



Iran Philharmonic Choir performance at the Vahdat Hall in Tehran, September 2015

## Market Overview 2

Year to date (YTD) performance of the market has reached to the low of - 6.5 % by end of August. According to data gathered by Turquoise Partners, trading volumes, excluding block and bond trades, dropped to less than \$30 million a day, the lowest level this year. On the valuation side, stocks traded at 5.6 times projected earnings, which is higher than 5.1 multiple in April. The decrease in corporate earnings in recent months is the reason for divergence between valuations and the direction that the stock market has taken. In line with this, listed companies lowered their profitability forecasts for the current fiscal year by 3% in August to \$14.5 billion. 50% of the negative earnings adjustments belong to the base metal sector as the global metal prices continued to fall.

## Country Highlights 5

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

## Economy 6

In this issue, the possibility of Iranian government and companies accessing global debt markets post sanctions and its impact on the financial sector in Iran is examined.

In August, the Tehran Stock Exchange (TSE) experienced further slowdown in trading volumes as stock prices continued to fall. The overall Index shrank by 3.8%, losing all it had gained after the announcement of the nuclear deal in Vienna. One reason for this is the significant drop in global commodity prices such as oil and base metals which has raised investor concerns for profit margins of commodity based companies. Year to date (YTD) performance of the market has reached to the low of -6.5 % by end of August. According to data gathered by Turquoise Partners, trading volumes, excluding block and bond trades, dropped to less than \$30 million a day, the lowest level this year. On the valuation side, stocks traded at 5.6 times projected earnings, which is higher than 5.1 multiple in April. The decrease in corporate earnings in recent months is the reason for divergence between valuations and the direction that the stock market has taken. In line with this, listed companies lowered their profitability forecasts for the current fiscal year by 3% in August to \$14.5 billion. 50% of the negative earnings adjustments belong to the base metal sector as the global metal prices continued to fall.

Key sectors and events are analyzed below:

### Auto Manufacturers

The auto manufacturing sector was one of the worst performers of the Tehran Stock Exchange in August, valuation of this sector doubled in the booming years of 2013. This sector is now faced with serious doubt with regards to its future profitability. The reason for this can be traced back to the fixed sales price imposed by the government more than a year ago. This, together with increase in fixed costs over the year, is causing profit margins of these companies to tighten to the point where certain products are becoming loss making. Analysts believe that this sector will continue to lose money this year after having experienced a short lived relief in 2014. This being said, consumers have become more cautious towards this sector as the possibility of new and modern cars entering Iranian market once sanctions are lifted in the coming months. This has resulted in a pile up of products as automakers

struggle to sell their old model cars. Iran Khodro is an example of this problem as the company faces major challenge to sell its old models of Peugeot which have been in production for more than 20 years. Shares of the two largest automakers in the Middle East, Iran Khodro and Saipa, fell by more than 10%, recording the sharpest monthly drop in 2015.

### Banks

For the first time in years, listed banks experienced a sharp decline of 20% in realized earnings relative to the previous year. Two of the reasons behind the weak performance is the large non-performing loans (NPL) ratio of Iranian banking sector as well as the rising cost of money which some of the banks are faced with. This happened largely due to the decision amongst banks to attract more liquidity in an environment where the central bank of Iran has implemented a severe contractionary policy to curb inflation. On the other hand, as inflation has decreased from 40% to 13% over the last two years, demand for credit facilities at the current rate of 25+% have also fallen significantly which is preventing banks from making money off of high interest bearing resources. Currently, one year deposit rates as well as overnight rates offered by banks are between 19 to 20% while inflation rate is far below this number. In fact, the government has publicly announced that their main target is to push inflation down to a single digit figure before the next presidential election in the first half of 2017. In August, the index of the banking industry fell by 4.8%. It is expected for some Iranian banks to face serious liquidity problems if the Central Bank does not ease monetary policy in the near future.

### Construction

Given the gradual recession in Iranian real estate prices over the past 30 months, companies in this sector have failed to provide solid returns to shareholders. In August, the real estate sector index fell by 3.2%. Taking this into consideration, the average loss of the industry index has now topped 40% since its peak on January 5<sup>th</sup> 2014. This has been the biggest fall ever in the value of

real estate companies. Having said that, for the past 30 years, recession in the real estate market in Iran has lasted 3 years on average, leading some to believe that circumstances may change in 2016. In line with this, as the fiscal year for majority of developers' ends on 21<sup>st</sup> of September, profitability forecasts for next year were published by listed companies in late August. Reports show a 15% increase in profitability projections for the coming fiscal year, which, signifies an optimism towards the potential of short term revival of the real estate market in Iran.

Performance of TSE All-Share Index (August)



Market Statistics (August)

Average P/E	5.7
Trade Value (\$ Billion)	1.0
Trade Value Monthly Change (%)	- 11.1
Market Cap (\$ Billion)	93.8

Top 5 Traded by Value (August)

Rank	Company Name	Turnover Value (\$Million)	% of Total Turnover
1	Mapna	63	6
2	Mobin Petrochemical Co.	35	3
3	Saderat Bank	29	3
4	Azarab Industries Co.	22	2
5	Iran Transfo Corporation	21	2

Top 5 Companies by Market Cap (August)

Rank	Company Name	Market Cap (\$Million)	% of Total MC
1	Persian Gulf Petrochemical Industry	8,795	9
2	Mobile Communications of Iran	4,624	5
3	Tamin Petrochemical Co.	3,851	5
4	Telecommunication Co. of Iran	3,643	4
5	Parsian Oil & Gas Development	3,387	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 29,958 as at 31 August 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.

➤ The Iranian President, Hassan Rouhani, travelled to New York to attend the 70th session of the United Nations General Assembly (UNGA). The Iranian President met with the leaders of France, Russia, Britain, Italy, China, Brazil, and Japan on the sidelines of the UNGA. Mr. Rouhani gave a speech during the General Assembly which covered issues including the death of hundreds of Iranian pilgrims in Saudi Arabia during the annual haj pilgrimage, the Joint Comprehensive Plan of Action which was reached between Iran and the EU3+3, as well as Iran's readiness to work with the international community against terrorism and extremism. Mr. Rouhani initially placed the spotlight on the government of Saudi Arabia to answer questions concerning the death of thousands of Muslim pilgrims and asked for an impartial enquiry into this incident. He further discussed the agreement reached between Iran and the six world powers in July in regards to the Iranian nuclear program and called it a victory over the calls for war. Mr. Rouhani stressed that the implementation of the deal will open a new chapter in Iran's relations with the world. He stated that the Iranian nation chose collaboration with the world in the Iranian presidential elections which was held in July 2013 and the JCPOA is a result of that decision by the Iranian population. The Iranian president stated that Iran will not forget the past and the sanctions that were illegally placed on it, but will not remain in the past and looks towards the future. Mr. Rouhani said that Iran is willing to work with international partners for resolving the issues in Syria and Yemen similar to the past experiences where Iran assisted in the establishment of a central government in Afghanistan and Iraq.

➤ The Iranian Ministry of Foreign Affairs announced that the Iranian Foreign Minister, Javad Zarif, had an accidental encounter with the President of the United States of America, Barack Obama, and the two exchanged pleasantries and shook hands. The encounter was reported to have happened when the Iranian delegation faced the American delegation on the sidelines of the United Nations General Assembly. The meeting lasted about a minute and Mr. Obama was introduced to Mr. Zarif by the US Secretary of State, John Kerry. This is the first time since the Iranian revolution that an American President has had a direct en-

counter and has shook hands with and Iranian official. Mr. Zarif and President Obama's encounter was met with a harsh reaction from conservative factions in Iran. Some conservative figures questioned the move and criticized the Iranian Foreign Minister for the hand shake.

➤ The Austrian President, Mr. Heinz Fischer, travelled to Tehran in September and met with senior Iranian officials. Mr. Fischer's trip to Iran is the first visit of a European head of state to Tehran since 2004. During his trip, President Fischer met with his Iranian counterpart, Mr. Rouhani, as well as the Iranian Supreme Leader, Ayatollah Ali Khamenei. The Austrian delegation including business executives held meetings with Iranian firms in order to explore potential cooperation once sanctions are lifted. Media reports suggest that Austrian firms have been negotiating to cooperate in the oil, gas and petrochemical fields with Iranian companies. Austria hopes to increase its trade with Iran by a factor of five in the next decade and also it hopes for trade to reach to over one billion Euros in the medium term. Other areas of cooperation which were discussed included tourism, environmental protection, civil protection, forestry and infrastructure development. In general, business delegations from various countries are flooding to Iran to explore potential opportunities. A French delegation of more than 150 executives is also expected to arrive in Tehran in the coming weeks and there has been many discussions already held between European and Asian delegations and their Iranian counterparts to expand their cooperation in the post-sanctions era.

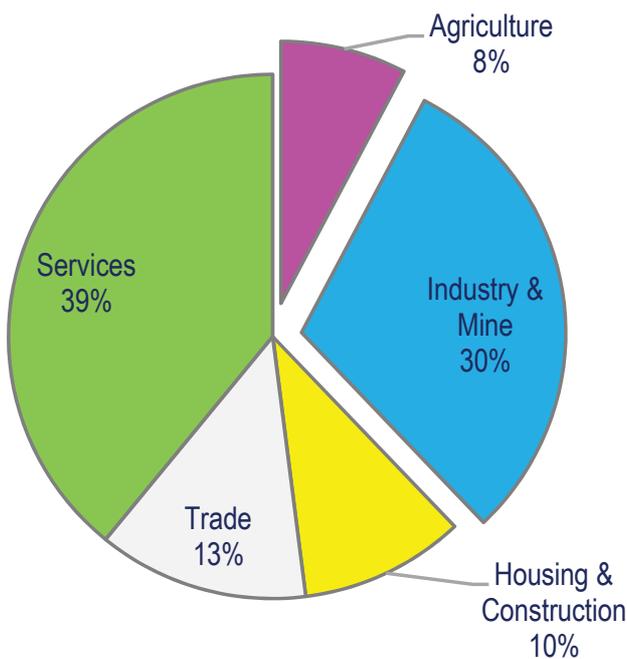
➤ President Rouhani gave in a speech to commanders of the Islamic Revolutionary Guards Corps stated that today, Iran enjoys its independence as a result of the unity that has strengthened the nation since the Islamic Revolution in 1979. The Iranian President also mentioned that even though the sanctions that were imposed on Iran were considered illegal and unjust, they had an effect on Iran's trade with other countries. Mr. Rouhani mentioned that Iran's oil exports as well as banking connections were hampered even with allies as a result of sanctions. He further elaborated that all factions of society must join hands to improve the country's economy.

In this issue, the possibility of Iranian government and companies accessing global debt markets post sanctions and its impact on the financial sector in Iran is examined.

**Establishing a strong regulated debt market enabling banks and private corporations to issue bonds to finance their projects**

Historically, the banking sector has been playing a major role in financing projects in the country. According to the Central Bank of Iran, between March and June 2015, the Industry and Mining sector financed USD 8.6 billion through the banking sector mainly for the purpose of running cash flow or funding their working capital; this was a 9.7% increase compared to same period last year. The total banking facility stood at USD 28.5 billion between March and June 2015 with an increase of 16.4% compared to the same period last year. The services and industrial sectors dominate the two highest shares in receiving loan facilities at 39% and 30% respectively. (fig 1)

**Fig.1 Share of banking facility breakdown by economic sectors**



Source: Central Bank of Iran – Data between March and April 2015

Over the past 8 years, tightening economic sanctions, a lack of foreign funding and the inefficiency of the traditional banking system has put pressure on industries especially industries with high turnover in working capital. Thus, the Security and Exchange Organization (SEO), a regulatory body of the Iranian financial market, introduced new methods of financing through the equity market and debt markets similar to what was experienced in other Islamic markets.

Over the last 8 years, 8 investment banking licenses were issued by the SEO to facilitate and introduce sharia compliant financial products. The share of financing through the regulated capital markets is growing steadily; however, traditional banking facilities dominate more than 80% of the market. (Fig 2).

**Fig.2 Share of finance methods in emerging markets Vs. Iran**



Source: SEO

On the debt market side, Salam Sukuk, a Shari'a compliant tradable Sukuk backed up by oil asset, was introduced for the first time in Iran's energy exchange market recently. Salam Sukuk issuance was aimed to finance the national Iranian oil company (NIOC) expansion projects. The model of trading was approved by Shariah Board of SEO and the first and second phase of issuance was launched successfully on April and June 2015. Debt market analysts believe that many companies have already started planning to design specific

financial instruments to attract foreign investor to enter to the Iranian market and if the sanctions are lifted, these companies are looking for aggressive Sukuk financing (Saeedi, 2015) .

Iranian large corporations are interested in issuing U.S dollar based and internationally tradable Islamic bonds (Sukuk) whereas on the corporate bond market, raising monies in the oil & gas and petrochemical industries benefit from sovereign collateral with attractive return on investment. Hence, some observers anticipate Iran to become the world's biggest Islamic banking market with assets estimated at \$ 482 billion (Islamic Finance, 2015). Currently, the size of debt market both private and governmental stands at USD 2.8 billion.

Prior to sanctions international credit rating companies like Fitch introduced the sovereign credit rating of the Iranian government. In 2002, Fitch assigned B+ rating to the 1 billion Eurobond that was issued by the Islamic Republic of Iran with stable outlook. In April 2008, Fitch removed its rating for Iran following the maturity and full repayment of the last outstanding Eurobond issued in 2002.

By removing sanctions and closer integration with international financial markets, the introduction of conventional debt market products for the Iranian state and corporates could have a massive impact on the Iranian economy and the financial sector in particular. Backed up by oil and gas reserves, the issuing of sovereign guaranteed bonds will enable the government to pay its debts and improve the balance sheet of the banking sector without relying on frozen assets abroad.

If large-state companies secure rating by international rating agencies, they will be able to finance their capital from international market, allowing the foreign investment flow in Iranian manufacturing sectors.

To summarize, it seems there is a huge demand from private sector business owners to seek “non-banking” sources of finance that is backed-up by the financial markets’ regulatory body, Iran’s Se-

curities Exchange Organization (SEO). By removing sanctions and establishing international financial standards such as a credit rating system and with the ongoing interest of doing business in Iran, this sector is expected to boom within the next 5 to 10 years.

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## 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.

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