

Bishapur Historical Site, Fars Province, Iran

Market Overview _____ **2**

The Tehran Stock Exchange (TSE) index increased by 6.6 percent in July after decreasing for 6 consecutive months in 2014. With the doubling of the production of auto makers during the first quarter of the current Iranian year compared to the same period last year, the auto sector index grew by 7 percent in July. After the government changed the basis of pricing of petrochemical products from the official exchange rate to the market exchange rate, the price of these products increased by an average of 11 percent on the mercantile exchange. The petrochemical sector grew by 3 percent in July.

Country Highlights _____ **5**

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

Economy _____ **6**

The government's plan to combat recession, Iran's tax revenues, foreign trades, and cost of sanctions will be discussed in this section.

After experiencing six continuous months of negative performance, the Tehran Stock Exchange had its first positive month this year with a 6.6 % increase in July; this resulted in the rate of decline of the market this year falling down to 14% from its peak of 21% at the end of June. It seems that the reasons behind the market reaching some balance are the promise of government support as well as price stabilization following a steep correction. Meanwhile, the forward P/E of the market remained around 5.7 following a drop in prices due to the close of the AGM season and the resumption of trading. In retrospect, this can be viewed as a reasonable valuation of the market especially when taking into account the historical valuation of the market with a long term P/E average of 6 over the past 20 years. In conclusion, assuming that factors such as exchange rates, deposit rates and political developments remain unchanged, the likely scenario for the short term is that the market will remain relatively stable.

Important Developments in July:

Quarterly Industrial Reports

In accordance with the Securities and Exchange Organization (SEO) regulations, listed companies have until 22nd of July each year to publicly issue their quarterly reports and their most recent budget predictions. In line with this, in the second half of July, all quarterly reports along with predictions were submitted to the Bourse website.

Although the number of reports released was extremely high, there were no real surprises in store for shareholders in terms of content; expectations were roughly met and there were no real changes from previous predictions. That being said, a number of sectors and companies released quarterly reports that caught the attention of market analysts. Some large petrochemical companies (such as Maroon and Pardis) have shown low profits in their reports due to difficulties in obtaining feedstock and also because of seasonal maintenance. A number of steel makers also showed a 9% decrease in profits due to Iran's economic climate.

On the other hand, the majority of pharmaceutical

companies performed better than expected with positive adjustments and higher profitability margins; this is noteworthy taking into consideration the sector's seasonal recession in spring.

The cement sector is another one that has managed to raise some hopes among its shareholders regarding performance in the coming months. This is because, despite the increase in energy prices and the failure to increase sale prices, the cement sector has published positive performance reports. However, despite these positive results, the cement industry was unable to grow, with the index of these companies facing a 2% decline in the month of July. This is due to the fact that 20% of the country's cement is exported to Iraq where political turmoil is increasing.

The real estate sector was the best performer of the market this month with an 11% jump; this was due to the news that the government's efforts to double housing loans may actually happen. That being said, there is some doubt as to whether companies in this sector will be able to reach their annual profitability targets, as the housing market has been in recession in recent months.

The automotive sector is going through a positive period with production doubling in comparison to the same period last year. Companies reported positive performances with the largest, Iran Khodro, covering half of its annual budget targets within just one quarter. The industry index rose 7% as a result of these optimistic reports.

The sugar sector joined the likes of steel makers with a weak performance due to the fall in global prices and the rise in sugar imports. As a result, companies in this sector made a downward adjustment to their annual forecasts, which resulted in the index falling by 5% in July resulting in it being the worst performing sector in July.

Petrochemicals

The largest sector, with a 25% share of the total market cap, strengthened the market with its positive performance, namely a 3% jump in its index in the month of July. This sudden jump stems

from a number of strategic economic decisions made by the government. The most significant change was that now petrochemical products will be priced at the market exchange rate which means that there will be no middlemen benefiting from the gap between official and unofficial rates. The price at the market exchange rate is 15% more than the price at the official rate and this decision has caused the price of petrochemicals to experience an average jump of 11% on the mercantile exchange. Based on preliminary estimates, the profitability of companies in this sector will increase at least at the same level as prices.

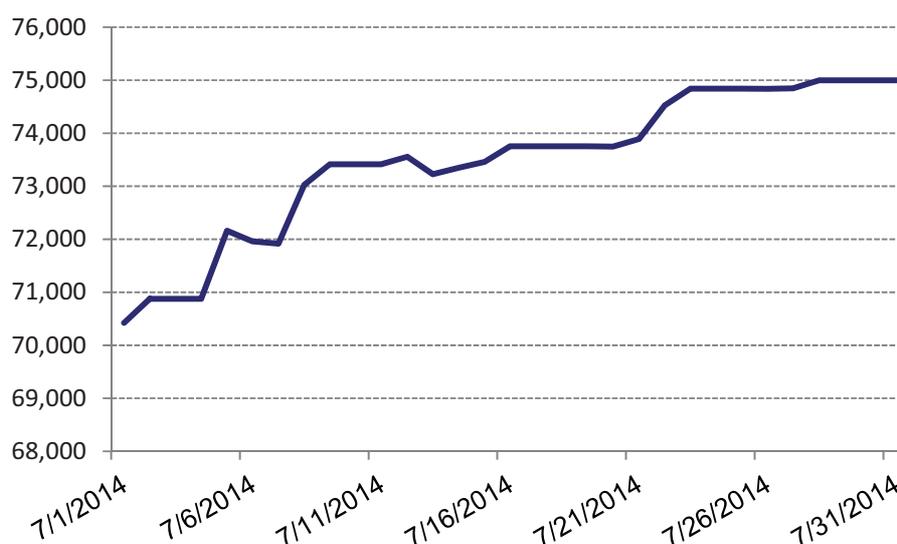
In summary, the Tehran Stock exchange performed well in July. In spite of a 32% decrease in the value of trades, the TSE index increased by 6.6 percent over the course of July, posting the best monthly performance of the market in 2014.

Mining Sector

The market cap of iron ore producers (three companies) and relevant investment companies comes to almost 10% of the market. In July, important news relating to this sector emerged that was fundamentally positive. An agreement was reached between iron ore producers and steel producers to increase the price of iron ore for 2013 and 2014; this agreement was also confirmed by the government. According to this agreement, the metric that determines the price of iron ore as a percentage of the price of steel will increase by 2 percentage points. As a result, the price of iron ore for domestic sales will reach 70 dollars per ton. Even though this price is still 20 percent lower than the global price of iron ore, it is much higher than the price of \$50 per ton two years ago.

An analysis of the budgets of iron ore producers shows that, given the new assumptions regarding their sales price, the profitability of these companies can increase by an average of 10%. On the export side, the implementation of a 20% tariff on exports has been postponed by the Ministry of Industry and Mines, a decision made mainly because of a 40% drop in the world price of iron ore in 2014; this has obviously led to a better position for exporters at a time of falling prices. Taking into account all the above, the changes in this sector are in favor of iron ore companies and will be reflected in the financials of these companies in the current year. The index of this sector increased by 5% in July.

Performance of TSE All-Share Index (July)



Market Statistics (July)

Average P/E	5.7
Trade Volume (\$ Billion)	1.2
Trade Value Monthly Change (%)	- 32
Market Cap (\$ Billion)	131

Top 5 Traded by Value (July)

Rank	Company Name	Turnover Value (\$Million)	% of Total Turnover
1	Pasargad Bank	95	8
2	Esfahan's Mobarakeh Steel Co.	83	7
3	Parsian Bank	58	5
4	Saipa Co.	50	4
5	Persian Gulf Petrochemical Industry	49	4

Top 5 Companies by Market Cap (July)

Rank	Company Name	Market Cap (\$Million)	% of Total MC
1	Persian Gulf Petrochemical Industry	14,700	11
2	Tamin Oil & Gas & Petrochemical Inv. Co.	5,807	4
3	Bandar Abbas Oil Refining Co.	5,771	4
4	Mobile Communications of Iran	4,920	4
5	Iran Telecommunications Co.	4,805	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 26,303 as at 31 July 2014. Due to Central Bank's revision on the official exchange rate of the Rial, TSE's market capitalization and trading value in USD have reduced dramatically.

- In a meeting with Iranian diplomatic representatives and officials from the Ministry of Foreign Affairs, the Supreme Leader stated he does not believe negotiating with US representatives will be fruitful although he supports the negotiations that have been started with the P5+1 group and thinks they should continue.
- President Rouhani delivered a speech to Iranian Foreign Ministry representatives and officials in which he strongly criticized the actions of hardliners and some political groups. The President's comments were made following expressed concerns by some conservative political figures in regards to nuclear negotiations with P5+1, and the possible concessions Iran would be willing to make in order to reach a comprehensive deal.
- The Iranian Parliament moved to impeach President Rouhani's Minister of Science and Technology, Mr. Farajidana. The impeachment resulted in a vote of non-confidence by the Parliament towards Mr. Farajidana with 145 votes in favor and 110 opposing the removal. President Rouhani reacted by stating the Parliament has a legal right to question and impeach ministers and the government will comply with the law. He appointed Mr. Najafi, a veteran politician and a close associate to the post of caretaker for the Ministry of Science and Technology. The President must nominate a Minister to the Parliament for a vote of confidence within 90 days.
- The Iranian Foreign Ministry's Deputy of Arab and African Affairs, Mr. Amir-Abdollahian, has travelled to Saudi Arabia for talks regarding regional affairs. The trip is significant due to the icy relations between the two countries for the past few years. Iran and Saudi Arabia continue to have different views regarding events in Syria, Bahrain, Egypt and Iraq. So far the Saudi government had refused to hold discussions with Iran for the purpose of reducing tensions. With the election of President Rouhani last year, Iran stated that improving relations with neighboring countries was a diplomatic priority. There had been meetings and trips to regional countries by Iranian Foreign Ministry officials; however, the trip to Saudi Arabia is the first since the election.
- Iranian diplomats had a bilateral meeting with their American counterparts in the Swiss city of Geneva on September 4. This meeting was in line with parallel negotiations Iran has been holding with the five permanent members of the UN Security Council plus Germany. The bilateral talks are meant to close the differences that remain between Iran and the P5+1 before the negotiations deadline of November 24. Both sides are striving to reach a comprehensive deal under which Iran would allay concerns regarding its nuclear program in return for complete sanctions relief.
- The Iranian Supreme Leader, Ayatollah Khamenei, underwent surgery in the Iranian capital city of Tehran. Media reports stated that an operation on Ayatollah Khamenei's prostate had been performed successfully. Following the Supreme Leader's admission to hospital and his subsequent surgery, the Iranian President, Hassan Rouhani, as well as a large number of political, judicial, cultural and sports figures visited the Ayatollah at the hospital. These figures included prominent figures such as former Presidents Akbar Hashemi Rafsanjani and Mahmoud Ahmadinejad, Speaker of Parliament, Ali Larijani, President Rouhani and the Iranian Foreign Minister, Javad Zarif. The Supreme Leader was discharged from the hospital on September 15.

Government's Proposal to Combat Recession

According to the latest report by the Central Bank of Iran (CBI), Iran's economy shrank for the second consecutive year. The GDP growth for the 1391 and 1392 Iranian calendar years were -6.8 percent and -1.9 percent respectively. As a result, Rouhani's administration has drafted and proposed a new plan which would over time help the country to come out of recession without significantly increasing the inflation rate. According to this proposal, financial restrictions, decreased demand in the economy, reduction in new investments, and international sanctions are the main obstacles to growth. While the removal of sanctions and growth of domestic and foreign investment are out of the government's control in the short term, the other two obstacles can be removed through sound economic policies. Considering the limited amount of resources at hand, the proposal emphasizes the importance of improving efficiency in the economy as a whole. Such improvements in efficiency would come through putting in place a disciplined fiscal and monetary policy which in return would make the economic environment more stable and predictable for market players. It would also help in allocating the country's resources more systematically to those sectors that contribute the most to national GDP.

Regarding financial restrictions, the proposal noted that the stagflation has increased demand for liquidity in the economy while financial institutions and the banking sector are under significant liquidity pressure. The hyper inflation of the last few years has increased the cost of production for manufacturers and also reduced the purchasing power of consumers; this has resulted in decreased demand for products and increased demand for liquidity. The government meanwhile believes that raising the money supply will only act as a short-term solution and will lead to higher inflation and further recessionary waves in the long run. The government's proposal suggests that the best way to solve current financial obstacles is implementing some restructuring in the banking sector as well as opening up the capital market. These reforms include share capital increases of banks, dealing

with non-performing loans on their balance sheets, and selling their non-banking assets such as properties and equities. For the capital market, the proposal suggests introducing new investment products and instruments to allow easier access to capital for companies through the stock market.

One of the key features of this proposal is the country's need to diversify its export products from oil. Iranian non-oil exports are increasing on an annual basis and this proposal aims at accelerating the rate of growth in order to secure a diversified source of foreign currency income for the country in the future.

The tools that the government will use to achieve the goals of this proposal are as follows: changing the tariff and interest rates, improving the tax collection system, price liberalization, capital investments, and drafting better regulations.

According to the proposal, the government aims at gradually liberalizing prices by the end of the current Iranian year. This means that except for a few "essential goods", all commodities will be priced by a supply/demand mechanism rather than a government pricing system. If implemented, this could have a very positive impact on the economy as a whole and also on listed companies since one of the biggest systematic risks of the market in Iran has always been government's interference in pricing and price controls. At a more micro level, this proposal has specific plans for the petrochemical, mining, manufacturing and property sectors in order to stimulate growth in the economy in the months to come.

Iran's tax revenues

During the first four months of the Iranian calendar year, total tax income amounted to 187 trillion Rials (around \$6 billion), according to the Director of the Iranian National Tax Administration, showing an increase of 49 percent compared to the same period last year. Direct tax income grew by 34 percent and value added tax income increased by 83 percent, making the current year an outstanding year for the Iranian National Tax Administration.

Iran's taxation system has been going through a reform process in the past few years. Value Added Tax (VAT) was introduced in Iran only a few years ago and has been increasing by one percent per annum over the last few years to reach 6% last year. However, the government decided to increase the VAT by two percent this year to 8% in order to combat the expected budget deficit caused by reduced foreign currency income.

Iran's foreign trade

According to Eurostat, Iran's trade with the European Union amounted to 2.8 billion Euros during the first five months of 2014, an increase of 5 percent compared to the same period in 2013. Iran's imports from the EU increased from 2.3 billion Euros to 2.4 billion Euros during this period while Iranian exports show an increase from 347 million Euros to 386 million Euros.

Iran's export of technical and engineering services during the first three months of the current Iranian year reached \$490 million, an increase of 40 percent compared to the same period one year ago, according to the Trade Promotion Organization of Iran. Total exports of technical and engineering services stood at \$2.26 billion last year and \$1.85 billion the year before that.

Cost of sanctions to the US and EU

According to a report by the National Iranian American Council, the total cost of sanctions against Iran to the US is estimated to be as much as \$175 billion between 1995 and 2012 as a result of lost exports. The report also estimates that sanctions resulted in an average loss of 50,000 to 66,000 jobs per year during this period. The cost of sanctions to the EU was more than the US between 2010 and 2012. The cost to Germany is estimated to be between \$23 billion and \$73 billion, while the cost to Italy and France is estimated to be between \$14 billion and \$43 billion, and between \$11 billion and \$44 billion respectively.

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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.

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

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