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Tochal ski resort, Tehran, Iran

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The Tehran Stock Exchange (TSE) experienced unprecedented daily trade volumes, averaging at USD 250 million per day during December. Buyers were particularly enthusiastic about shares of some of the larger companies; consequently, the TSE all-share index witnessed a further 4% growth this past month. The 5.5-fold leap in trade volumes compared to the same period last year is indicative of investor interest towards the stock market. Among the main contributors to this increase are individual investors, who based on official reports, carried out 70% of purchases in the market. In addition, 70% of the number of trades was carried out online, indicating the increased presence of individual buyers in the market. This positive atmosphere and increased trade volumes have resulted in large price movements. A clear example of this trend was observed in trading of smaller companies such as tile makers, automotive and rubber manufacturers. Given the influx of individual investors and the reluctance of larger shareholders to sell, the stocks of these companies experienced a 5 to 10 fold increase in value over the past year.

To keep up with the increasing demand, major shareholders started to offer their shares heavily at market value, yet, they did not succeed to respond to the buyers' thirst. To temporarily balance against the share price increases and the heavy influx of liquidity, the stock exchange officials have been trying to encourage the government and semi-governmental entities to increase their offerings of shares to the market.

We shall now examine in greater detail several individual sectors of the market:

Stock market valuation

The average P/E of the market reached the vicinity of 8.5 by the end of December. This valuation level has been seen only in 2003 and 2004 and, very briefly, in the spring of 2010. The highest average P/E was observed in 2004, which reached a high of 8.9. Once again, there is the potential for the P/E to reach its previous highs, if the current increase in share prices does not translate into profit for companies. However, with the banks' annual deposit interest of 20%, the 100% gap between yields and the average cash returns of the market must be compensated for through increasing future profits. Otherwise, given the current stock price levels and the relatively low dividend payout ratio of companies, purchasing some of the stocks poses serious price risks. This is while expectations of 2 to 3% economic growth in 2014 joined with 20% appreciation of the Rial in the past six months have slowed down the profitability growth of companies.

On the other hand, stock prices of some of the major holdings and investment companies (especially in the petrochemical sector) surpassed their net asset value (NAV) in the past few weeks. This event has happened only once before, namely in the first half of 2004. A comparison of this current situation with the long term average ratio of P/NAV in investment companies, indicate a deviation of ratios of these companies from the average valuation levels by at least 25%. Another recent phenomenon has been the growth in the stock prices of newly-launched petrochemical and cement projects on the over the counter (OTC) market. Projects that are not yet operational but due to the positive sentiment in the market, the stock prices of these projects have reached their post-completion values. This suggests that some of the share prices are deviating from their fundamental values; this can be partially attributed to the fresh liquidity inflows and the absence of comparable stock offerings. Following and due to these developments, the market capitalization (both the TSE and OTC) surpassed USD 180 billion in late December.

All the while, the accelerating growth of stock prices has made market players more cautions in regards to their investment decisions. At the same time, the heavy influx of liquidity has left no room for price corrections over the last few months.

Privatization

The head of the stock market organization attended the government committee in mid December, in which important decisions were made in regards to strengthening stock offerings. Based on these decisions, the government has agreed to offer stocks equal to 5% of the ownership value of the companies privatized gradually on the market under article 44. This policy aims to help balance the current supply and demand in the capital market.

In the last week of December, privatization was set in motion through the government's offerings in the amount of USD 50 million in the steel, petrochemical and banking sectors. In addition, stock exchange officials have been successfully encouraging semi-governmental financial institutions (such as banks, retirement funds and the social security fund) to join forces and increase their offerings on the stock market. Tehran Stock Exchange and Farabourse (the OTC market) officials are trying their best to prepare the necessary ground for such developments and to pave the way for companies to absorb the roaring influx of liquidity so they can strengthen their production and development plans.

Real Estate

Often in boom periods, various sectors will absorb much of the liquidity despite sometimes lacking compelling fundamentals. The TSE has not been an exception to this trend in the past few months and stocks of many industries have experienced constant growth regardless of their risk and potential. The construction industry was a prime example of this event and it performed particularly well in December. The industry marked an average growth of 42%, which not only made it the star performer of the stock market, but also documented the best month for the industry over the past 43 years. In addition, the P/E ratio of the industry surpassed the figure of 9 towards the end of December, which is the highest level for the stocks of this industry over the past 8 years. More detailed analysis of this industry show that the year-to-date price index and P/E ratio of the industry have doubled since the beginning of 1392 (March 2013), which proves the relative, and yet constant, profitability potential of construction companies despite the leap in stock prices. The shares of construction companies witnessed a boom while the actual real estate market is experiencing a period of stagnations. Official indicators show a reduction of 10-15% in the price of urban properties in the summer compared to the spring. Moreover, the 50% reduction in the sector's trade volumes indicates that, even with current prices, there are not enough buyers for the large supply of properties. Given that the stagnation cycles of the housing market historically last for 2 to 3 years, it is unlikely for the industry to emerge from the current sentiment in 2014. As such, the continuation of the current sentiment will make the business environment for construction companies on the stock market more challenging.

Cement and Petrochemical

In December, the market witnessed two developments in terms of natural gas for industrial use, which had a negative impact on the profitability of companies. The first event was the lowering and eventually cutting off supply of industrial gas used by factories, which was concurrent with a drastic temperature fall in the second week of December. Initial news indicates that the problem is most serious in the Mahshahr area, which is a centre for the Iranian petrochemical industry. In addition, due to a shortage of gas, nearly all cement companies have resorted to fuel oil for energy. Nevertheless, with the price of every liter of fuel oil being three times higher than a liter of gas, these companies are being exposed to substantially higher costs.

The second piece of news relates to nearing of the deadline for the pricing of petrochemical natural gas feedstock after 15 months. The consensus is that the current government will finalize the scenario put forward by the previous government ($0.13 per liter), which after having been compared with neighboring countries' prices, has been approved. The issue now is whether these prices will be implemented as of the new year in a couple of months. In reaction to these events, the market witnessed a fall in the shares of petrochemical companies by an average of 3.1% in December. It seems that they will aim to announce the final decision on the issue later in January. With this, however, the biggest uncertainty for investors in regards to the petrochemical industry will disappear.

Budget plan and the stock market

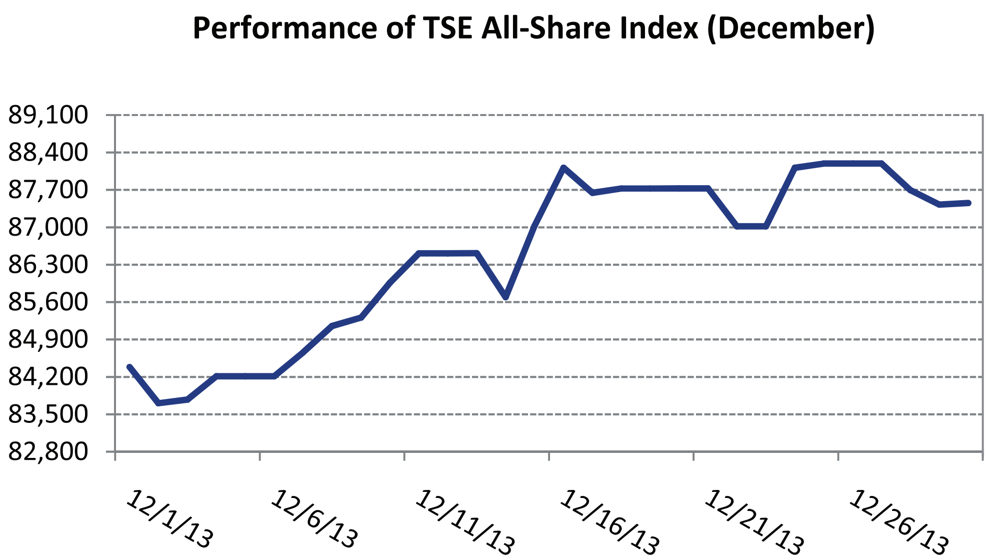
The budget bill for the Iranian calendar year 1393 (starting on March 2014) was handed to the parliament in time this year. The content of the bill does not encompass drastic changes compared to the current budgetary path set out in 1392. Nonetheless, some analysts have voiced their concerns about the income side of the budgetary bill, especially in the area of oil sales and tax income and customs charges, which are estimated to be 40% higher than the previous year (660 trillion rials). Moreover, forecasting an inflation rate of 21-24% and liquidity growth of 18-20% resulting from the implementation of the new budgetary bill show that the current policies over liquidity creation and the resultant inflation are likely to linger. As such, any expectation of a reduction in bank's interest rates in the medium-term is unlikely. Therefore, there is a slim chance that the new budgetary bill will succeed in increasing the P/E ratio of the stock market. On the other hand, the prediction of the bill of an exchange rate of 26500 rials for every dollar unveils the government's intention to stabilize the exchange rate at 10% lower than its current free market rate. Should these predictions materialize the outlook for the profitability of industries will be limited in 2014. So far, the average exchange rate in 1392 has been 32000 rials per dollar. As such, achieving a rate of 26500 rials per dollar will affect the profit margin of a wide spectrum of major companies in the market, especially in the petrochemical, metals and mineral sectors. On the other hand, the more than doubling of proprietary interest and government royalties (now set at USD 600 million) has caused mineral stocks to fall and the main index of metal ore industries to drop by 3.1% in December. However, these costs have not been accepted by mineral groups for the current year. However, the passing of official legislation by the parliament will oblige the companies to accept the specified costs next year.

9-month corporate earnings report

In January, the market is about to witness one of the most important annual developments, namely the release of the companies' performance report over the past nine months. Given that a substantial part of the market's boom over the past 16 months has been the result of exchange rate fluctuations, attention to this variable is of paramount importance in speculations over the upcoming report.

The value of every dollar in the unofficial market stood at 29000, 31000, and 35200 rials over the summer, autumn and winter of 2012 respectively. In 2013, the value of dollar remained on average between 35400 and 32100 over the spring and summer. However, in the autumn of 2013, the exchange rate stood on its lowest over the past four seasons with one dollar selling at 29980 rials in the unofficial market. Given the high correlation between the profitability of various listed companies and the unofficial exchange rate, it is safe to expect a reduction in the average profit of such companies in the fourth quarter of 2013 compared to their performance in previous quarters. The value of each dollar has dropped by at least 15% compared to spring of 2013.

Overall, the combination of the foreign exchange rate depreciation and persistent stagnation due to a reduction in demand for stocks could potentially be reflected in the 9-months report resulting in a weaker performance for listed companies in the winter compared to the past spring and summer.



Market Statistics	
Average P/E	8.5
Trade Volume ($ Billion)	4.5
Trade Value Monthly Change (%)	36
Market Cap ($ Billion)	173

Top 5 Traded by Value

Rank	Company Name	Turnover Value ($Million)	% of Total Turnover
1	Tamin Petrochemical Co.	162	4
2	Saderat Bank	161	4
3	Ghadir Investment Co.	161	4
4	Persian Oil and Gas Development Co.	158	3
5	Bandar Abbas Oil Refining Co.	138	3

Top 5 Companies by Market Cap

Rank	Company Name	Market Cap ($Million)	% of Total MC
1	Persian Gulf Petrochemical Industry	16,759	10
2	Bandar Abbas Oil Refining Co.	7,980	5
3	Isfahan Mobarakeh Steel Co.	6,990	4
4	National Iranian Copper Industries Co.	6,658	4
5	Iran Telecommunications Co.	6,681	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 24790, as at 31 December 2013

Due to Central Bank's revision on the official exchange rate of the Rial, their equivalent value in USD has reduced dramatically.

Implementing the Interim Nuclear Deal

After the historic deal over Iran's nuclear program in November, it was announced by Iran and the P5+1 that both parties had reached an arrangement that would implement the terms of the agreement starting on January 20th 2014. The implementation of the deal made back in November was an important step in the action plan that was accepted by both parties. The P5+1 and Iran met on a number of occasions on a technical level, in order to discuss and negotiate the terms of how the accord would be implemented. The diplomats had continued to discuss ways on how each party planned to put into affect the terms of the action plan they had earlier agreed to, and the timeframe of when each step would be taken.

With the implementation of the so called action plan, Iran, the European Union and the United States, started the process of executing their respective requirements in accordance with the deal. Iran for its part, started its voluntary suspension of enriching uranium to 20% levels, along with other specified measures such as more frequent inspections by the International Atomic Energy Agency, while the E.U. and U.S. both moved to ease sanctions as was planned under the terms of the Geneva accord. These included the transfer of some of Iran's oil revenue in tranches which is currently frozen in accounts outside of Iran, and the removal of sanctions on Iran's automotive and petrochemicals sectors.

Over the period of the provisional deal, which is due to last 6 months, the P5+1 and Iran will continue negotiations on the terms of a permanent deal. President Obama has welcomed the implementation of the interim deal, but stated that a permanent deal would require negotiations and discussions that may be difficult. The execution of the deal comes against a continuous campaign in the U.S. Congress to levy harsher sanctions against Iran, which is against the agreement made in Geneva. The Obama administration has stated that it is eager to prevent this move as it would weaken U.S. credibility among the P5+1 and disrupt the current possibility of improving U.S. and Iranian relations.

In Iran, members of the Iranian parliament are also working to pass a law, under which the Iranian government would be forced to enrich uranium to a level of 60%, if the current accord is not respected by Western countries and new sanctions are placed on the Islamic Republic. The Iranian government, states that Iran fully respects its commitments under the Geneva agreement and will fully implement its part of the deal during the period when the country would negotiate for a final and comprehensive agreement.

Analysts state that the implementation of this deal is an important step towards resolving a decade-long dispute over Iran's nuclear program and possible further expansion of ties between Iran and the West.

The Iranian Parliament warns three government cabinet members

The Iranian parliament (Majlis) has on three separate occasions presented official warnings to three cabinet members of Mr. Rouhani's government in the past four months. The first warning or "yellow card", as the warning is referred to in the Majlis, was to the Iranian Minister of Economy, Mr. Ali Tayebnia. The parliament had on a number of occasions summoned Mr. Tayebnia to explain different economic matters; however, in the most recent case, members of parliament were not convinced by the minister's explanations and hence presented him with an official warning. The question that led the parliamentarians to issue the warning was regarding comments by the Governor of Iran's Central Bank on the issue of foreign exchange rates where it was discussed whether current levels can be deemed logical. The Economy Minister had argued that volatility in exchange rates was not beneficial to the country and that he supported efforts to increase the value of Iran's national currency in a logical way. The warning was issued despite the fact that Mr. Tayebnia had received a record vote of confidence of 96% from the Majlis during the cabinet's formation in the summer of 2013.

The parliament's warnings were not, however, limited to the Economy Minster, but were later issued to the Science and Culture Ministers as well. In the second warning, three weeks later, Iranian members of parliament summoned the Science, Technology and Research Minister, Mr. Faraji-Dana, for questioning regarding some managerial changes and appointments in the ministry. The parliamentarians were once again unconvinced by Mr. Faraji-Dana's explanations and presented him with an official warning as well.

The third warning went to Mr. Janati who is the government's Minister of Culture and Islamic Guidance. Mr. Janati's summons to the parliament was due to his stated regret over the suspension of a newspaper that had published a sensitive article that was deemed to be against the country's religious edicts. The Minister, similarly to his colleagues, was unable to convince the parliamentarians with his explanations and hence received an official warning.

According to the Iranian parliament's guidelines, when a member of the government's cabinet receives three warnings, arrangements for the impeachment of that cabinet member can be initiated. The recent moves are regarded by analysts as a way to exert pressure on President Rouhani's government by the Iranian parliament. This is because the majority of parliamentarians are regarded as belonging to different conservative political factions that are at odds with moderate factions close to Mr. Rouhani.

The Iranian President however dismissed the warnings and said that his government will continue to push its policies forward.

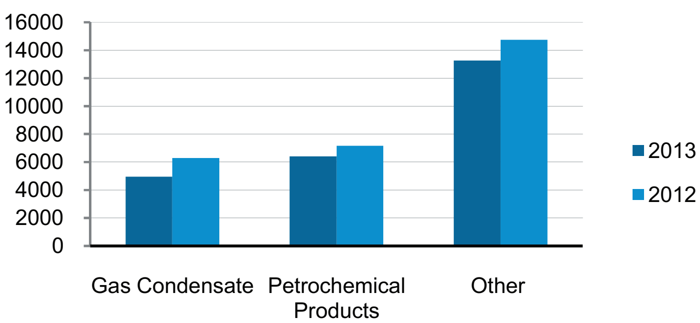
Iran's non-oil exports behind schedule

The Trade Development Organization (TDO) set a target value of USD 59 billion for non-oil exports for the Iranian calendar year 1392, starting on March 2013, (the third year of the fifth development plan). The TDO's ideal was for non-oil exports to reach USD 89 billion by the end of the fifth development plan. Meanwhile, the non-oil export value was USD 43 billion in the previous year. So, for the TDO's target to materialize, the non-oil export value needs to increase by USD 16 billion in 2013 over the 2012 figure.

However, based on the 8-months report published by the Islamic Republic of Iran Customs Administration (IRICA), Iran's overall foreign trade value currently stands at USD 52.85 billion, of which the share of non-oil exports is USD 28.6 billion. This shows that only 48% of the target value has been achieved.

Economic activists attribute these events to exchange rate instability, international sanctions and economic inactivity in the period before and after the presidential election. Currently, the most important destinations for Iran's non-oil exports are China, Iraq, UAE, Afghanistan, India, Turkey, Turkmenistan and South-East Asian countries. However, it is expected that the alleviation of sanctions can expand Iran's trade partners to include EU countries to a greater extent. The easing of sanctions can also rejuvenate Iran's competitiveness in the regional market. In the past 8 years, the trade cost of exports has increased by 70%. This is while other Middle Eastern countries have experienced a rise of only 8% in their trade costs over the same period.

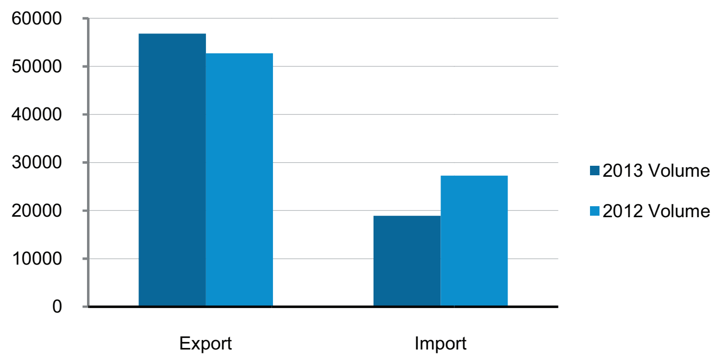
Comparison of the value of non-oil exports in the first 8 months of 1392 (Mar-Nov 2013)- million dollars



Analysis of the trade balance is indicative of a healthier trend. Although Iran's export value of non-oil commodities dropped in 2012 compared to 2011, the gap between export and import values has been narrowing. In other words, 70% of the foreign currency required for imports in 2013 has been secured through exports, whereas only 30% of the required foreign currency in 2005 was provided for through non-oil exports.

Based on IRICA's report, although the export value is lower in 2013 compared to 2012, export volumes do not show a significant difference. In fact, in terms of volumes, Iran has exported more and imported less in the first 8 months of 1392 (Mar-Nov 2013) compared to the same period last year.

Comparison of the volume of non-oil exports/import in the first 8 monthsof 1392 (Mar-Nov 2013)-thousand tons

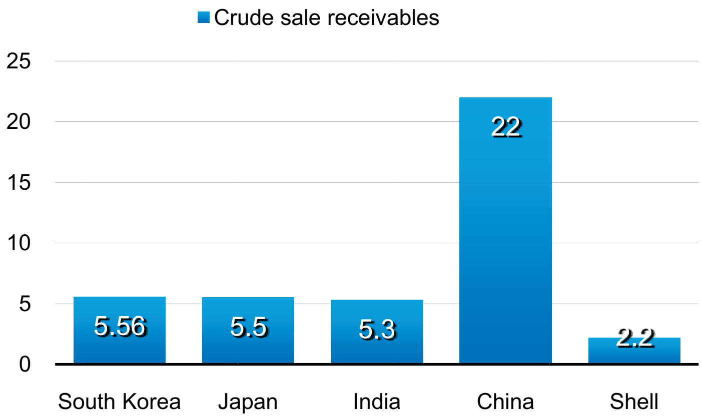


Iran's receivables from the world

According to Iranian officials, more than $60 billion of the country's oil revenues are frozen in foreign banks and out of reach. In addition to oil revenue, Iran seems to have about $40 billion of its non-oil revenue frozen in foreign banks. Nearly half of Iran's monthly earnings from crude oil exports are accumulating in accounts outside the country because of sanctions that restrict Tehran's access to the money. Currently, around $1.5 billion of crude oil revenues is piling up in restricted foreign accounts every month. Crude revenues overall averaged about $3.4 billion monthly in the first half of the year. This means Iran is not able to either spend or repatriate about 44% of its crude oil income.

South Korea has $5.56 billion of Iran's money stuck in its bank accounts, with a similar amount held up in Japan since the beginning of the year, according to Reuters. Iran has previously said that China, its top oil purchaser, owes Iran around $22 billion. India is Iran's second-largest buyer and owes Tehran about $5.3 billion for oil shipments, according to the government and refining sources.

Iran's receivables from crude importers (billion dollars)



The repatriation of oil revenues is only part of the problem. Estimates show that Iran's trade surplus is gradually disappearing due to a gradual drop in oil exports. According to the Institute of International Finance (IIF), Iran's total trade surplus has fallen from about $70 billion in 2011 to about $44 billion in 2012. IIF estimates that it will reach about $38 billion by the end of 2013. In addition, crude oil revenues have fallen by 58 percent since late 2011 because of sanctions. The revenues averaged an estimated $8 billion per month in the first half of 2011, and then fell to $6.3 billion in the first half of 2012 and an estimated $3.4 billion monthly in the first half of 2013.

However, following the recent political developments in Geneva, some of the frozen monies are expected to be released and repatriated through official routes. The interim deal will be worth up to $7 billion to Iran, consisting of $4.2 billion in Iranian oil sales revenue unblocked from frozen accounts, $1 billion repatriated from petrochemical sales, a possible $500 million in extra production and sales by the Iranian automotive industry due to the lifting of the ban on imports of car parts, and the unblocking of $400 million in Iranian frozen assets to help pay the costs of Iranian students abroad. A suspension on a ban in Iran's trade in gold and other precious metals is also expected to bring in less than $1 billion.

The easing of sanctions is also expected to increase Iran's crude sales in the region. The removal of the EU restrictions on insurance opens the door for Indian refiners to increase imports to contract levels without breaching sanctions that remain in place that limit Iran's overall exports to around 1 million barrels per day (bpd).

Property prices

According to Iran's Statistical Center (ISC) report, the average price of apartments in Tehran has dropped by 4% in the summer of 2013 compared to the spring. Similarly, land prices have slumped by 10% in the same period. Based on this report, the price of land in the capital has reached to 52 million Rials per square meter, representing an increase of 100% compared to the previous summer but a reduction of 10% compared to the spring of 2013.

Rent prices have also experienced a downward trend. Although most often rent prices act independently of land and property prices and usually increase, they have been declining recently due to expectations of a downward trend. A major part of these deflationary trends can be attributed to the reduction in transaction volumes in the housing sector. According to the ISC, the volume of transactions has dropped by 23% in the spring of 2013.

In the hope of repairing such a reduction in transactions, the government recently presented the parliament with a bill suggesting a loan of 1 billion Rials be given to builders and buyers of property. However, the Central Bank of Iran believed that this figure may inflict a sudden shock to the prices in the sector and thereby have an inflationary influence on a macroeconomic level.

Bank loans and the growth of prices in the housing sector

Period	Bank loans	Percent increase in bank loans	Percent increase in property prices
1990-1993	25,000,000		
1994-1997	35,000,000	40%	215%
1998-2001	70,000,000	100%	148%
2002-2005	120,000,000	71%	85%
2006-2009	180,000,000	50%	200%

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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