



*Irrigation system dating back to Sassani era, Shushtar, Khouzeestan province*

## **Market Overview** \_\_\_\_\_ **2**

The month of June was an exceptionally good month for the Tehran Stock Exchange (TSE), with a 14% increase in the TSE's main index. The 2013 year to date performance of the TSE stood at 35% and the market's P/E increased to 6.6 at the end of June. During this month, some sectors that have been the laggards of the market over the past few years experienced sharp rises in their stock values. In addition, investors are expecting both the release of 3 month corporate reports and the announcement of Annual General Meetings (AGMs) by listed companies in the coming weeks.

## **Country Overview** \_\_\_\_\_ **5**

Events following Mr. Rowhani's election and the new President's agenda and outlook will be discussed in this section.

## **Economy** \_\_\_\_\_ **6**

An overview of foreign direct investment in Iran, the behavior of the currency market after the presidential election and Iran's real estate market over the period covered by the last three Iranian administrations are covered in this section.

Following the victory of moderate Hassan Rowhani as Iran's next president, the month of June ended up being an exceptionally good month for the Tehran Stock Exchange (TSE), with a 14% leap in the TSE's main index. The 2013 year to date performance of the TSE stood at 35% at the end of June, representing a higher return compared to other parallel investment classes such as gold, real estate, and foreign currencies. During this month, stocks of some sectors that had been perceived as being less attractive over the past few years, were once again recognized and favored by many investors in the stock market. It is important to note that the expectation of a more economically liberal and moderate administration, along with potential positive changes in the country's macroeconomic policies, are the main reasons behind this bullish market sentiment. In this regard, the automotive sector, being the weakest performer of the TSE over the past two years, attracted the most investor interest and became the best performing sector of the market this month, with the sector index increasing by 29% in June. Note that, over the past eight years, the Iranian capital market had adjusted its assumptions to Ahmadinejad's policies; now with the presidential transition from Ahmadinejad to Rowhani, some of these assumptions are exposed to fundamental changes. In addition, investors are expecting both the release of Quarter 1 corporate reports and the announcement of Annual General Meetings (AGMs) by listed companies in the upcoming weeks. The combination of the above mentioned factors is expected to result in an investment environment that is moderately positive in July. One will then have to wait until the inauguration of the new government and the selection of its cabinet members in order to try and assess the direction of the stock market in the following months.

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

### Banking

Sectors that have been the laggards of the market over the past few years experienced inexplicable rises in their stock values during the month of

June. In line with this, the most prominent sector that was strongly favored by investors was the banking sector. With an unprecedented 28% increase, the banking sector recorded its best monthly performance in 2013. Analysts believe that a series of unexpected economic events along with the macroeconomic policies imposed over the past two years had resulted in investors steering clear of stocks in this sector. The staggering increase in bank's overdue receivables (by more than 20% based on latest statistics), resulting from inflationary pressure on one side and customer's inability to meet their repayments to the banks due to difficult economic circumstances on the other side, has negatively affected Iranian bank's balance sheets. Furthermore, the sharp devaluation of the Rial against all major currencies led to a flow of liquidity from long term bank deposits into short term investments such as gold, the stock market and foreign currency. As a result, banks compensated for the shortages resulting from loans-to-deposits imbalances through excess borrowings from the Central Bank at higher rates. However, the new government is expected to make the following changes that are relevant to the banking sector. Firstly, they will try to control and reduce the country's inflation rate and adjust it to bank's interest rates. Secondly, they will attempt to further liberate the banking system (particularly in liberalizing the interest rate setting mechanism) in the hope of absorbing some of the excess liquidity in the market. Finally, they will try to control the foreign exchange volatility in order to avoid foreign exchange market manipulation. The likelihood of the above mentioned changes taking place made the sector highly attractive, as was shown by the increase in the value of the banking sector index this month.

### Real Estate Construction

In June, following an injection of fresh liquidity into construction activities after a period of recession, the real estate sector bucked the trend and with strong buying demand from investors, the sector index gained 22% in value (its best monthly performance in 2013). One should note that real estate stocks are booming despite the ongoing stagnation in the actual housing market and a

negative general outlook on the real estate sector. It seems that the 50% price growth in the housing market over the past year or so has hit its price ceiling and as a result, the purchasing power of real estate buyers has reduced dramatically. In addition, the contraction of liquidity over the past three months (barring the fresh injection in June) had also added to the downtrend of the Iranian housing market. According to some analysts, the recent jump in stock prices of this sector can be explained by the sectors' lag to the real growth (of around 50%) in the value of assets of real estate construction companies.

### Petrochemical

With a 5% increase, the petrochemical sector recorded its weakest monthly performance in 2013. During this month, the Annual General Meetings (AGMs) of most companies in this sector were held. The quadrupling of the price of gas as a feedstock for petrochemical companies is an ongoing rumor which was also discussed in the AGMs by managers of these companies; this development, if true, could threaten the stock prices of this sector in the short term. However, even with a four-fold increase in the feedstock cost, companies in this sector are able to sustain their attractive profit margins based on their 2013 forecasts. High transportation costs and difficulties faced in transporting petrochemical products (particularly condensates) were also mentioned in the AGMs. In connection to this, the cost of transporting condensates from the point of origin (Iran) to different destination markets (mostly China) has soared from USD 50 per ton in 2012 to USD 120 today, indicating a significant increase of 140% in a year. Another common point worth mentioning in these AGMs was the high dividend payout ratios (95% on average) of companies in this sector; this indicates the lack of future development plans by these companies and the tendency of major shareholders to prefer to receive dividends rather than retaining the companies' profits.

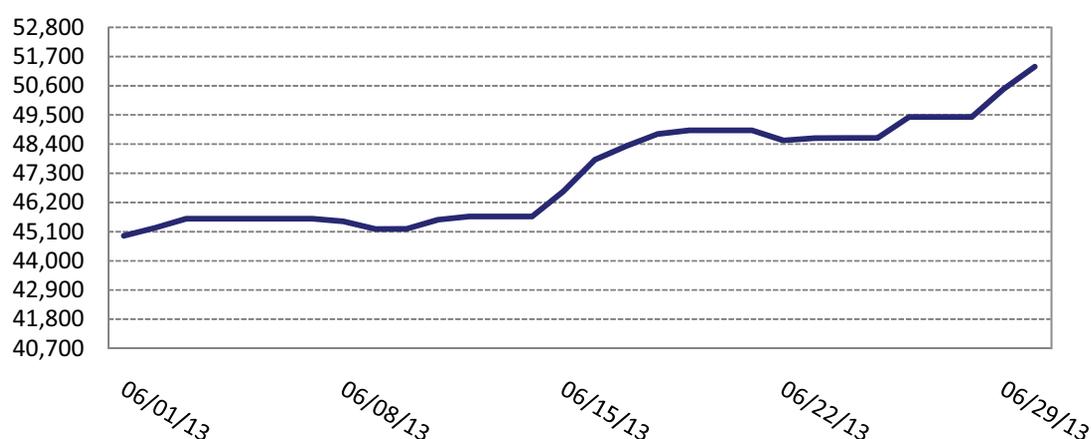
### Mining and Base Metals

Following the 15% weakening of the dollar against

the Rial in June, signs of confusion was seen amongst traders of mining and metals shares. Although some investors are jittery over stocks with high exposure to foreign currencies, others believe that the recent appreciation of the Rial is just a psychological reaction to the victory of Rowhani and is a temporary event. Foreign exchange-sensitive stocks retreated slightly in the last week of June; however, the base metal and metallic minerals extraction sector indices grew by 13.4% and 17.3% respectively over the month. In addition, on the Iran Mercantile Exchange (IME), the anticipated price corrections did not materialize in major metal products (except for copper that was affected by the drop in global copper prices), indicating that mercantile traders are yet uncertain about the continuation of the fall in value of foreign currency that occurred in the past few weeks. Although the concerns over the further devaluation of Rial have eased after the election of Rowhani as Iran's next president, strengthening the Iranian currency will require some drastic and strategic amendments in the supply and demand of foreign currency in the unofficial free market.

Overall, the month of June was a period marked by increased volatility for the TSE; which finally culminated in a 14.2% rise in the main index of the TSE. Meanwhile, the weighted average price to earnings ratio (P/E) of the market increased from 5.8 in the previous month to 6.6 in June, almost 1 above the market's 10-year average P/E of 5.8.

Performance of TSE All-Share Index (June)



Market Statistics

Average P/E	6.6
Trade Volume (\$ Billion)	4.1
Trade Value Monthly Change (%)	- 62
Market Cap (\$ Billion)	199

Top 5 Traded by Value

Rank	Company Name	Turnover Value (\$Million)	% of Total Turnover
1	Isfahan Oil Refining Co.	1,208	15
2	National Iranian Copper Industries Co.	505	6
3	Persian Gulf Petrochemical Industry	238	3
4	Pasargad Bank	112	1
5	Chemical Industries Investment Co.	108	1

Top 5 Companies by Market Cap

Rank	Company Name	Market Cap (\$Million)	% of Total MC
1	Persian Gulf Petrochemical Industry	20,084	5
2	Isfahan Mobarakeh Steel Co.	11,147	3
3	Isfahan Oil Refining Co.	9,941	3
4	Gol-e-Gohar Iron Ore Co.	8,903	2
5	National Iranian Copper Industries Co	8,873	2

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 June 2013

**The new President's outlook:**

Since the election of Mr. Rowhani as the incoming President of Iran, there has been much speculation in regards to the selection of the cabinet and the President-elect's agenda once he takes office on August 3rd. The first insights into the prospective policies of the new government were received during Mr. Rowhani's press conference with representatives from domestic and international media outlets three days after his election. The one and a half hour press conference included Mr. Rowhani expressing his appreciation to the Iranian public for bestowing their trust in him through appointing him to lead Iran's executive branch. Mr. Rowhani had picked the title of "Moderation and Prudence" to describe his policies and operating method during his campaign; he has promised to carry out his promise of taking a more moderate stance in comparison to the previous government. The question and answer session included topics such as the Iranian economy, Iran's nuclear programme, as well as Iran's relations with the West.

Regarding the economy, Mr. Rowhani stated that he seeks to improve the business environment in Iran and tackle issues such as high inflation and unemployment. He also mentioned that he will attempt to reduce the economic sanctions that have been placed on Iran by the West. Mr. Rowhani said that he will try to do this by further increasing transparency in Iran's nuclear activities and engaging in confidence building measures. Mr. Rowhani emphasized that the era of Iran suspending uranium enrichment, which is one of West's major demands, is over and that there are many other confidence building measures that can be taken in order to help resolve the nuclear issue. He also mentioned that he is open to dialogue with the United States in a manner based on mutual respect and trust in order to move towards mending the icy relations the two countries have shared over the past three decades.

In his press conference, Mr. Rowhani also invited all countries to take advantage of the new opportunity which has been created by the Iranian public for better relations with Iran. In his comments, Mr. Rowhani mentioned that his government's priority in regards to foreign policy is to create better

relations with Iran's 15 neighbours, especially the Persian Gulf states. He also mentioned that his view towards Syria is that the Syrian people are the ones who should decide their own future, and that he is opposed to terrorism and foreign intervention in Syria.

A few days later, Mr. Rowhani appeared at a symposium on "The Role of Media" where he gave a speech in which he defended the freedom of press and openness in reporting. Mr. Rowhani criticized the national TV and radio, Islamic Republic of Iran Broadcasting, and mentioned that the organization should adopt a fairer and more open position in its reporting. He further stated that one of the country's major persistent problems is radicalism and the way to resolve it is by applying moderate policies.

Many analysts are waiting to see who will be selected as cabinet members of the new government. Considering the economic problems the country is facing at the moment, such as high inflation and unemployment, the public is eager to see what the new government will do in order to improve conditions. Mr. Rowhani said that he has been discussing and meeting with potential candidates and has not yet decided on administration members.

Since Mr. Rowhani's selection which saw spontaneous celebrations in major cities around Iran, the public has had many other reasons to celebrate. Iranians from all walks of life poured into the streets once again a few days after Mr. Rowhani's election in order to celebrate the Iranian national football team's qualification to the World Cup 2014 in Brazil. After months of uncertainty and at times disappointing results, the Iranian national football team managed to win its last three games and directly qualify to the World Cup as the first team in its group by defeating the South Korean team in South Korea in its final qualification game. Furthermore, the Iranian public was once again in a celebratory mood after the Iranian national volleyball team performed well in the World Volleyball League against heavyweights such as Serbia, Italy, and Germany.

Overall, it is fair to say that June was a relatively jubilant month for Iranians despite the economic hardships they are facing at the moment.

### Overview of Foreign Direct Investment in Iran

Foreign Direct investment (FDI) in Iran grew by 17.35% in 2012, reaching a historic high of almost USD 5 billion. FDI inflows to Iran have increased by 143% over a five year period from 2007 to 2012, according to a new report on FDI flows published by the United Nations Conference on Trade and Development (UNCTAD). In spite of the tough sanctions implemented against Iran and the perceived economic instability, the country has seen FDI inflows amounting to USD 4.87 billion in 2012, sustaining its positive growth trajectory since 2008. This is despite an overall downward trend in investment flows globally and in most regional categories as specified by the UN.

### Foreign Direct Investment in Iran Since 2007

Year	Foreign Investment Inflow (USD billion)	Annual Growth	Growth to Base Year (2007)
2007	2.005	-	-
2008	1.909	-4.78	-4.8
2009	3.047	59.63	52
2010	3.647	19.68	81.9
2011	4.150	13.78	107
2012	4.870	17.35	142.9

The FDI volume worldwide decreased to USD 1.35 trillion in 2012, falling by around 18%. FDI flows in Iran's regional group—South Asia—along with neighboring West Asia and Central Asia also fell by 24, 4, and 6 percentage points respectively. Accordingly, Iran ranked 35<sup>th</sup> in FDI (inflows) in the world in 2012 up from its position of 49<sup>th</sup> in 2011, placing the nation behind neighboring countries such as India, Kazakhstan, Turkey, Saudi Arabia, and the UAE but above the likes of Lebanon, Turkmenistan, Egypt, Iraq, Azerbaijan, Uzbekistan, Bangladesh, and Pakistan. 76.46% of Iran's incoming FDI (USD 3.5 billion) were directed toward the extractive mining, quarrying and petroleum sectors (including the oil, gas, and mining industries). The services and manufacturing sectors respectively attracted 8.25% (USD 382 million) and 8% (USD 371 million) of the incoming investment. The transportation and communications sectors saw the lowest portion of the injected FDI at 0.1%. As such, the most oil-&-gas-rich provinces, Bushehr (USD 1.83 billion) and Khuzestan (USD 1.78

billion), attracted the greatest amount of FDI. Kerman, Fars, and Tehran provinces drew in the FDI targeting the services and manufacturing sectors.

### Iran Foreign Direct Investment Classification by Sector (2012)

Sector	% of Total	USD million
Mining	76.46	3,500
Services	8.25	382
Industry	8.03	371
Energy	4.43	205
Construction	2.51	116
Agriculture	0.32	15
Transportation	0.0	0.1

According to this report, the growing Iranian expatriate community was responsible for 8.11% of Iran's incoming FDI in 2012 (USD 395 million), a fall of almost two percentage points in the share of Iranian expat's in-bound investments in comparison to 2011. Despite the relative decrease in investment from the Iranian expat community in 2012, the contribution of the Iranian expatriate community to Iran's FDI has grown exponentially from a meager USD 200,000 in 2007 to USD 395 million in 2012.

### Iranian Expatriate's contribution to FDI

Year	% of Total FDI
2007	0.009
2008	1.19
2009	5.11
2010	0.74
2011	9.95
2012	8.11

### Iran's Currency Market after Presidential Election

The Iranian Rial strengthened by more than 16% after the victory of moderate Hassan Rowhani as Iran's next president. The Rial was trading at under IRR 30,000 to the dollar the day after Rowhani's win, compared to IRR 35,000 before the election. The county's currency briefly reached

its strongest level in nearly 10 months as the Rial had not dipped below IRR 30,000 since late September. However, the trend did not continue over the course of the month and the value ended up at around IRR 32,000.

Analysts argue that the recent appreciation in the Rial value was a psychological reaction to the surprise victory of Rowhani, who promised to improve the country's economy through attempted rapprochement with the world's major powers over the nuclear issue which would help ease international sanctions. As a result, many Iranians who had converted their Rial-based savings into US dollars and were stashing them at home started selling them after the election because they feared that the prospect of dialogue with the US and a more restrained diplomatic style on the nuclear front could strengthen the Rial. According to the Central Bank, Iranians have collectively stashed around USD 18 billion in their homes.

However, analysts believe that there is no basis for the fall in the value of hard currency, as sanctions – which are the main reason behind the fall of the Rial- remain in place.

In addition, during the month of June, the Iranian Central Bank eliminated the subsidized rate of 12,260 Rials to the dollar and stated that the only official rate would be the one of 24,779 Rials. This new reference rate is still far stronger than the value of the Rial in the country's unofficial market rate of 33,000 Rials, a rate at which most Iranians can access hard currency.

Since January 2012, the Iranian government had maintained a subsidized rate of 12,260 rials to the dollar; this rate was meant to be used principally to import the most vital goods, such as food and medicine. At times over the last year, the government had recognized multiple rates in a tiered system designed to provide dollars at prices depending on what class of imports they were being used to purchase, with basic goods prioritized over what were considered luxury items. However, the newly announced rate means that the government now recognizes only one official reference rate for the Rial.

### Iran's Real Estate Market

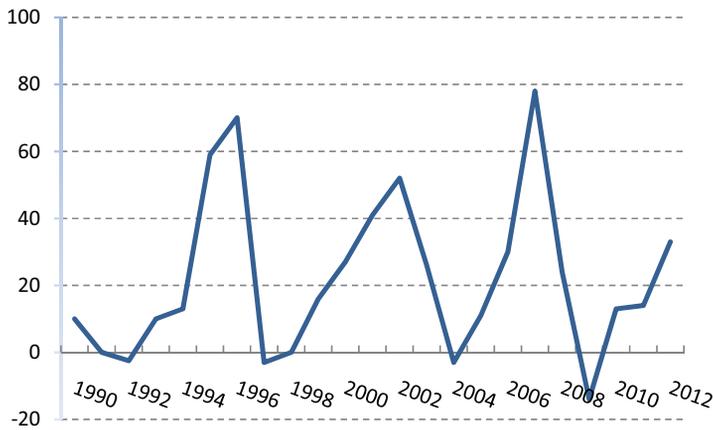
Housing prices in Iran have marked a fifty-three-fold increase over the twenty year period starting in 1372 (1993). A new report by the Statistical Center of Iran (SCI) on the housing sector has evaluated the developments in Iran's housing market during the period spanned by the last three Iranian administrations (Rafsanjani, Khatami, and Ahmadinejad).

According to this report, on average, the price of housing almost quadrupled during the tenure of each of the last three presidents (1989-2013). Over the same 24-year period, more than 8 million residential units were constructed, close to 5 million units of which were built during Ahmadinejad's tenure. In fact, during Ahmadinejad's second term alone, more than 3 million residential units were constructed by the public and private sectors. This amount exceeded the total number of residential units built in the combined 16 years of the Rafsanjani and Khatami presidencies. Furthermore, the average price increase (per sq. meters) in the housing market during the 8 years of the Rafsanjani administration was 20% per annum, a rate that remained more or less the same during Khatami's two terms (19.5%), while under Ahmadinejad's government, the housing sector witnessed an average growth rate of around 24% per annum in prices. Interestingly, the Ahmadinejad period marked both the highest increase in the housing supply (his second term) and the highest one-year increase in real estate prices in real terms (first term).

Indeed, following the 78% increase in the housing prices in Tehran in 2007, the government devised a comprehensive housing development plan (Mehr Housing Scheme) under which it authorized and financed the construction of 700,000 new residential units on government-owned property. This sharp increase in the quantity of housing units offered led to a decline in real estate prices in real terms in the second term of Ahmadinejad (the housing price increase was lower than inflation). With the market responding to the government's Mehr Housing Scheme, 2009 saw a 14% drop in real estate prices, the greatest decline in housing values on record.

Ahmadinejad’s Mehr Housing Scheme emphasized the role of comprehensive government planning in the expansion of the housing sector and signified a major shift in policy compared to the previous administrations of Rafsanjani and Khatami. In the previous two administrations, the Iranian real estate market was mostly the preserve of private developers, absent any major state housing construction programs. In spite of the Ahmadinejad administration’s aggressive housing policy, real estate prices have begun to recover since 2010 due to rising inflation costs and fluctuations in the value of Iranian Rial; this has resulted in a growth rate of 33% in 2012 up from 13% in 2010.

**Real Estate Price Growth**



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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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