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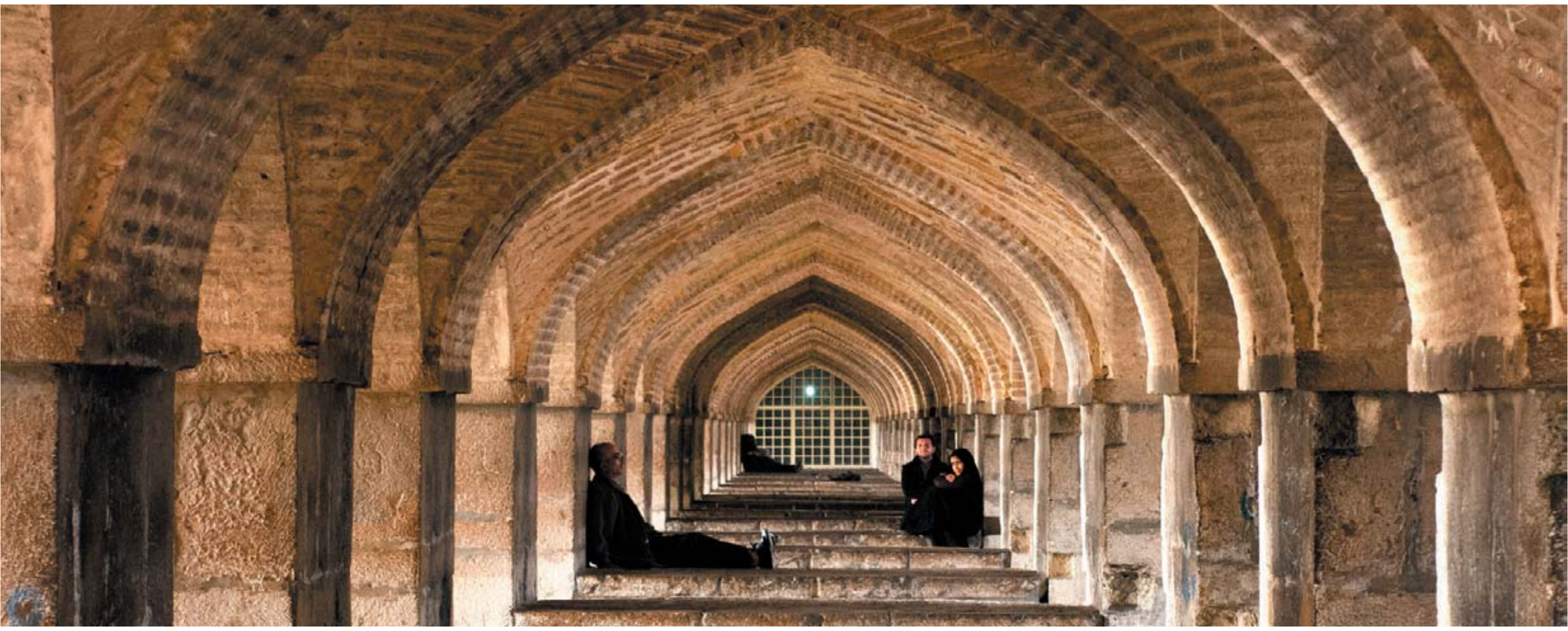

Si-o Se Pol (Bridge of 33 Arches), Esfahan province, Iran

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Chief Editor: Ramin Rabii
Authors: Shervin Shahriari, Sanam Mahoozi, Elham Fotovat, Radman Rabii

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.

This month, the Tehran Stock Exchange (TSE) continued its upward trend with positive growth of 3.5% in Rial terms. Analysts cited the main reason behind this bullish market sentiment as being the recent political calmness in the country which attracted many short term investors into the equity market. The cancellation order by the Supreme Leader in regards to questioning President Ahmadinejad along with a relative reduction in tensions over Iran's nuclear program brought about positive investor sentiment amongst TSE investors. Stocks of large companies in the petrochemical, mining and metal sectors were strongly favored by investors this month.

In addition, the re-election of President Obama was strongly embraced by TSE investors in November. Some market players are optimistic that Obama will articulate a coherent strategy in regards to Iran's nuclear program. However, some analysts believe that the continuation of Obama's presidency could have a double effect on the Iranian stock market. On one side, the optimism that emerged after Obama's re-election caused the Rial to appreciate in November; this resulted in price slumps in stocks of many leading companies that were benefiting from the devaluation of the Rial, particularly in the mining and metal sector. These companies have been the main drivers of the stock market's upbeat performance in the past months. Therefore, further decreases in their share value might affect the stock market dramatically. On the other side, potential political stability and economic improvement resulting from a reduction in international sanctions would have a positive effect on the investment climate. Thus, the twofold effect of Obama's presidency has increased the volatility in stock prices, causing further confusion for investors. The above mentioned factors, along with a further price drop of goods on the Iran Mercantile Exchange (IME) due to the appreciation of the Rial by around 15%, is expected to result in stock buyers entering into a cautious phase.

Some of the key sectors of the market will be examined below:

Mining

In November, after the release of six month corporate earnings reports, shares of some of the most favored companies re-opened for trading on the TSE after a rather long period of trade suspension. Stocks of Chadormalou, the largest Iron ore producer in Iran, started trading after a positive earnings adjustment of 80%, resulting in a 16% leap in the share price of this company. TSE investors showed less excitement towards Gol-e-Gohar and with a positive earnings adjustment of 26%, the share price of this company rose by less than 1%. This month, the metal sector index grew by 16.3%, making it the star performer compared to other large sectors in the stock market. Although in their six month earnings reports, mining companies showed a significant increase in their earnings forecasts, stocks of these companies were moderately received by investors after re-opening. Following recent earnings adjustments, the average price to earnings ratio (P/E) of the market dropped from 6 to 5, indicating investor's aversion to risk in recent months. According to forecast of market analysts on real earnings of mining companies, stocks of these companies were trading at P/Es of 3.9 during November; this was the lowest P/E ratio of this sector in the past decade.

Petrochemical

The petrochemical sector, of all the TSE sectors, has the greatest exposure to exports and, as a direct result has benefitted the most from the devalued Rial in the past couple of months. Therefore, recent government guidelines to control the foreign exchange fluctuations have strongly influenced this sector. On top of this, the latest regulations about banning the export of some major petrochemical products such as polyethylene, polymers, etc, caused further difficulties for companies in this sector. Currently, some major products of these companies are lying in warehouses, leading to significant price drops of petrochemical products on the Iran Mercantile Exchange (IME). In addition, the unofficial news regarding a significant price increase in natural gas, as the main feedstock for the petrochemical production, can be a potential threat to these companies. There are rumors that the gas price might increase by 5 times in the near future. Furthermore, authorities are trying to convince petrochemical companies to convert their foreign currency proceeds at the currency room rate (which is currently at a 20% discount compared to the unofficial market rate). The above mentioned factors are a reflection of the risks and uncertainties that this sector is facing.

Yet, the index for the entire petrochemical industry was up by 7.7% in November. However, if these risks and ambiguities continue in upcoming months, the petrochemical sector would likely be amongst the first to face price corrections.

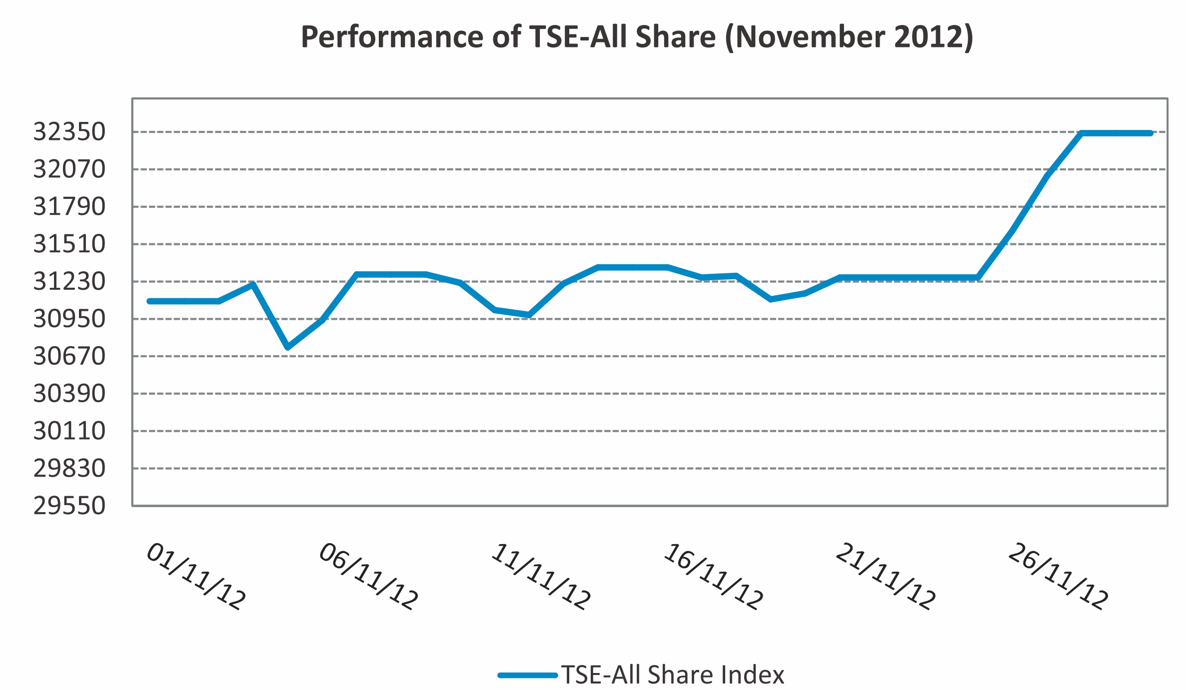
Real Estate Construction

The construction industry attracted a great number of investors during the second half of November, leading to an increase of 4% in the sector index this month. The surge in construction activity in 1391 and the 30% rise in property prices (based on unofficial statistics) were the main factors behind the sector's performance. Despite this positive news, it is worth mentioning that companies in this sector continue to be plagued by a lack of adequate liquidity. With an average P/E of 4.6, the construction sector was amongst the expensive sectors of the market (compared to other sectors). Therefore, shares of construction companies might be less attractive to investors seeking stocks with further room for growth.

Market Valuation

The latest inflation rate published by the Central Bank in November confirms steep price increases on goods and services in recent months. According to the Central Bank report, in October the country's monthly inflation rate stood at 4.6%, its highest monthly rate in the past decade or so. In addition, Iran's annual inflation rate (October 2011-October 2012) reached an unprecedented rate of 32%, recording its highest level in 16 years. Therefore, given the current inflationary environment in the country, analysts expect the average P/E of the market to stabilize at 3 to 4. Based on corporate earnings forecasts of listed companies, analysts estimate a P/E of 3.6 in November; this would seem a reasonable figure considering the current inflationary climate in Iran.

Overall, November turned out to be a good month for the TSE with more liquidity coming from individual investors (as opposed to institutional investors) into the stock market. The TSE All-Share Index gained 4% this month. However, trade volumes dropped from IRR27 trillion in October to IRR15 trillion this month, a considerable decline of 45% in comparison to the previous month.



Market Statistics	
Average P/E	5.2
Trade Volume ($ Billion)	1.2
Trade Value Monthly Change (%)	- 45
Market Cap ($ Billion)	120

Top 5 Traded by Value

Rank	Company Name	Turnover Value ($Million)	% of Total Turnover
1	Telecommunications Co. of Iran	46	10
2	Mellat Bank	33	7
3	Pasargad Bank	30	6
4	Telecommunications Co. of Iran	26	5
5	Saderat Bank	23	5

Top 5 Companies by Market Cap

Rank	Company Name	Market Cap ($Million)	% of Total MC
1	National Iranian Copper Industries Co.	9,199	8
2	Telecommunications Co. of Iran	8,494	7
3	Isfahan Mobarakeh Steel Co.	7,763	7
4	Chadormalu Petrochemical Co.	5,130	4
5	Gol-e-Gohar Iron Ore Co.	4,741	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 12260, as at 30 November 2012

Parliament's Planned Questioning of the President:

In November, Iranian parliamentarians signed a petition to summon President Ahmadinejad to the Majlis for questioning. This was the second time in the history of the Islamic Republic that this action was taken, both during President Ahmadinejad's presidency, and both within this past year. The new questioning was due to economic issues and fluctuations in the value of the Iranian currency.

According to reports, 77 lawmakers had signed the petition for questioning, stating that the President's administration has been unable and unwilling to some extent to address the economic problems of the country and to make efforts to control the currency market. Even though most of the blame for the recent devaluation of the Iranian Rial has been attributed to Western backed sanctions and the restrictions that have been placed on the Central Bank of Iran, conservative lawmakers who were once supporters of the President nevertheless argue that the President's mismanagement of the economy has also had an adverse effect on the stability of the Iranian currency and inflation.

Prior to the signing of the petition by the lawmakers, President Ahmadinejad had blamed Western sanctions for the devaluation of the Rial and criticized the Parliament and the Judiciary during a press conference for not being aligned with the executive branch in order to resolve the problems quickly. His comments were not well received by members of parliament who later posed further questions about the President's management of the country's economic challenges.

The President had already been questioned by the Parliament once in March, which was the first time such an action had been taken since the Islamic Revolution in 1979. The questions were mostly regarding the state of the economy and Mr. Ahmadinejad's allegiance to the Supreme Leader. Reports at the time suggested that the Parliament was not pleased with the President's answers.

Initially, the plan to question the President in November had been well received but days before the planned questioning was to take place, Ayatollah Khamenei asked the representatives to stop the process by mentioning that the questioning at this time would only benefit Iran's enemies. He argued that this would cause more divide in the government and would lead to further instability. He also thanked the Parliamentarians for their sense of responsibility and urged for unity between the different branches of power. This led members of parliament to withdraw their request to summon President Ahmadinejad to the Majlis and hence the plan to question the President was aborted.

US elections and outcome for Iran:

During the Unites States (US) Presidential debates which took place in October, the two final candidates, the incumbent President Obama and Governor Mitt Romney shared their views on foreign policy and on Iran with the general public.

Aside from the first debate which was focused on domestic policy, the other two debates involved discussions on US foreign policy. During these debates the two candidates stated their views on Iran and its nuclear program. Although the candidates manner of expression differed slightly in regards to to the challenges they face with Iran, they both stated firmly that they would not accept Iran building a nuclear weapon, a charge which has not been confirmed by the International Atomic Energy Agency (IAEA) and has been repeatedly denied by Iran.

The newly re-elected President Obama expressed his views on Iran with a less harsh tone than Mitt Romney. He stated on numerous occasions that the US is more than capable of taking action should Iran ever pose a serious threat. At the same time, he gave examples of countries such as Russia and China that not long ago were considered as threats to the US and now are considered allies. President Obama stated that the US will face Iran with strength but is willing to listen and search for common interests to reduce problems in the world. During his time as President, sanctions against Iran have been strengthened and the country is facing economical challenges. Negotiations regarding the nuclear program have not reached any significant conclusion and both the US and Iran continue to look for common ground on this matter. On the topic of Israel, the President made it clear that the US perceives Israel as its strongest ally in the region and that he will back Israel against Iran if need be.

Mitt Romney's views on Iran were similar to that of President Obama; however, he stated them in a much harsher tone. He criticized the President for not taking stronger action towards Iran and its government. He argued that the President had the chance to side with the people who protested against the result of the Iranian Presidential election in 2009. He even went as far as quoting one of the slogans which was going around at that time which called for the US to help and take the side of the opposition. He then stated that the sanctions which the US has placed on Iran are not as crippling as they should be. His views highlighted the possibility of military action if Iran did not halt its nuclear program. He said that if he were to be elected, he would do everything in his power to stop Iran from developing nuclear weapons. He mentioned that if he were President, he would have considered working with the opposition forces in the country to encourage regime change. He stated that political and economic pressure would be to the extent that would force the Iranian government to stop their nuclear program. On the subject of Israel, Romney's statement was as strong as President Obama's. He stated that the US is behind Israel and that they would stand by their side should they be threatened by Iran.

There have not been any improvements on bilateral talks since President Obama took office again in November. This being said, there have been some indications that the 5+1 group and Iran will be holding negotiations in the near future.

As for the domestic Iranian reaction to the US Presidential elections, the people were divided between two groups. The majority wanted Obama to win as his rhetoric towards Iran seems more lenient than that of Romney's. Military action is something that most of the people want to avoid as they have seen its disastrous effects on Iraq and Afghanistan during the Bush administration. Sanctions, however, are a topic that the Iranian people are extremely sensitive about as their lives have been disrupted by their negative effects. Some were of the opinion that if Romney would have been elected, the Iranian government would have been more pressured to compromise due to the threat of military action.

According to reports, the government of Iran has not changed their position on its nuclear program. This being said, President Ahmadinejad has stated that Iran is willing to hold talks and negotiate. President Ahmadinejad mocked the US elections and criticized the US for their spending on the election process calling it a "battleground for capitalists". The Islamic Republic's view on the US election was that it really does not make a difference whether Democrats or Republicans win the race as long as neither of them respect the country's rights. According to reports, the Islamic Republic stated that both candidates are the same and are backing Israel and denying Iran its rights to a peaceful nuclear program as enshrined in the Nuclear Non-Proliferation Treaty.

Iran's economic outlook according to the Economist Intelligent Unit (EIU)

According to a report published by the Economist, the Iranian government will tighten its fiscal stance as revenues are squeezed by a fall in oil exports and weak tax receipts; this will happen as the economy contracts in 2012-2013 and has weak growth in 2014-2017. Iran's fiscal position is heavily reliant upon oil earnings which are estimated to account for around 50% of its fiscal revenue. The Iranian government will encounter difficulties in its public finances mainly due to a sharp decline in oil export volumes in the fiscal year 2012-2013.

Following an estimated deficit of 5.2% of GDP in 2012-2013, the report stated that the deficit will widen to 5.9% of GDP in 2013-2014 assuming a lack of significant diplomatic progress on the issue of Iran's nuclear program. The official net fiscal account will remain in deficit for the remainder of the forecast period (until 2017), as oil income is reduced by sanctions and tax receipts are limited by poor economic performance. The deficit is normally covered by transfers from the National Development Fund (NDF), which receives payments when oil revenues are higher than budgeted. However, the government may have to borrow from state owned banks if the fund runs low.

Iran's external balances will be weakened by sanctions. The trade balance will deteriorate from a surplus of $35 billion in 2011-2012 to a small deficit, estimated at $600 million, in 2012-2013 as exports of crude oil decline sharply. The trade balance is expected to move back into surplus from 2013-2014 as Iran reduces imports and as oil exports stabilize, supported by a base of demand from major buyers such as China and India. The non-merchandise deficit is expected to remain relatively steady. Following perennial current-account surpluses, the report estimates a non-merchandise deficit of 1.9% of GDP in 2012-2013.

In addition, subsidy reductions and high inflation will depress private consumption (the largest component of GDP) in the first half of the forecast period especially, despite some compensatory cash handouts by the government. Industry will also be influenced dramatically, although it is assigned to receive 30% of the savings accrued by the government from the removal of subsidies in compensation. Limitations on cross border trade mean that Iranian industrial companies will find it difficult to source equipment, weakening production. This will contribute to an extremely weak export outlook, which will primarily suffer from ongoing sanctions hitting sales of oil and related products.

Iran's foreign debt in spring 1391

According to a report published by the Central Bank, Iran' total external debt has started to decline. The country's external debt amounted to $14 billion in Khordad 1391 (June 2012), a 40% fall compared to the same period last year. The declining trend is expected to continue and analysts estimate total external debt of $8.4 billion by the end of 1392.

Iran's short-term external debt dropped from $7.7 billion in the first month of the Iranian calendar year 1391 (Farvardin – March 2012) to $7.5 billion in the third month of the same year (Khordad – May 2012). Similarly, medium and long term debts crawled back by 5% to $3.8 billion down from $7.8 billion during the same period this year. In the first quarter of the previous year, the country's external debt amounted to $23 billion in Farvardin (March 2011), $22 billion in Ordibehesht (April 2011) and $23 billion in Khordad (May 2011). Therefore, the country has experienced a steeper decline in its external debt in the first quarter of 1391 relative to the same period of the previous year.

The history of Iran's external debt goes back to 1370's. The country's first record of substantial foreign debt at this time was $17.7 billion in 1376 before easing to $9 billion in the beginning of 1380. Debts climbed back to $23 billion in 1384 in an effort to attract foreign investment through medium and long term external debt. The country's foreign debt continued its growth in the following years and hit an all time record of $28.6 billion in 1386. During this period, short-term debt constituted a large portion of the country's total debt, indicating a substantial growth in the amount of imports. The growth in imports corresponded to the country's oil revenue growth rate during 1386. In the following years, external debt resumed its downward trend and after five years, it almost halved to $ 14 billion since its peak of $28.6 billion. Favorable oil prices, along with the government's National Development Fund (NDF), have had an active role in the downward trend of Iran's external debt in recent years.

Iran's Foreign Debt at the End of Each Month (USD million)				
Month	Short-Term	Med-Long Term	Total	Monthly % Change
1390				
Farvardin (March)	12,247	11,127	23,374	-
Ordibehesht (April)	11,996	10,906	22,902	-2
Khordad (May)	12,046	10,875	22,921	0.8
1391				
Farvardin (March)	7,722	8,714	16,436	-5.2
Ordibehesht (April)	6,721	8,516	15,237	-7.2
Khordad (May)	5,737	8,288	14,025	-8

Iran cut tariffs on imported products

In early November 2012, Iran's Minister of Economic Affairs and Finance decided to cut the tariff on top priority products. "Priority products" is a term coined by the government and refers to goods that are deemed crucial in an average Iranian's basket of goods but either cannot be produced domestically – or – domestic production cannot meet domestic demand. This ten-tier list was prepared in an attempt to limit the outflows of foreign currency from Iran at the time the country's economy is being squeezed by international sanctions and the Central Bank's foreign reserves are almost depleted. The logic behind the list is to filter out what the government considers avoidable, or "unnecessary luxury", in order to channel the limited foreign currency reserves for the necessities. The contents of this list vary from meat, sugar, wheat, medicine and related goods (i.e. the absolute essentials) to electronic devices, industrial machineries or minerals, etc (i.e. important goods). The top two tiers (i.e. the absolute essentials) can take advantage of the cheaper currency exchange rate of IRR 12,260. With the enactment of the rule stated above, the tariff rate to these goods will drop by 45% of their base price; the remaining tiers can acquire currency at a rate twice as expensive, at what the Central Bank refers to as the "currency room rate" which is around IRR 25,000. Under the new rule, the tariff rate on these goods is set at 50% of their base price. Goods that are not included on the priority list cannot acquire foreign currency at subsidized rates, and in many cases their imports are banned altogether. Of course, those goods purchased before the enactment of this law were exempt from this rule.

In addition, the imports of foreign cars were resumed in November after the government froze imports of luxury products, including foreign cars, in the previous month. Before the announcement, high tariff policies imposed on the imports of foreign cars benefited domestic car manufactures a strong lobbying power to compete with foreign cars that were imported to the country. However, since international sanctions have taken their toll on the Iranian auto manufacturing industry, domestic car production has fallen by around 50% due to high production costs and limitations in importing car parts. The ban on importing foreign cars from one side and the steep decline in local car production reduced the market's capacity to meet all demand. Therefore, the Iranian Customs

Administration opted to cut tariffs on a range of products, including high-end cars in order to respond to the increasing demand in the domestic market. Based on this new legislation, Iran Customs recognizes only the currency room rate of IRR 25,000 for calculating customs and duties of imported products. This news was against the interests of car importers who were obtaining high margins by paying duties for their imported cars based on the official rate of IRR 12,260 and selling at the unofficial market rate, which has been around 50% above the unofficial rate over the past few months.

Criticism arose in opposition to implementation of this new legislation. Firstly, uncertainties as to which products are “prioritized” still prevail. The 10-tier list mentioned earlier was revised three times, all within a short timeframe. As products moved in and out of these lists, importers found themselves in a difficult position, both as regards to order registration and also foreign currency allocation. Secondly, the enormous challenges of carrying out international transactions with Iranian banks (due to sanctions) have already sapped the value of the country’s national currency, fueled inflation and created goods shortages in the country. Therefore, such policies will not compensate the 100% price hikes in some imported goods, which still prevail with or without changes to tariffs.

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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