



Shahdad Desert, Kerman Province, Iran

Market Overview _____ **2**

The Tehran Stock Exchange (TSE) index dropped by 3.8% in December, making 2014 the worst performing year since 2008. Following the best year in its history with a 131% return in 2013, the TSE fell by more than 21% during 2014. The average forward P/E ratio decreased from 7.1 at the beginning of 2014 to 5.3 at the end of the year. As more than half the weight of the Iranian market cap belongs to companies which produce commodities, the recent decline in global commodity prices was a dominant factor in the market in December. During the course of the month, the petrochemical sector lost 5% of its value, metal ore mining stocks plunged 9% on average, and the basic metals sector experienced a loss of 3.5%.

Country Highlights _____ **4**

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

Economy _____ **5**

Iran's GDP growth and inflation, the effect of oil price decline on the government budget, and industrial production will be detailed in this section.

With a 3.8% drop of the overall index in December, the TSE registered its worst performance since 2008 with the index falling by more than 21% over the course of the year. Therefore, following the positive performance of 131% in 2013, the best performing year of the TSE's history, market participants have had a disappointing 2014. Valuations have also gone lower in the stock market as the average forward P/E ratio fell from 7.1 at the beginning of 2014 to 5.3 at its end. As political prospects surrounding the nuclear dispute remain unclear and interest rates have stabilized higher than the inflation rate, there is not much incentive for the stock market to rise. The trend in the oil price also hasn't helped the market as the government may face a 15% budget deficit in 2015 if prices remain at \$50 per barrel.

Now we will examine some important developments of the market in December:

Commodity producers

More than half the weight of the Iranian market cap belongs to listed companies which produce global commodities that are either exported or sold on the free market domestically. Thus, fluctuations in global prices of commodities and the Iranian exchange rate have a big impact on the profitability of these companies. As the decline in the oil price accelerated in December, the prices of most commodities started to depreciate including basic metals, mining and petrochemical products; this was one of the main negative drivers of the Iranian market this month. In line with this, the petrochemical sector lost 5% of its value, the metal ore and mining sector plunged 9% and there was a 3.5% fall in the basic metal sector. Even the 8% devaluation of the Rial, the steepest depreciation of the local currency in the past 18 months, couldn't compensate for the collapse of global prices due to the prospects for commodities. Therefore, if the Rial value stabilizes in the short term, it is expected that listed commodity producers will receive a bigger hit in the coming months.

Management developments

After 9 years of the TSE being supervised and

regulated by a team of young managers at the Securities & Exchange Organization (SEO), the government decided to make a change by replacing the head of the SEO. The SEO is widely seen as the most powerful organization in the Iranian capital market as it is in charge of implementing new regulations as well as monitoring financial institutions. The new president of the SEO, Mr. Fetanat, is 44 years old and is a graduate of one of the local universities. Mr. Fetanat majored in financial management and has worked in the banking sector but has no particular experience in the Iranian capital market. In a recent press conference, the new president promised that he will use his leverage with the government to revise some of the regulations such as mining fees, pricing controls and natural gas feedstock prices which could help the profitability of the listed companies. He also emphasized that he will try to some extent deregulate the market over time and eliminate some trading restrictions, such as the 4% daily price cap.

Auto Industry

Amongst the top ten sectors in terms of market cap, the auto sector was the worst performer in December with a fall of 10.4%. Earning reports of the industry didn't satisfy investor expectations as companies didn't change their total earning projections overall even though the market expected positive adjustments. Utilization rate of the Iranian auto industry stood at 70% in the autumn which is unchanged relative to the past quarter. This implies that the upward trend in capacity utilization rate in early 2014 has faltered and the companies slowed down growth in production due to weak demand. However, because of the rout in the oil and commodity prices, some analysts believe this factor will help the Iranian auto makers to reduce the cost of raw materials and boost their profitability in 2015.

Performance of TSE All-Share Index (December)



Market Statistics (December)

| | |
|--------------------------------|-----|
| Average P/E | 5.3 |
| Trade Volume (\$ Billion) | 1.4 |
| Trade Value Monthly Change (%) | -31 |
| Market Cap (\$ Billion) | 117 |

Top 5 Traded by Value (December)

| Rank | Company Name | Turnover Value (\$Million) | % of Total Turnover |
|------|-------------------------------------|----------------------------|---------------------|
| 1 | Bahman Group Co. | 218 | 15 |
| 2 | Iran Transfo Corporation | 117 | 8 |
| 3 | Mines & Metals Dev. Inv. Co. | 116 | 8 |
| 4 | Persian Gulf Petrochemical Industry | 56 | 4 |
| 5 | Iran Tractor Manufacturing Co. | 49 | 3 |

Top 5 Companies by Market Cap (December)

| Rank | Company Name | Market Cap (\$Million) | % of Total MC |
|------|-------------------------------------|------------------------|---------------|
| 1 | Persian Gulf Petrochemical Industry | 10,367 | 9 |
| 2 | Bandar Abbas Oil Refining Co. | 5,514 | 5 |
| 3 | Telecommunication Co. of Iran | 4,468 | 4 |
| 4 | Mobile Communications of Iran | 4,407 | 4 |
| 5 | Esfahan Oil Refining Co. | 4,191 | 4 |

All figures quoted in USD in this Newsletter are calculated based on the Central Bank of Iran's official USD/IRR exchange rate of 27,138 as at 31 December 2014. 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.

➤ President Rouhani attended the first Iran Economy Conference held in Tehran in early January. Mr. Rouhani delivered a widely covered speech in which he stated the importance of focusing on the country's economy. The Iranian President stated that the Iranian economy has been hindered to some extent by politics in various forms over the past few decades and that he would like for this to be reversed so that politics can support economic issues. Furthermore, Mr. Rouhani focused on the need to use expert advice in the country's decision making process for economic matters and stated that his government is serious about accommodating expert advice on all levels. The President mentioned that he hoped the country can act on the unused constitutional clause of holding a referendum on important and national issues for the first time during his presidency. He stated that it has been 36 years since the establishment of the Islamic Republic, and this constitutional clause has not been used. Mr. Rouhani expressed the hope that conditions for holding a referendum, where the people could directly vote on national matters, could be established.

President Rouhani then defended the economic achievements of his government in bringing down inflation from more than 40 percent to under 20 percent during his one and a half years in office. The President also stated that the country experienced economic growth in the spring and summer of 2014 averaging at 4%, after two consecutive years of economic recession mixed with high inflation which were unprecedented in Iran's economic history. Mr. Rouhani added that he believes greater interaction with other countries will improve Iran's national security.

➤ In January, the Iranian Foreign Minister, Javad Zarif, held direct discussions with his American counterpart, John Kerry, in the Swiss city of Geneva. The talks were held in line with the decision to reach a political solution to Iran's nuclear dossier by March and a comprehensive deal between Iran and the EU3+3 by the end of June. The US Secretary of State and the Iranian Foreign Minister's encounter included a fifteen minute stroll along Lake Geneva for which Mr. Zarif was later criticized

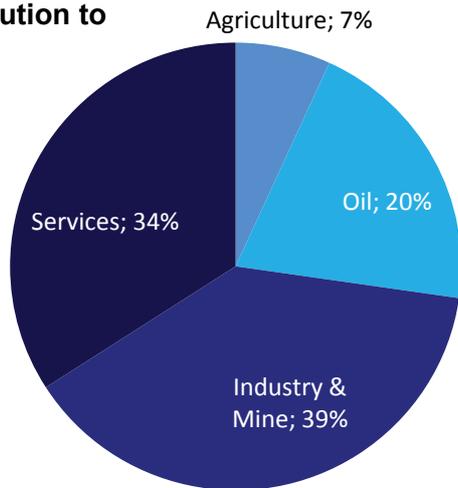
for by conservative factions in Iran. 21 members of the Iranian parliament have requested Mr. Zarif to provide an explanation to the parliament for this move. The talks included expert level technical negotiations regarding issues which would need to be addressed in order to reach a full agreement. The sides later mentioned that the talks have become more detailed and at the same time more political will needs to be illustrated to reach a final deal. Iran and the EU3+3 had initially set a deadline of November 24, 2014 to reach a comprehensive agreement. However, after intense talks in Oman and later in Vienna, the sides were unable to meet that deadline and instead they extended a previous interim agreement reached in Geneva in November of 2013 until mid 2015.

➤ The Iranian Parliament witnessed a rare incident of physical conflict when a prominent Iranian MP, Ali Motahari, requested an end to the house arrest of the two presidential candidates who had protested against the results of the 2009 Iranian presidential elections. Mr. Motahari, who is known as a conservative MP from the 'principalist' camp, drew harsh criticism from a number of MPs when he publicly stated that the house arrest of Mr. Karroubi and Mr. Mousavi should end. Mr. Motahari had mentioned that he believes the house arrest of the two presidential candidates for the 2009 election for the past few years is against national interest. The criticism from opposing MPs included shouting in response to Mr. Motahari's speech but was later escalated when MPs brought Mr. Motahari down from the podium by force. The news received widespread coverage in Iran when many accused Mr. Motahari of joining the 'seditionists', a term used for protesters to the result of the controversial presidential election in 2009. Meanwhile, reformist politicians praised Mr. Motahari, who they oppose in many areas for his conservative beliefs, for this act of bravery.

GDP Growth, Inflation, and Unemployment

The Central Bank of Iran (CBI) published the latest news on GDP growth and inflation. According to the report, GDP growth in the first half of the Iranian year (ending in September 2014) was 4 percent, while growth for the same period last year was negative 2.4 percent. The oil sector experienced growth of 9.2 percent, while the largest sector of Iran’s economy, the services sector, grew at 2.5 percent.

Sector Contribution to 4% Growth



Iran had negative GDP growth for eight consecutive quarters until the spring of 2014. In spring, the economy grew by 4.4 percent followed by a growth of 3.7 percent over the summer. The mining sector grew by 17 percent in spring and 3 percent in summer. The construction sector’s growth in summer was 15 percent after negative 1 percent in spring. Government consumption shrank by 0.7 percent over the summer, while it grew by 8.7 percent in spring. The export of goods and services grew by 16% and 3% in summer and spring respectively.

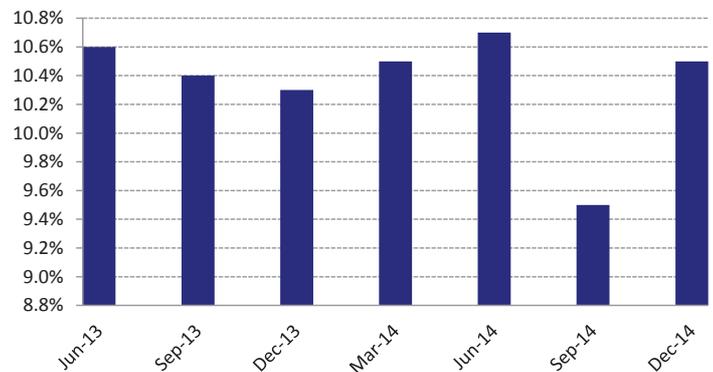
The CBI announced the monthly inflation rate of 1.9% for December. The inflation rate has been increasing for the past four months. The yearly inflation rate also reached 16.7 percent after being 14.4 percent in September. The CBI stated that it is targeting a 15 percent inflation rate for 2015 and a single digit inflation rate for 2016. Considering the recent devaluation of the Rial, the fall in oil prices, the current amount of government debt to the private sector, and non-performing loans in the banking system, the CBI is facing a challenging situation in order to reach the targeted inflation rate.

Monthly Inflation Rate

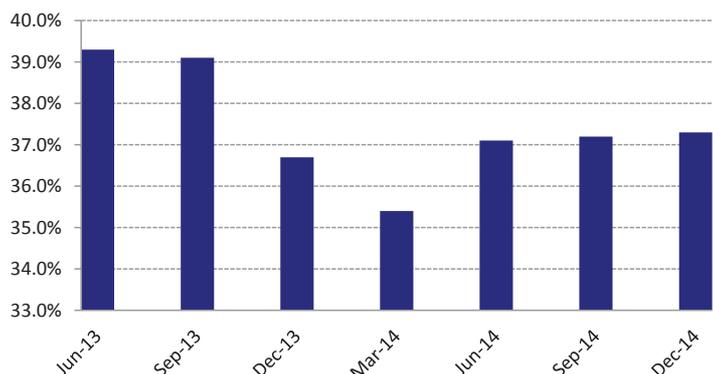


The unemployment rate in autumn 2014 became double digit after one calendar quarter of a single digit rate, according to the Statistical Center of Iran. The 10.5% unemployment rate in autumn is higher than the 9.5% of summer and the 10.3% of autumn 2013. Even though the participation rate is slightly higher than last year, there is no sign of significant long-term improvements in the labor market. The coming to the labor market of several million of graduates in the future has the potential for the country to grow faster assuming that the economy is able to provide enough job opportunities for this highly educated generation.

Unemployment Rate



Labor Participation Rate



Government Budget and Oil Price

The government delivered next year's budget to the parliament for approval. As the government is believed to be highly dependent on revenues from the sale of oil and the oil price has been falling, there are concerns about the next year's budget and its consequences on the macro situation of the country. According to the proposed budget, the total revenue of the government is \$79 billion, of which 31% is proceeds from sale of oil and gas condensates. The budget assumes that the country exports 1 million barrels per day of crude oil and 0.3 million barrels per day of gas condensates at an average price of \$72 per barrel of crude. The official exchange rate is projected to be on average 28,500 USD/IRR while it is 26,500 for the current year. An average oil price of \$50 for the coming year would result in a deficit of \$7.5 billion. The government can lower this deficit by increasing the official exchange rate but it is concerned about higher inflation. Other components of the government's revenues are believed to be optimistically projected and there is not enough flexibility, if any at all, in order to compensate for the drop in oil revenues. The performance of the government regarding issuing government bonds during recent years casts doubt on its ability to raise money through debt financing. Also, given the fact that currently the cost of money is more than 20 percent, the government would face a challenge raising debt at attractive rates.

On the expense side of the proposed budget, the current expense is \$58 billion. Of that amount, \$39 billion is salary payments to government employees and retirees. Development expenditure is proposed to be \$17 billion. As historic performance suggests, this is the most flexible component of the budget. During the last two years, less than 40 percent of the approved development expenditure was covered. Estimates provided by the government suggest a coverage of 73% for the current year. As the government would not have any better choice, decreasing development expenditures could be the main solution if oil prices don't go back to its 70-80 USD range. However, this would have its own consequences. As the country is trying to continue its path of economic growth after two years of shrinking GDP, decreasing develop-

ment expenditures would not be good news. In addition, it could decrease revenues from taxes as a result of a slowing economy.

Industrial Production

According to a report by the Ministry of Industry, Mine, and Trade, the total production of automobiles in the first eight months of the current Iranian year (ending in November 2014) amounted to 612,800, an increase of 70% compared to the same period last year. Out of 31 groups of goods that are included in the report, 19 of them experienced an increase in production for the named period. The short-term trend for the growth of production of mining and petrochemical products was in line with the long-term trend. During the 8-month period, the total production of raw steel increased by 6.8% to 10.6 million tonnes. Copper cathode production increased by 6.5% to 0.13 million tonnes while alumina production increased by 1.9% to 0.17 million tonnes. Iron ore production stayed at almost the same level of 22 million tonnes. Cement production decreased by 6.6% to 47 million tonnes and tile production increased by 30% to 253 million m².

In the oil and petrochemical products, the total polymer production reached 3.6 million tonnes from the 3.4 million tonnes last year. The production of urea decreased by 2 percent to 2.7 million tonnes and that of ammonia increased by 9 percent to 2.2 million tonnes. During the period, the export of petrochemical products increased by 11 percent volume-wise and 22 percent value-wise to 11 million tonnes and \$9 billion respectively. The total export of gas condensates stood at \$8.8 billion, an increase of 53 percent.

About Turquoise

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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.

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