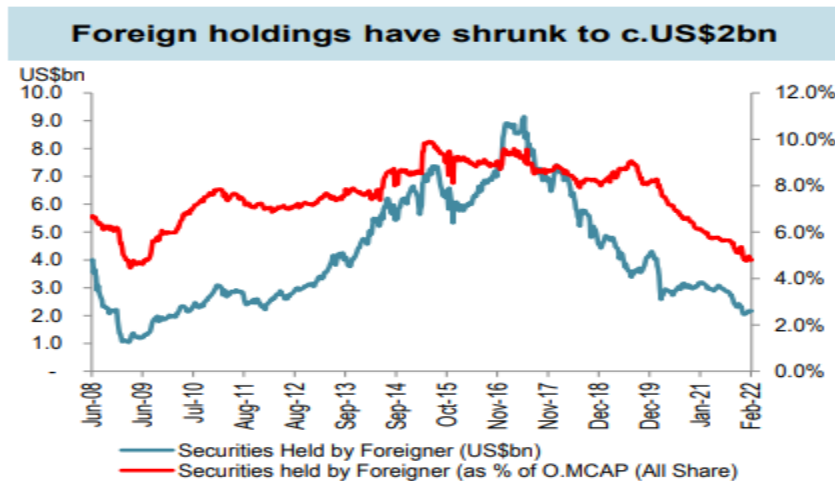


Outlook: Betting On Pakistan

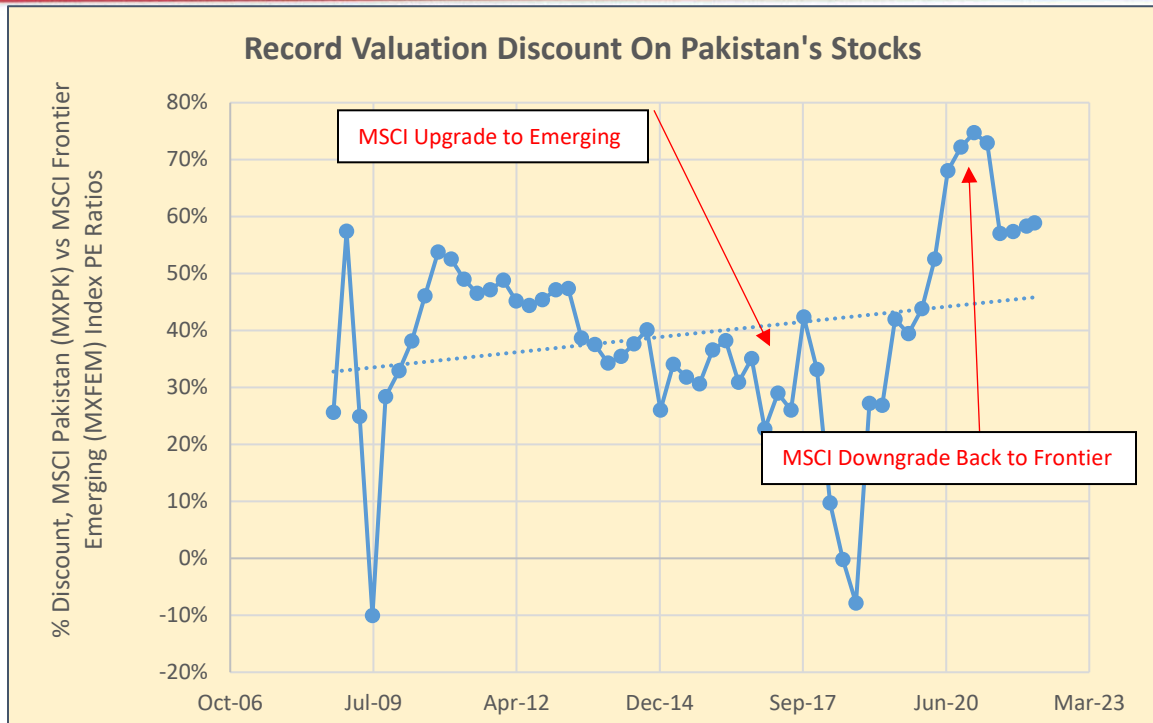
“Money doesn’t change people. It mainly exposes them.” Pakistan Proverb

We recently added to our positions in Pakistan. The country’s complex buy case is neatly summed up in two charts (below). Foreign investors, who come and go, already came and went, significantly triggered by a major MSCI “upgrade” of Pakistan to its Emerging Markets Index in 2017, followed by a “downgrade” back to its Frontier Markets Index in 2021. Foreign ownership of Pakistani stocks is now near an all-time low of under 5% and below one-half of peak levels, with the remaining stakes mainly held by strategic investors.

As a result, the **valuation discount on Pakistan’s stock market** versus similar small emerging and frontier markets is about 60%, also a near-record level, and the index’s trailing PE ratio is about 6. Cheap stocks abound in Pakistan.



Source: Tellimer



We think that **Pakistan's most compelling investment opportunity** is in its technology exporters and the beneficiaries of increasing technology adoption. We have held a position in Systems Ltd since mid-2020. Systems provides IT services to foreign companies. As a Google job search illustrates, Systems' key competitive advantage is the cost of its workers, with posted annual salaries for software engineers a small fraction of those in the U.S. or India at under \$30,000. The company also benefits from a near-perfect hedge to currency risk, since it pays wages in Pakistani rupees and generates sales almost entirely in hard foreign currencies, so a currency devaluation increases profit margins and enables lower prices. After a series of upgrades to our forward earnings estimates, we see the shares at a PE ratio of about 17, still an attractive level for its compelling growth prospects.

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In February we **added TRG** to the portfolio, which is a technology play and a high-risk special situation with high potential upside. TRG is a holding company, with significant equity stakes in Afiniti, a private AI applications provider; in Ibex, a separately listed software company; and a cash pile equal to about one-third of TRG's market capitalization. TRG shares plummeted after its prominent founder was forced out of all management roles in late 2021 due to a nasty Me-Too scandal. Our bet now is twofold: that TRG's re-constituted board, composed of Pakistani technology figures with solid backgrounds, will successfully improve the company's governance and standing with investors to put the scandal behind them, and that Afiniti, its key asset, will continue its phenomenal growth story. Assuming that Afiniti maintains its pre-scandal sales level and is valued on nine times its sales, TRG shares would more than double from current levels (including a holding discount of 30%). Adding to that potential would be a future continuation of sales growth, which historically averaged over 50% per year. Risks to this scenario include unexpected scandals or legal exposures at Afiniti or TRG, a complicated holding company structure, unpredictable timing of sales for software companies, and possible pressure on Afiniti sales if its Big Tech clients decline. We like the profile of Afiniti's new CEO, who formerly ran Verizon, and its natural protection against a weak Pakistan currency, with two-thirds of its employees based there. As a stock, TRG is a swing for the fences.

We also recently **added Air Link Communication** to the portfolio, after it had declined following its IPO in September 2021. Air Link is a cellphone distributor for Apple, Samsung and most other manufacturers, and they are expanding aggressively. A meager 14% of Pakistan's population currently own a smartphone, and Air Link stands to benefit from increasing consumer demand as internet apps are rolled out and wireless internet speeds improve. Cellphone manufacturers favor modern retailers like Air Link over mom & pop retailers, in order to reduce the one-third of the market that is imported illegally into Pakistan. Air Link plans to multiply the number of its stores by 10 times by 2025, and it is now the local assembly partner for Xiaomi, a red-hot Chinese brand. The PE ratio of its shares is about 12 on our forward estimates, which we see as attractive.

Charlie Gushee
February 28, 2022

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t: 646.738.8078
cgushee@kykloscapital.com