 'debate' over Kashmir.*

The stock we would like to highlight this month is ***Asian Paints,*** the largest paints company in India, operating in both the decorative and the industrial coatings segments. With 60,000+ dealers across the country, Asian Paints is primed to benefit from the continued build-out of urban infrastructure and rural housing, the revival in urban discretionary spending, and an improving product mix.

Looking out over the next three years, we expect revenues to compound at 15%+ annually versus the market projecting revenue growth in-line with nominal GDP growth of 11%-12%.

- Having boosted capacity by 50% with two brand new plants coming online, Asian Paints is primed to take advantage of its dominant brands presence (30% market share of the domestic paints market, 3x larger than its nearest competitor, with revenue per dealer 60% higher than competition), the nascent demand from the government's 'housing-for-all' initiatives in rural and semi-urban India, and the significant upside in the 're-painting' segment (which accounts for 90%+ of overall decorative demand in the country).
- The recent GST slab reductions have opened up several new market segments, and management is singularly focused on driving market share gains in the distemper, putty, and emulsion segments at the expense of the unorganized sector.

We expect earnings to compound at 18%+ annually over the next three years versus consensus projections in the 10%-12% range.

- A benign input cost environment will be supportive of higher margins; however, we are not yet modeling in any upside since we expect management to use price to drive sustained volume growth and higher plant utilization rates.
- We expect to see 50bp of operating margin improvement over each of the next three years as capacity utilization ramps up in the two new plants, and as management's deliberate focus on brand positioning and product recall drives volume growth and improving product mix.

Given capex having peaked, and significant free cash flow, we believe there is good impetus to model an improvement on the current 45% pay-out ratio.

Bottom-line, as negative as sentiment seems to be at the current point, we can definitively point to at least three occasions in the last six years (August 2013, December 2016, and November 2018), when sentiment was actually even worse!

- With ample domestic liquidity, we expect a more efficient transmission of the RBI's clear messaging on easing rates over the next 12 months.
- We expect a revival in government spending, the recapitalization of the public sector banks, and a further rationalization of the GST tax slabs.
- Valuations are attractive, and especially for the small and mid-cap universe, attested to by a spate of corporate M&A and continued FDI inflows.

We would simply underscore our **conviction in India's idiosyncratic growth opportunity** and specifically, the opportunity in *financial services, consumer discretionary, and real estate.*

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

Sectoral Break-down:	As % NAV
Financials:	38%
Consumer Discretionary:	23%
Materials:	11%
Consumer Staples:	8%
Industrials:	6%
Technology:	6%
Real Estate:	4%
Energy:	3%
Retail:	1%
Health Care:	0%
Utilities:	0%

Sector Performance	MTD Performance
Financials:	-1.68%
Consumer Discretionary:	-1.72%
Materials:	+0.18%
Consumer Staples:	-0.41%
Industrials:	+0.01%
Technology:	-0.81%
Real Estate:	-0.01%
Energy:	-0.15%
Retail:	+0.01%
Health Care:	+0.00%
Utilities:	+0.00%

