Iran Investment Monthly

June 2013 - Volume 7, No 81

TURQUOISE PARTNERS

Iranians celebrate Dr.Rowhani's election as president and Iran's qualification to the World Cup 2014

Market Overview ———————— 2

The Tehran Stock Exchange (TSE) continued its upward trajectory in May. The market experienced some volatility due to the uncertainty over the Iranian Presidential Elections but managed to sustain its positive performance again this month. Overall, the TSE can be expected to act cautiously until the completion of the transition in the executive branch of the country.

Country Overview ———————— 6

The outcome of the presidential elections and the election of Hassan Rowhani along with the approved state budget for 1392 are discussed.

Economy ———————— 8

The decline in Iranian industrial production, the growth of liquidity and its causes, and Iran's rising position as a top cement producer in the region are covered 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
Elham Fotovat
Radman Rabii
Houman Rahbaritabar

Turquoise Partners, No. 17 East Gord Alley, Bidar St., Fayyazi (Fereshteh) Ave.
Tel : +98 21 220 35 830 Fax : +98 21 220 49 260
Email : info@turquoisepartners.com
To find out more about Turquoise Partners, visit our website at: www.turquoisepartners.com.

After a period of decline, due to stock price adjustments in the first half of May in which the main index fell some 3%, the Tehran Stock Exchange (TSE) recovered its losses in the latter half of the month. It finished the month on a high with an overall 2.7% increase. In 2013, TSE's year to date performance stood at 19.3% at the end of May; this represented a higher increase compared to Iran's other investment classes (gold, real estate, and foreign currencies). Nevertheless, the looming presidential transition from Ahmadinejad to Rowhani and uncertainty over both petrochemical feedstock prices and also the government's earmarked royalty fee from the mining sector are potential causes for increased market volatility in the coming month. It is important to note that the upcoming change in the executive branch and the expectation of a more economically liberal and moderate Rowhani administration will be key in assessing Iranian macroeconomic policy, which is of direct consequence to the stock market. Consequently, the TSE could be expected to adopt a more cautious approach as a hedging mechanism until the inauguration of the new government.

Some of the industrial sectors and market developments are examined in more detail below:

Mining Sector

From the second week of May, the Iranian parliament began reviewing the government's proposed budget plan for the Iranian calendar year 1392; this was two months into the year. The passing of the 1392 budget, the approval process of which has faced record delays, bears immense implications for the Iranian capital market and the profitability of listed companies. One of the major issues involved is the proposed quintupling of the government's entitled royalties from the mining sector relative to the year before. In another development, Iranian MPs have forced the country's iron ore producers to transfer at least 5% of the average steel sales prices in each quarter to the state treasury as a licensing fee. This puzzling amendment, which has markedly failed to define the relationship between the tonnages of produced iron ore to the price of an ingot of steel, has also completely ignored the role of steelmakers in the payment of duties. Irrespective of the steel industry's agreement to this imposition of new duties, previous arrangements for the financing of the new tax called for dividing the expense between iron ore producers (40%) and steelmakers (60%). Nevertheless, the announcement of the above proposal created anxiety in the mining industry; this caused a 5% drop in the index prices for this sector in the latter half of May.

Refinery Sector

Without a doubt, 2013 had until this month been a year of unrivalled prosperity and growth for the refining industry as demonstrated by the sector's stock performance on the TSE having grown by 100% in the period from January to May. However, with the Iranian parliament's rejection of the proposal to eliminate the 26% fee private refineries pay on their export earnings to the National Development Fund (NDF) (a routine payment until last year) as part of the 1392 budget, the shares of this sector fell 16.7% to become TSE's worst-performing sector in May.

Automobile Sector

Up until a few years ago, the automobile industry, despite all the risks associated with this industry and its relatively low profit margins, was among the most attractive sectors for buyers. This led to a 140% increase in the stock value of this sector in 2010. However, since then the appeal of this sector has cooled and the overall prices of shares in this sector have seen an average fall of 60% over the past two years. Despite the industry outlook which suggests continued troubles for this sector, especially given the inability to hit full production capacity due to the sanctions and the obstacles on product pricing (in which the state continually interferes to keep prices down), the industry offers prospective investors a high-risk high-reward scenario. In fact, the market capitalization of the companies in these sectors has reached incredibly low levels from a buyer's perspective: based on current valuations, it is possible to purchase both Iran Khodro and SAIPA (the largest automakers in the Middle East and Central Asia) for a meager $600 Million (based on the unofficial market rate). This can be considered a tantalizing prospect by international standards given the production capacity of the factories of these companies. The capital-intensive nature of this industry is such that only recreating the production capacity (replacement value) of these companies would itself cost 10 times their market capitalization. Moreover, improvement in production and a gradual upward price correction is a viable possibility in the medium term, especially given the constant lobbying of the management of these companies. Given that the sector's share prices have already gone into freefall, the massive fall in the volume of production, and the pricing controls which have already been implemented by the government could suggest that the automobile industry has already hit its lowest point and that over the medium term the value of this sector may improve. The market index of the automobile sector rose 2.1% in May.

Petrochemical Sector

The refining and petrochemical sectors have principally accounted for the boom of the TSE in 2013 so far. Indeed, the petrochemical companies, with an average increase of more than 37% since the beginning of 2013, have been fundamental to the rise in the TSE's main index. Within this period of growing interest in petrochemicals, there have been a number of influential factors affecting this industry. In an important development, the month of May saw the temporary removal of the export ban which had been introduced on some petrochemical products since the latter half of 1391. In other good news, the Iranian parliament, as part of its review of this year's budget, did not approve a proposal which compelled the country's exporters (principal among which is the petrochemical industry) to exchange their export revenue at the lower trading room rate; this guarantees their access to the higher free market rate and thereby protects the net income of these companies in Rial terms. Perhaps, the most important factor affecting the petrochemical industry is the possibility of price increases in the gas feedstock. There are rumors about the quadrupling of the price of gas for the petrochemical industry for this coming year (1392), a development which if true could threaten the stock prices of this sector in the short term. In any case, given the first two factors discussed above, the petrochemical index continued its upward trend again in May. It increased by 4.8% to reach 37.5% growth overall for this sector in the TSE since the start of 2013.

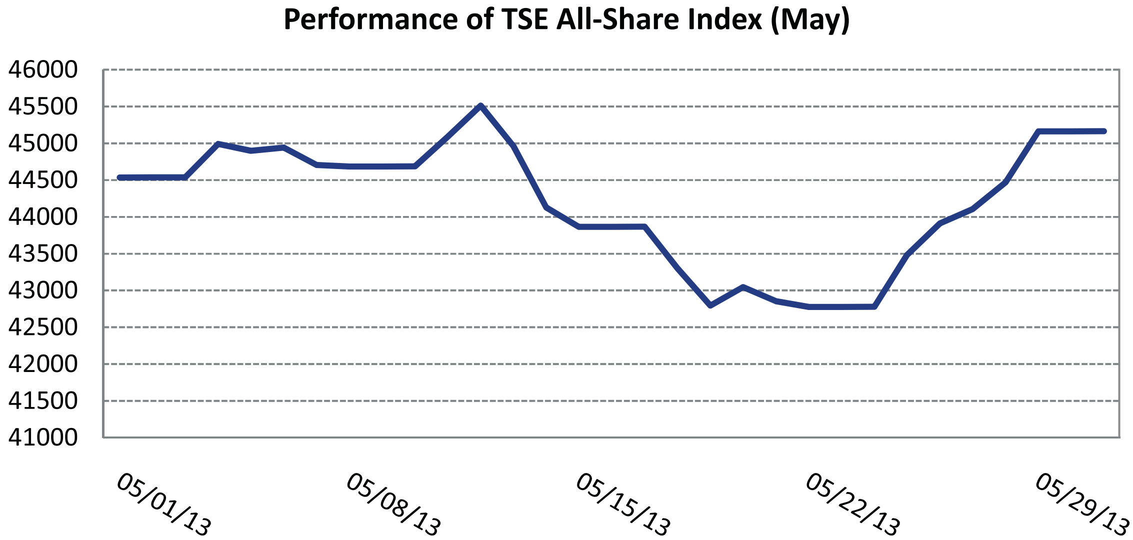
Small Businesses

Two smaller sectors active in the TSE (cement and pharmaceuticals) saw heavy purchase orders, especially from individual investors over the month of May. Shares of the cement industry, after the government sanctioned a 20% increase in domestic price of cement, continued their unprecedented growth and soared by some 31% this month. This in turn raised the average P/E of this sector by 1.5. A less publicized yet important development relating to this sector involves rising energy costs; this has been mostly overshadowed by reassuring news regarding the rising domestic and export prices of cement. However, cement companies' financial reports indicate a three-fold increase in the fuel oil cost for cement factories (from 700 Rials to 2000 Rials per liter). Considering the 20% energy cost that is reflected in the full price of cement, such a jump in the fuel oil price for cement factories will reduce the expected profitability growth of cement industry.

On the pharmaceutical front, confirmation of reports regarding the 30 to 40% increase in prices of different kinds of pharmaceutical products has stimulated market interest in the shares of this sector. As such, after months of stagnation, the pharmaceutical sector finally saw a significant 12.5% rise in its index value in May. The reason behind the government's consent to the above price increase in pharmaceuticals is the shift of the pharmaceutical sector's foreign exchange rate from the subsidized reference rate to the trading room rate. Thus, the increase in domestic prices of pharmaceutical products, rather than being a revenue maximizing measure, is a compensatory measure to balance against the lower returns the pharmaceutical industry will have (in Rial terms) by utilizing the trading room rate as opposed to the subsidized reference rate. It follows that market expectations of profitability growth for the pharmaceutical industry based on the domestic price increase may be misguided.

As such, it appears that both the cement and the pharmaceutical industries, despite the recent influx of favorable reports about these sectors, owe at least part of their current growth to those investors seeking short-term returns with the increased liquidity available in the market; given the small market cap of these industries, there is an increased likelihood of a bubble being formed, and the actual value of these sectors being overlooked.

Overall, the month of May was a period marked by increased volatility for the TSE which finally culminated in a 2.7% rise in the main index of the TSE. Meanwhile, the value of transactions in the TSE also increased in this month from IRR 7.03 trillion to IRR 13.2 trillion—a remarkable 88% growth.



Market Statistics	
Average P/E	5.9
Trade Volume ($ Billion)	10.7
Trade Value Monthly Change (%)	88
Market Cap ($ Billion)	177

Top 5 Traded by Value

Rank	Company Name	Turnover Value ($Million)	% of Total Turnover
1	Persian Gulf Petrochemical Industry	497	18
2	Bandar Abbas Oil Refining Co.	247	9
3	Isfahan Oil Refining Co.	228	8
4	Iran Power Plant Project Management Co.	189	7
5	Parsian Oil and Gas Development	163	6

Top 5 Companies by Market Cap

Rank	Company Name	Market Cap ($Million)	% of Total MC
1	Persian Gulf Petrochemical Industry	20,792	12
2	Isfahan Mobarakeh Steel Co.	9,259	5
3	Isfahan Oil Refining Co.	8,935	5
4	National Iranian Copper Industries Co	8,473	5
5	Bandar Abbas Oil Refining Co.	8,226	5

All figures quoted in USD in this Newsletter are calculated based on the Central Bank of Iran's official USD/IRR exchange rate of 12260, as at 31 May 2013

Iranian Presidential Elections 2013

The 11th Presidential election of Iran was held on the 14th of June; the event dominated the public domain and overshadowed all other news in the country. Dr. Hassan Rowhani was able to secure a majority of 50.68% of the total votes, and consequently became the Islamic Republic's 7th President.

Out of the eight candidates approved by the Guardian Council, Mr. Mohammad-Bagher Ghalibaf, Mr. Ali-Akbar Velayati, Mr. Gholam-Ali Haddad Adel, and Mr. Saeed Jalili belonged to the so called "Principalists" camp close to conservative political factions within the country. Two others, Mr. Hassan Rowhani and Mr. Mohammad-Reza Aref were considered respectively as a moderate and a reformist who were close to centrist circles. The remaining two, Mr. Mohsen Rezaei and Mr. Mohammad Gharazi, were dubbed as independents. Out of this group of candidates, two dropped out in favor of their respective camps before the elections; Mr. Aref stepped aside from the reformist camp, giving the opportunity to the moderates for a better performance in the elections, and Mr. Haddad Adel on the Principalist side in order to support the conservative candidates.

While the moderates and reformists coalesced around Mr. Rowhani, on the conservative side, calls for unity among the Principalists, for voters to rally behind one of Ghalibaf, Jalili, and Velayati failed, and the Principalist factions remained divided over their candidate of choice. Hence, in contrast to the 2009 elections when the conservatives united behind Mr. Mahmoud Ahmadinejad, the conservative front appeared fragmented this time around. Mr. Velayati served as the preferred candidate of traditional conservative groups, Mr. Jalili championed the discourse of resistance and Islamic revival through presenting himself as the status quo candidate, and Mr. Ghalibaf projected an image of a disciplined technocrat and a successful manager as the current Mayor of Tehran.

More than 36 million people, amounting to 72.7 percent of those eligible to cast their ballots, participated in the elections. Mr. Aref's exit from the race in the final week of the campaign and key endorsements from the well known leaders of the moderate and reform movements, former Presidents Hashemi Rafsanjani and Khatami, combined to effect the election. These factors significantly raised the level of public enthusiasm for Mr. Rowhani, providing him with a last minute boost amongst the electorate. Mr. Rowhani's more than 18.6 million votes were higher by a ratio of more than 3 to 1 than those of the runner up, Mr. Ghalibaf, who secured around 6.07 million votes. The final tally had Mr. Rowhani a considerable distance above Ghalibaf, Jalili, and Rezaei, who came in second, third, and fourth. After the official announcement of Mr. Rowhani's victory as President-elect by the Iranian media, many people filled the streets of the capital Tehran and other major cities of Iran in order to celebrate the news. Iran's Supreme Leader, Ayatollah Khamenei, the Speaker of the Parliament, Mr. Ali Larijani, the Head of the Judiciary, Mr. Sadegh Larijani, the Army, the Revolutionary Guards, and many other political figures and state and non-state organizations have all issued congratulatory statements to the President-elect, who will take office on August 3rd.

Mr. Rowhani's outright victory caught many observers by surprise, as many analysts had predicted the lack of majority for any of the candidates and a subsequent second round of the elections. The domestic and international reactions to Mr. Rowhani's election as President were reported to be positive. On the economic front, following the initial unconfirmed reports of Mr. Rowhani's election, both the Tehran Stock Exchange (TSE) and the Iranian Rial saw a modest increase in value. Mr. Rowhani's rhetoric of moderation and pragmatism was also well-received in the country by the majority of people in policy-making circles and amongst the business community, who remain hopeful of a change in the direction of the country and a more sound economic and foreign policy. In his acceptance speech, Mr. Rowhani himself called his victory the "triumph of moderation" and promised a new tone in Iranian foreign policy. In response, on the international side, many major governments including the United States, France, and Britain welcomed the election of a centrist, moderate figure to replace the controversial President Ahmadinejad and expressed hope of future direct negotiations with

Iran and possibly reaching a workable compromise on the nuclear issue.

Dr. Hassan Rowhani has been an active participant in Iranian politics for about forty years. He was a close figure to the late Ayatollah Khomeini during his exile in Paris under the Shah and was later elected to the Parliament several times after the Iranian revolution. He later headed the Supreme National Security Council of Iran for sixteen years from 1989, and as such was Iran's first top nuclear negotiator with the European 3 (Germany, France and the UK) from 2003 to 2005. Mr. Rowhani was appointed as a member of Iran's Expediency Council where he headed the council's Strategic Research Center and was also elected to the Assembly of Experts which oversees the position of Supreme Leader. Dr. Rowhani finished his undergraduate studies in judicial law at Tehran University before the Iranian revolution and later received his Masters and PhD in Law from Glasgow Caledonian University in Scotland. He is considered to be a close associate of the former Iranian President Mr. Rafsanjani, and is believed to have centrist and moderate political views.

Iran's State Budget for 1392

In May, the Iranian Parliament approved the country's state budget for the fiscal year 1392 (which commenced on 20th March, 2013). This was the third consecutive year that the budget was approved after the New Year, due to delays in the submission of the draft budget by the government to the Parliament. After receiving the draft budget following an eighty four day delay, the Parliament finished reviewing the document on the 9th of June and the Guardian Council, which must approve legislation before it is turned into law, gave its approval on the 10th of June and consequently the state budget was finalized.

The approved total state budget figure stands at 7,277 trillion Iranian Rials which shows a 28% increase in Rial terms, in comparison to the previous year's budget. Of this amount 2,360 trillion Rials accounts for the government's general budget and 5,357 trillion Rials for state owned companies and organizations.

Every year, the state budget usually includes an official dollar rate according to which the country's revenues from crude oil exports are calculated. However, due to fluctuations of hard currency prices in the previous year, the budget does not include an official rate for the dollar this year. Instead, Iran's Monetary and Credit Council has been tasked with determining the dollar rate and the Minister of Economic Affairs and Finance is to report to the Economy and Budget, and Planning Commissions of Parliament on a monthly basis as to the status of the foreign exchange rate. The budget states that a single exchange rate should be adopted and that the rate will be publicized by the Central Bank of Iran.

The amount of revenue expected from crude oil exports has also been extracted from the state budget, but earlier estimates and discussions within the Parliament placed the figure at around $29 billion. This figure would result in a 41% drop in comparison to last year's estimated revenues from the exports of crude oil which stood at $49.8 billion. The Petroleum Ministry has been allowed to invest the upside from the export of crude oil and natural gas up to a maximum of $7 billion, in the development of oil and gas fields and prioritizing fields which Iran currently shares with its neighbors.

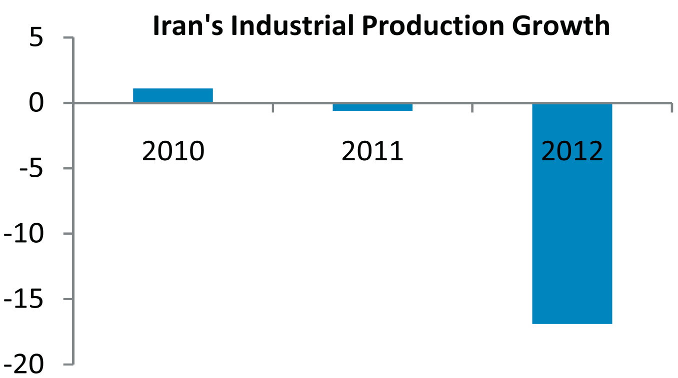
The budget law also includes income of 500 trillion Rials from the subsidies reform plan. Out of this amount, 410 trillion Rials is allocated for direct cash handouts to those eligible who have registered and for social funds. 40 trillion Rials are allocated for the support of industry, and energy consumption planning and efficiency programs. The remaining 50 trillion Rials is planned to be used for the improvement of health care services and monetary assistance in providing health care products and services for the public.

President Ahmadinejad had earlier tried to push for the start of the second phase of the subsidies reform plan and an increase in the amount of direct cash handouts which are paid to the public. However, the Parliament blocked those efforts in order to prevent the inflationary effects of such an act.

The Sharp Decline in Iran's Industrial Production

According to the latest statistics published by the World Bank, Iran's industrial production experienced the largest drop in comparison to other industrialized countries; it stood out above the other 28 major global economies in this regard due to the extent of its decline. From 1975 until 2010, Iran's industrial production growth averaged 6.9%; it's all time high was 102.8% in December of 1979 and record low was -61.3% in December of 1978. In Iran, industrial production measures the output of businesses involved in the industrial sectors of the economy such as manufacturing, mining, and utilities. Industrial development has had an important role in the economic growth of the country. However, reports by the Iranian congressional research center indicate that Iran's economic growth rate shrunk significantly in 2012, resulting in a sharp fall in the country's industrial output. In addition, the Iran Chamber of Commerce, Industries and Mines announced that over 6000 manufacturing units, around 67% of the country's total units, were pushed towards bankruptcy during the Iranian calendar year 1391 (2012-2013). This trend might continue in the following year if major steps are not taken by the government to support the industrial sector.

The World Bank report stated that the global industrial production increased by 2.4% in 2012, whereas Iran's industrial output fell by 16.9% during the same period, the lowest level amongst the 28 largest economies in the world. This figure was at -0.6% and +1.1% in 2011 and 2010 respectively. Economists believe that international sanctions have taken their toll on the Iranian manufacturing industry, and domestic production has fallen dramatically due to high production costs and limitations in importing raw materials.



All-time High Liquidity in Iran

The increase in liquidity in the Iranian economy for the last Iranian calendar year (1391) was 30.8% as was announced by the head of the Iranian Central Bank (CBI), Mahmoud Bahmani. Another 1085 trillion Rials has been added through quantitative easing to the economy since last year, bringing the total money supply by the end of 1391 to 4607 trillion Rials. Meanwhile, the average annual liquidity growth rate for the 8-year period from 1384-1392, corresponding to the time period of the Ahmadinejad administration, is 26.9% or around 490 trillion Rials per year.

Growing by 27.2% in 1391, the country's monetary base was reported to be around 900 trillion Rials, which compared to the money supply of 4607 trillion Rials puts the ratio of Iranian currency (cash) to total money supply in the economy at a 1-to-5 rate. Such a substantial increase in the growth of liquidity in Iran has inevitably led to record inflation rate of 30.5% for 1391.

The expansionary monetary policy adopted by the Central Bank as part of the populist agenda of the Ahmadinejad administration led to a dramatic escalation in state spending and creation of state-sponsored loan programs to finance various government projects such as the Subsidies Reform Plan, the Small-Business Incentive scheme, and the Mehr Housing Development scheme. In addition, the mounting pressures of international sanctions targeting the Iranian financial system and the country's trade balance, restricting Iranian access to foreign reserves, along with the state's own devaluation policy which sought to subsidize Iranian exports, are among the chief contributing causes towards the high growth rate of the money supply in Iran.

Period	Liquidity value (IRR billion)	Liquidity increase (IRR billion)	Change (%)
1384	921,019	235,152	34.3
1385	1,284,199	363,180	39.4
1386	1,600,293	316,094	27.7
1387	1,901,366	301,073	15.9
1388	2,355,889	454,523	23.9
1389	2,948,874	592,985	25.2
1390	3,522,204	573,330	19.4
1391	4,607,000	1,084,796	30.8

Iran's Cement Industry boasts the highest competitive advantage in the Middle East

Iran is the 8th largest cement producer in the world and 2nd largest in the Middle East after Turkey. Cement production is a highly energy intensive industry, and plays a major role in the country's attempts to move towards sustainable development. The Trade Promotion Organization (TPO) announced that Iran's cement output experienced a remarkable increase after the inauguration of several production plants in recent years and in 1391, the country's total annual production was approximately 80 million tons from 57 active production units.

According to a report published by the Iranian Mines and Mining Industries Development and Renovation Organization (IMIDRO), Iran's total cement exports increased from 400,000 tonnes in 1389 to 8 million tonnes in 1390. This number rose up to 13.6 million tonnes in 1391 and it is anticipated that the total exports for the year 1392 will reach 18.5 million tonnes. Iran is currently exporting cement to more than 24 countries, despite the US-led Western sanctions against Iran. Iraq, Azerbaijan, Turkmenistan, Afghanistan, Russia, Kazakhstan, Tajikistan, Kuwait, Pakistan, and Qatar were the main destinations for Iranian cement in 2012.

The Iranian cement industry is faced with the problems of a command economy. Since 2000, the cement price has been set by the government. Manufacturers' unions and related lobbies have tried to encourage the government to liberate the price. However, the government believes that cement is a strategic product and a rise in its price could result in wide fluctuations and cause side effects to the economy. However, the government is adjusting the cement price to a more appropriate level and in recent months the Ministry of Commerce ratified a 10% increase in the price ceiling for cement products intended for export.

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.