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
June 2019:	-0.19%	-0.48%	+0.29%
2019 YTD:	+4.47%	+6.98%	-2.51%
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:	+21.22%	+28.91%	-7.69%

Compound Returns	+5.15%	Volatility	+19.90%
3 month US T-bill	+2.08%	Sharpe Ratio	+0.154

FUND DETAILS

The Tantallon India Fund

AUM USD 32,000,000

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 -0.19% in June with anxiety over multiple trade conflicts, heightened concerns over a potential military conflict with Iran, and expectations of a more populist tilt in the Budget, keeping investors on the sidelines.

- **We are disappointed that the Budget was not more 'bold' with targeted infrastructure and rural spending given the sharp slowdown in the real economy. That said, we are encouraged by the fact that Modi has chosen to stay fiscally disciplined.**
    - *The Budget is rational and goal-oriented, stressing sustained, inclusive growth, the reduction of stark income inequality, the systematic build-out of a digital ecosystem to create a cashless economy, accelerated infrastructure and affordable housing investments, the recapitalization of the public sector banks, and stability in the non-bank financial services and SME sectors.*
- **We expect robust capital flows and lower real interest rates to be supportive of higher multiples as the corporate earnings cycle inflects positively to the upside.**

On the budget specifically:

- The narrative in the recent Budget and the Government Economic Survey focused explicitly on investment and export-led, sustainable, inclusive growth.
- The budget math is 'reasonable,' attested to by the +2% appreciation of the rupee versus the US$ since the budget. We are particularly encouraged by:
    - demonstrated fiscal restraint *(as opposed to devolving to short-term debt-funded fiscal stimulus and unsustainable subsidies)* in maintaining the fiscal deficit at 3.3%;
    - the explicit focus on bringing down real interest rates and the cost of capital;
    - the re-capitalization of the SOE banks;
    - the commitment to ensure adequate systemic liquidity in the non-bank financial services and SME sectors;
    - the reduction in the corporate tax rates for SMEs to 25% in order to stimulate new capacity creation and employment.
- The negatives in our view are 1) the surcharge levied on the highest tax bracket, potentially dampening domestic high net worth investor risk appetite; 2) the proposal to increase the minimum free float listing requirements from 25% to 35%, creating a (unnecessary) potential overhang for stocks in the short-term; and 3) the absence of specific measures to revive the property sector – the government's focus affordable housing while laudable, does not have the multiplier effect that we had hoped for.

There is a slow-down at hand: *the data points we have tracked over the last month of travel would suggest that the real economy slowed precipitously in the last few weeks of the June quarter.*

- The primary culprit seems to have been the delayed onset of the monsoons, negatively impacting rural sentiment and demand.
- We would also point to the pull-back in SME and rural lending given the tight liquidity conditions for the small non-bank finance companies.
- Vehicle sales continue to be extremely sluggish, posting year-over-year declines for the first time in almost a decade, as buyers digest higher vehicle prices following the imposition of more stringent emissions and fuel efficiency norms.
- Jewelry sales have also lagged expectations, as have sales of white goods and consumer electronics, pointing to significantly tighter liquidity conditions

YEAR	RETURNS	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC
Inception	+21.22%												
2019	+4.47%	-6.16%	+1.05%	+9.08%	-1.89%	+3.14%	-0.19%						
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%

On a more positive note, following Modi's decisive victory in the General Elections, domestic equity inflows rose to a three-month high. *The locals believe!*

- Equity inflows into domestic mutual funds increased to Rs.63bn in June (v. Rs.34bn in May).
- Including ETFs, equity mutual funds reported inflows of Rs.119bn (v. Rs.61bn in May).

The Key risks we continue to assess:

1. **Tight liquidity conditions on the ground.**
2. Geo-political uncertainty escalating into military conflict(s), unpredictable trade conflict outcomes, and messy custom-union break-downs will weigh on **global growth and risk appetite.**
3. **Higher energy prices** weighing on the rupee, and potentially restricting the government and the RBI's ability to deliver on fiscal and monetary stimulus.

The stock we want to highlight this month is ***Nestle India Limited,*** the Indian subsidiary of Nestle SA, with a portfolio of dominant brands in the key categories of instant noodles (Maggi), instant coffee (Nescafe), chocolates (Kitkat), baby foods (Lactogen), and condensed milk (Milkmaid). The new management's focus on product innovation for the local Indian market, and the commitment to deliberately invest in new categories and brands from their global portfolios in order to drive new category growth, product penetration, and market share gains, sustains our conviction in compounding top-line growth and margin expansion.

We expect Nestle India's consolidated revenues to compound at a minimum of 12.5% annually over the next three years, well ahead of market consensus anticipating top-line growth in line with real GDP growth, in the 7-8% range.

- We are comfortable projecting product volume growth compounding at a 10%+ CAGR over the next 3 years.
  - *We believe that the market is under-estimating management's clearly articulated goals to increase product innovation for local market tastes and preferences, to localize global brands, and to invest significantly to improve product quality, and to support new category growth, brand awareness and market share gains.*
- We are comfortable building-in an annual 2.5%-3% increase in effective value realization given a relatively benign competitive environment in Nestle's key product categories, and the ability to sustain mix improvement on the back of the new product launches.
  - *We believe that Nestle's global product portfolio and brands are uniquely positioned to benefit from the Indian middle class's increasing propensity to consume/spend on the back of rising disposable incomes, improving affordability, and the proclivity for global brands. Frankly, we might well be under-estimating Nestle India's inherent mix/pricing tailwinds over the next several years.*

We expect Nestle India to compound earnings at 18%+ annually over next three years, well ahead of consensus estimates projecting a more modest 12% CAGR.

- Despite some raw material price inflation, and the 100bp increase in advertising and promotion expense that we are currently modeling, we expect sustained top-line growth, improving product mix, and strong operating leverage to drive 100bp of margin accretion annually over the next 3 years.
  - *We believe that the market is ignoring the deliberate investments that have been made over the past three years in the Milk and Nutrition categories to (i) improve product quality, (ii) improve product awareness and brand recall by building out distribution and the medical representative networks, and (iii) drive mix improvement through the introduction of healthier variants (Atta Noodles and Oats Noodles), and brand extensions in the emerging soups and sauces categories.*

To conclude:

- **We expect that Modi will (1) accelerate his reform / development agenda, (2) catalyze a new infrastructure driven investment cycle, and (3) deliver on sustained, inclusive growth, and job creation.**
  - *We believe that Modi's focus priorities (investments, job creation, infrastructure, industrialization, and resolving farm distress), the recapitalization of the public sector banks, and the commitment to ensure adequate liquidity for the non-bank finance companies, will deliver on clear development goals in a growth-challenged world, sustaining a long-tern tailwind for Indian equities.*
- We would underscore our **conviction in India's idiosyncratic growth opportunity** and specifically, the opportunity in *financial services, consumer discretionary, and real estate, (while minimizing exposure to the sectors most vulnerable to a global slow-down, i.e., IT Services, energy, and generic pharmaceuticals).*
  - *We expect our portfolio companies to deliver on earnings and cash flows compounding at 15%+ annually over the next three years.*
- **Valuations and the risk/reward are compelling** (and especially in the small and mid-cap space) given *our expectations of sustained revenue and earnings growth, the near certainty now, of further easing by the Reserve Bank of India, and improving systemic liquidity.*

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:	+0.24%
HDFC Bank Ltd	Consumer Discretionary:	24%	Consumer Discretionary:	+0.30%
Titan Co Ltd	Materials:	11%	Materials:	-0.03%
Kotak Mahindra Bank Ltd	Consumer Staples:	7%	Consumer Staples:	+0.12%
Housing Development Finance	Technology:	6%	Technology:	+0.10%
	Real Estate:	6%	Real Estate:	-0.20%
	Industrials:	5%	Industrials:	+0.13%
	Energy:	3%	Energy:	-0.31%
	Retail:	1%	Retail:	-0.54%
	Health Care:	0%	Health Care:	+0.00%
	Utilities:	0%	Utilities:	+0.00%