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4 December 2021

Research Flashnote: TRG (Suspended coverage) – the path to redemption

- The unfortunate chapter in TRG might have ended with its CEO resigning from the board and position at TRG Pakistan. As we wrote in our earlier report, academic research which tracked more than 200 such cases shows that on average the negative hit is around 1.5% to share price. However, TRG's share price has declined by more than 50% - a far extreme outcome. While this looks an anomaly, we think the share price reaction is demonstrating that the market is treating this as not just a CEO scandal but a deeper issue of trust in the company. It is important for the sponsors to be cognizant of this, as this shows that the path to normalcy might require re-building trust of minority shareholders.
- TRG has been a difficult stock for the local market to understand and appreciate. This is also reflected in the fact, that over the past two years, most newspaper articles have been critical of its bull run (read: [Dawn: Beware of the bubble](#)). The primary reasons was that being a venture capital firm which had incubated early stage technology companies, the company generated no profits, limited positive cash flows and paid no dividend. Its shareholding was dominated by local brokers, rather than by institutional investors, or the founders. A lot of this changed over the past 18 months. Two of the three companies in TRG's portfolio had liquidity events, and the company paid a dividend. The stock price rally from the trough of less than PkR13 in March 2020 to a peak of PkR170 per share was driven by this change.
- Despite the rally, there were always red flags which explained why it traded at a deep discount to the potential value of its portfolio companies. We had raised these red flags in our March 2021 note and that is why we treated TRG as a special situation stock. The red flags included the dominance of politically connected people on the company's board of advisors. Of course that was not only unusual for a technology company but also must be a significant direct cost. The highly promoted Ski-trips of the company, while commendable as a marketing promotion of Pakistan as a tourist destination, hardly seemed to add to its credentials as an AI company ([click here](#)). Earlier examples of Pakistani businessmen mixing geopolitics with business also do not make good case studies, something which the market must be worried about.
- Such a strong political clout usually also does a dis-service to the businessman by clouding his judgement as many close to him may hesitate to provide negative feedback. This chapter has ended and now the onus is on the new management and board. The first task for TRG's board and management would be to prove that it is focused on business and is not entangled in some broader geo-political game. Perhaps hiring board advisors and management who have strong technology backgrounds could be a good starting point.
- In the last analyst presentation, the former CEO had laid down a plan; he had guided that the company will return the cash generated from the sale of etelequote, either through dividend or by buyback of shares (depending on whichever was more tax efficient). He had also expressed hope that Afinti would have a liquidity event in 2022 (the market was initially expecting it in 2021). The primary question for the market is whether the company can still deliver on these expectations.

- We are conscious that liquidity event on Afinti is not something which can be done in a short time horizon, especially after this event. This is why the use of cash would be the first litmus test of the new management team. As the Dawn article cited earlier shows that high level of sharholding of local brokers in the stock, has sometimes created concerns about volatility in the stock price. This issue was inflated by limited direct interaction of management with investors. The task of investor engagement and communication should not be outsourced to sponsor shareholders. We hope that the new CEO of TRG Pakistan will directly engage with the market and establish trust and credibility.
- On Afinti, perhaps hiring a new tech CEO from an AI company could be a positive step. Even better would be a female CEO, to show cimmitment to gender equality. The most important ofcourse would be evidence that the company can retain its contracts. We think a private equity exit might be better than a SPAC route.
- As we stated in our last note, TRG board and management have a strong responsibility and duty to Pakistan's capital markets and its minority shareholders. Firstly, TRG is the only company in Pakistan's history, which was allowed to use the capital raised through the IPO to invest in seeding companies offshore. Pakistan has strict capital controls and any offshore investment of more than \$5m by a Pakistani company requires approval from the National Parliament. TRG got this previlged exemption on the back of their strong vision and solid plans. Their success would enable other software companies to also get similar approvals. This is critical for the growth of Pakistani technology sector. Secondly, TRG is a highly coveted employer of technology talent. Afinti as an employer is considered to be a top place for university graduates. The company is, and has been a source of inspiration and pride for Pakistan's technology sector. On a personal note, its founders have been inspirational role models for many like me. Zia Chishti was the Chief Guest at LUMS convocation of Class of 2002, which I attended as a final year student and I wrote fan-email to Mohammed Kaisghi, his co-founder as a student in Oxford in 2004. I think the positive impact from being a good role model, is far greater than recognition from the political power circles. In this spirit, we think it is imperative for the new management of of TRG to set a good example as a responsible publicly listed company.

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- Neutral: -10% to 10% potential relative to KSE100 Index
- Underperform <-10% downside potential of relative to KSE100 Index