Iran Investment Monthly

July 2015 - Volume 9, No 106

TURQUOISE PARTNERS

Iran and EU3+3 announced the reaching of a comprehensive agreement on the Iranian nuclear program on July 2015

Market Overview — 2

The average price to earnings ratio of the market stood at 5.5 at the end of June, about 0.5 points lower than the 20 year average valuation of the Iranian stock market. Shares in the automotive sector showed a positive performance in June as the index grew by 8.6%. Shares of Iran Khodro, the largest automotive manufacturer in Iran, gained 9% in value. The sector's average P/E ratio reached 15, the highest valuation amongst the top 10 largest industries in terms of market cap. Based on a survey by a private financial consultancy firm in June, more than half of those active on the market predicted that banks will benefit the most from the nuclear deal in Vienna. Once sanctions are lifted, banks will be faced with a number of important developments, such as the opening of banking routes, Letter of Credit (LC) and trade and finance which would lead to the resumption of more activity for Iranian banks.

Country Highlights — 4

The most recent and important news about the country will be mentioned in this section.

Economy — 5

A general overview of foreign investment and expected major economic developments in post sanction economy of Iran, will be detailed in this section.

Iran Investment Monthly is produced by Turquoise Partners and distributed electronically by exclusive subscription.
Chief Editor: Ramin Rabii
Authors: Shervin Shahriari
Sanam Mahoozi
Radman Rabii
Yeganeh Eghbalnia

Turquoise Partners, No. 10, 7th St. Khaled Eslamboli (Vozara) Ave.
Tel : +98 21 887 26 681 Fax : +98 21 887 26 680
Email : info@turquoisepartners.com
To find out more about Turquoise Partners, visit our website at: www.turquoisepartners.com.

The stock market rebounded by 2.8% in June as investor optimism grew in relation to the nuclear negotiations in Vienna. Sectors benefiting from the deal with good performance were sectors such as banking and automobiles whereas, exporters performed poorly due to their sensitivities to Rial appreciation. With AGM season kicking off, almost 60% of the companies on the TSE held their annual AGM's in June. These companies distributed more than 80% of the total earnings of last year which, was higher relative to the long term 70% payout ratio of the TSE. High payout ratios were enforced by major shareholders from semi governmental entities who, due to cash flow problems and financial commitments to pensioners and privatization organizations, had little choice but to take this course of action. The average price to earnings ratio of the market stood at 5.5 at the end of June, about 0.5 points lower than the 20 year average valuation of the Iranian stock market.

A number of key sectors are analyzed below:

Banks:

Based on a survey by a private financial consultancy firm in June, more than half of those active on the market predicted that banks will benefit the most from the nuclear deal in Vienna. Once sanctions are lifted, banks will be faced with a number of important developments, such as the opening of banking routes, Letter of Credit (LC)s and trade and finance which would lead to the resumption of more activity for Iranian banks. This aside, the political breakthrough provides a great deal of hope for the improvement of the country's monetary and financial systems with expectations of financing costs falling once foreign money comes in. This will also positively affect Iranian banks which, are currently suffering from high real interest rates given their debts to depositors due to the Central Bank's tight monetary policy. Taking all this into consideration, fluctuations in banking stocks in June were tied to the news coming out of the negotiations in Vienna. Overall, the sector's index rose by 7.7%, resulting in the stocks trading 5.6 times higher than their forward projected earnings at the end of the month.

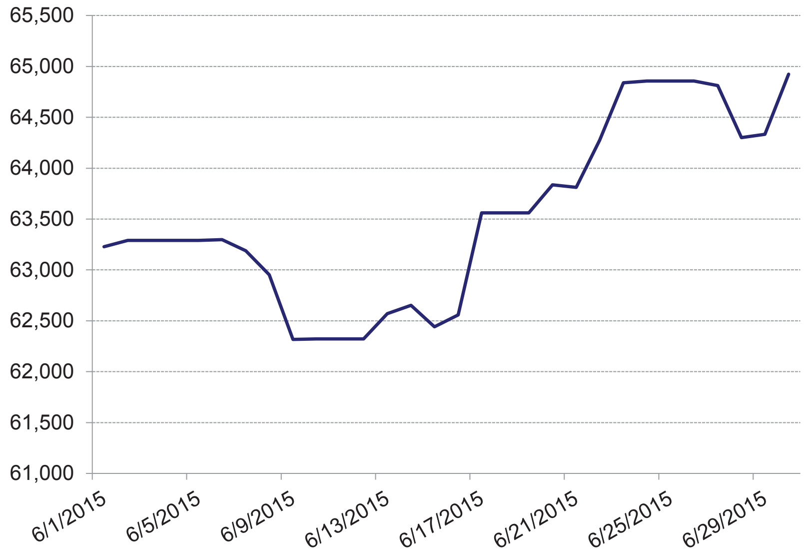
Automotive:

Shares in the automotive sector showed a positive performance in June as the index grew by 8.6%. Shares of Iran Khodro, the largest automotive manufacturer in Iran, gained 9% in value. The sector's average P/E ratio reached 15, the highest valuation amongst the top 10 largest industries in terms of market cap. The recent gains as well as high valuations were again products of the positive outcome in nuclear negotiations and optimism surrounding the removal of sanctions. Expectations are that with the easing of sanctions, there will be great opportunities for Iranian automakers to partner up with Europeans on joint ventures to produce new and modern cars. This could be a very likely scenario as the car market in Iran has been more or less closed to the global market for the past several years and there is high demand for modern cars, especially taking into consideration the 80 million population of Iran, of which 65% are below the age 30.

Cement:

The seasonal popularity of the cement sector is not a new occurrence in the history of the stock market; however, the story seems to be different this time around. In recent months, this sector has very much lagged behind resulting in strong selloffs across the sector. In addition, the news which came out of the AGMs resulted in the weak performance of the sector of – 3.6%. According to managers in this sector, the excess supply of cement is an ongoing problem for Iranian producers which has worsened over the past year. As the amount of unsold cement in warehouses reached 20 million tonnes (equal to one third of the annual production of the country), cement producers have begun to curb their production for the first time in the history of this industry. Investors did not react well to this news, causing the index of the industry to fall by 23% year on year, placing the sector amongst the worst performers of the TSE during this period. Analysts believe that the recent cuts in production will not resolve the problems in the plants; they argue that positive developments will come once the economy starts to improve and once government spending on infrastructure and construction projects picks up. This, however, depends on when access can be gained to blocked money of oil revenues that were sold during sanctions.

Performance of TSE All-Share Index (June)



Market Statistics (June)	
Average P/E	5.5
Trade Value ($ Billion)	0.8
Trade Value Monthly Change (%)	6.6
Market Cap ($ Billion)	96

Top 5 Traded by Value (June)

Rank	Company Name	Turnover Value ($Million)	% of Total Turnover
1	Persian Gulf Petrochemical Industry	57	7
2	Saderat Bank	38	5
3	Khark Petrochemical Co.	34	4
4	Tamin Petrochemical Co.	26	3
5	Saipa Co.	25	3

Top 5 Companies by Market Cap (June)

Rank	Company Name	Market Cap ($Million)	% of Total MC
1	Persian Gulf Petrochemical Industry	9,086	9
2	Tamin Petrochemical Co.	3,647	4
3	Mobile Communications of Iran	3,412	4
4	Mellat Bank	3,291	4
5	Parsian Oil & Gas Development	3,287	3

All figures quoted in USD in this Newsletter are calculated based on the Central Bank of Iran's official USD/IRR exchange rate of 29,319 as at 30 June 2015

Due to Central Bank's revision on the official exchange rate of the Rial, TSE's market capitalization and trading value in USD have reduced dramatically.

- After more than a decade of disputes, many years of negotiations finally came to an end when Iran and the group known as the EU3+3 (Germany, UK, France, China, Russia and the United States of America) announced the reaching of a comprehensive agreement on the Iranian nuclear program. The latest round of negotiations, which lasted for more than two weeks in the city of Vienna, was one of the longest and toughest in recent history. Many of the meetings held at deputy and ministerial level between all the negotiating parties lasted into the late hours of the night and early hours of the morning after. Media reports during the negotiations suggested a few heated discussions and long hours of bilateral and multilateral meetings. Finally, the negotiating parties were able to conclude the discussions and close all the gaps that had remained in the talks. These issues included the process of removing sanctions placed on Iran as well as limitations on the Iranian nuclear program. On the morning of Tuesday July 14, 2015, Iran and the EU3+3 announced that a deal had been reached. The Iranian Foreign Minister, Javad Zarif, and the High Representative of the European Union for Foreign Affairs and Security Policy, Federica Mogherini, read out a joint statement which described the reaching of the agreement termed the Joint Comprehensive Plan of Action (JCPOA). The agreement envisions the termination of all previously applied sanctions by the United Nations Security Council through various resolutions passed since 2006. It also paves the way for all unilateral sanctions placed on Iran by the European Union, the United States and other states in regards to its nuclear program, to be terminated or cease to apply. For its part, Iran is also required to abide by a number of limitations regarding its nuclear program which include reducing the number of centrifuges which will be enriching uranium, as well as limiting enrichment levels to 3.67%. Iran is also to reduce stockpiles of enriched uranium and work on re-designing a heavy water reactor to produce less plutonium. The removal of sanctions and the verification of Iranian compliance will be carried out in a few months, after the plan has been approved by the parties' domestic legislative branches. The Joint Comprehensive Plan of Action also includes various provisions which have called for technological cooperation between Iran and the negotiating parties in the fields of nuclear sciences and technology.

- On Monday July 20th, the United Nations Security Council (UNSC) endorsed the Joint Comprehensive Plan of Action which was concluded on July 14th. The UNSC resolution which was unanimously approved by a vote of 15 to 0, will replace all previous resolutions concerning the Iranian nuclear program (resolutions 1696, 1737, 1747, 1803, 1835, 1929, and 2224) and states that all of these resolutions will be terminated upon verification by the International Atomic Energy Agency (IAEA) that Iran has complied with its obligations under the JCPOA. As a result, all sanctions that were applied by the aforementioned resolutions will be terminated.

- The Iranian Supreme Leader, Ayatollah Seyed Ali Khamenei, in his speech marking the end of the Islamic month of Ramadan, stated that Iran's policy towards the United States will not change as a result of the reaching of a nuclear agreement. He stated that regardless of whether the provisions of the JCPOA are approved or not, Iran will not allow foreign powers to misuse the terms of the agreement. Ayatollah Khamenei stated that Iran will continue supporting its allies in the region in their fight against terrorism.

Post Sanction Economy: General overview

The nuclear deal agreed between Iran and EU3+3 in July 14th, 2015, is expected to become a historic turning point in regards to economic reforms over the past decade in the country. Many financial analysts consider the nuclear agreement a breakthrough opportunity for the local entrepreneurs and global investors to step into the Iranian capital markets. The Iranian Rial foreign exchange rate against U.S Dollar stabilized at a certain level in the same week. In the short to medium-term (1 – 3 years), the Iranian post-sanctions economy could undergo major developments particularly in three sectors that has great influence on GDP: banking and financial sector, oil and gas sector and trade of goods and services.

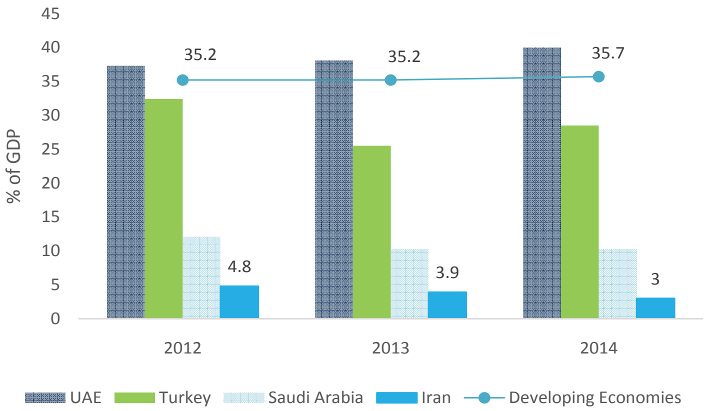
Major developments in the short to medium-term

- Relief in banking sector: An end to banking sanctions, would allow many local banks to benefit from foreign funding opportunities and to increase their revenues through introduction of international banking services. By removing international financial sanctions over the Iranian banking industry, local banks and financial institutions are able to connect with their international counterparts, offering credit cards and opening financing facilities for traders and business owners.
- Investment and technology boost in oil & gas sector: According to the ministry of petroleum, the crude production capacity will reach 4.7 million barrels a day (mb/d) by introducing a new Iran Petroleum Contract Scheme in near future, a 52% increase from 3 mb/d as of May 2015 (OPEC, 2015). The natural gas output is expected to hit 1,000 million cubic meter per day (mcm/d) within the next 3 years, a 50% increase from 666 mcm/d as of March 2015. The terms of the deal allows the EU to restore petroleum trading with Iran and will likely allow European oil and gas companies to resume investing in the sector.
- Increase of production capacity in the industrial sector: The industrial sector which encountered lower local demand and a decline in foreign sales due to transaction barriers and obstacles in access to feedstock and parts, is likely to regain its potential for producing at their nominal capacity. It is estimated that Iranian industries are producing 60% to 70% of their nominal production. For example, Iranian local pharmaceutical producers who play a major role in supplying medicines experienced significant challenges on importing finished products and pharmaceutical raw materials. If such challenges are removed, there will be huge partnership possibilities between local pharmaceutical manufacturers and their foreign counterparts. Having said that, there are serious hurdles for industries to get back on track to their pre-sanctions position in regional and global markets. A similar scenario is applicable to automotive and other industries as well.
- 2.5% to 3% growth in the short-term: According to IMF and CBI officials, if the sanctions are removed, the economy will struggle to deal with the immediate impact during the initial months of removal, although the impact could result in a 2.5% to 3% growth rate for the year 1394 (March 2015 to March 2016).
- Foreign exchange rate stabilization: Release of Iranian foreign assets of over USD100bn and increase in government revenues from petroleum exports, especially the revenues that have not been accessible due to sanctions, would improve the country's balance of payments. These conditions would enable the central bank to stabilize Iranian Rial foreign exchange rate fluctuations. The authorities have signaled their preference to unify the official and unofficial rates to get back to the stable situation that market experienced between 2002 and 2010.

Reintroduction of foreign investment in the long term

Apart from the above adjustments in the short and medium-term, the Iranian economy is expected to go through fundamental changes via foreign direct investment (FDI) in the next 5 to 10 years, assuming sanctions will be removed. According to economic principles, FDI acts as a catalyst in developing countries through technology shifts in labor and industrial oriented sectors, especially those countries with high potential of becoming a large emerging market such as the BRICS[1]. For example in the case of Turkey, FDI brought a considerable boost to the economy through productivity growth, simultaneously the government encouraged domestic private investment by providing an improved investment atmosphere. Likewise, in Iran, economic studies indicate significant and positive relationships between the increase of FDI and the economic growth over the past 30 years. A regional comparison of the FDI trend show that the sanctions influenced Iran's FDI level significantly, compared to its regional peers, in recent years (figure 1).

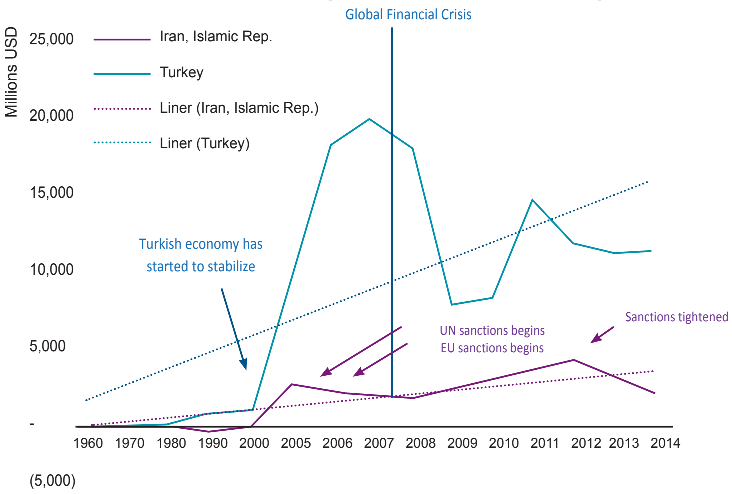
Figure 1. Foreign Direct Investment Inward Flows & Stocks



Source: UNCTAD

A longer view on Turkey's FDI trend indicate that since the year 2000, FDI witnessed continuous positive growth of 29% on average year on year. In Iran, FDI that have risen up between 2000 and 2005, experienced declines since 2005 up to 2008. In 2012 the flow was severely depressed with the tightening of the sanctions (Figure 2).

Figure 2. Foreign direct investment, net inflows (BoP, current US$)



Source: World Bank

Assuming stable conditions, rational and market-driven economic policies are expected to bring positive growth in FDI in the long run for the Iranian economy. Macroeconomic stability, political maturity, openness of trade and investment policies and the quality of education are likely to count as promising factors over the next decade. This is part of the reason as to why Iran is one of the Next 11 Counties[1] selected by Goldman Sachs for high growth potential. In best case scenario, foreign investment will likely go into the equity market through investment funds. Government privatization plans of its state-owned factories and companies will also increase the possibilities of investment in the equity market.

There are encouraging factors suggesting a boost in foreign investment in the long-run:

1.During sanctions, Iran maintained a well-developed manufacturing base accounting for 12% of GDP.
2.Iran's non-oil sectors, like retail, hospitality and services will play an important role in attracting foreign investment. The young and educated population profile are a key factor in the growth of the aforementioned sectors. In addition, non-oil sector exports strengthened significantly during sanctions, reaching to USD 15 billion between January and May 2015, registering a growth of 7% compared to the same period last year.
3.Foreign investment legal framework both for direct investments and also investing in financial markets are already developed and institutionalized in the country. The legislation has been approved by the high-level decision maker authorities such as the Expediency Council.

Nonetheless, Iranian's long run economic outlook is affected by many factors beyond economic research and data analysis. Iranian economy was isolated for more than a decade; thus it requires certain adjustments over a period to find its equilibrium as one of the largest economies in the

1. According to a research paper by Goldman Sachs Investment Bank, eleven countries (Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, Philippines, Turkey, South Korea and Vietnam) are known as the next eleven countries with high potential of growth along with the BRICs (Brazil, Russia, India & China), as the world's largest economies in the 21st century.

region. Certainly the business atmosphere has many obstacles to overcome: inefficient bureaucracy in the government sector, traditional and outdated commercial codes, mismanagement, dominance of state-linked corporations, and a low level of productivity are among the main challenges to overcome. Therefore, the longer view remains uncertain and depends on policy makers' ability to carry out major steps to stabilize the economy and business atmosphere to make it appealing enough for foreign investors.

References

International Monetary Fund. (2014). Iran Country Report. Washington: International Monetary Fund.

OPEC. (2015). OPEC Monthly Oil Market Report. OPEC. Retrieved from http://www.opec.org/opec_web/static_files_project/media/downloads/publications/MOMR_June_2015.pdf

Ostadi, H., Rafat, B., & Raeisi, A. (2013).
نقش سرمایه گذاري مستقیم خارجی (FDI) در رشد اقتصادي ایران(1357-1387) و بررسی رابطه متقابل آنها. فصلنامه تحقیقات توسعه اقتصادی(9), 147-172.

UNCTAD. (2015). World Investment Report. Geneva : UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT.

World Development Indicators. (n.d.). Retrieved from World Databank: http://databank.worldbank.org/

About Turquoise

Turquoise is a boutique investment firm based in Iran. Turquoise creates financial products and offers financial services to select clients and investors who are interested in the Iranian market. Having a qualified and diverse management team with a wealth of international expertise enables Turquoise to benefit from coupling a network of global expertise with an enviable reputation for local knowledge, professionalism and integrity.

Turquoise publishes this electronic newsletter, *Iran Investment Monthly*, with the aim of keeping its recipients updated on the latest macroeconomic developments in Iran, providing an in-depth analysis of the Tehran Stock Exchange as well as introducing new financial products and private equity opportunities to potential investors.

Iran Investment Monthly is distributed exclusively amongst Iran analysts and potential investors who have worked closely or have been in contact with Turquoise Partners. Subscription to this newsletter is by referral only or through an online request sent to: *info@turquoisepartners.com*

Disclaimer

This material is for information purposes only and does not constitute an offer to sell, nor a solicitation of an offer to buy any specific shares.

The analysis provided by this publication is based on information that we consider reliable and every effort is made to ensure that the facts we publish are correct. However, we do not represent that all facts and figures are complete and accurate; therefore, we can not be held legally responsible for errors, emissions and inaccuracy.

This publication does not provide individually tailored investment advice and may not match the financial circumstances of some of its recipients. The securities discussed in this publication may not be suitable for all investors. The value of an investment can go down as well as up. Past performance is no guarantee of future success.