

Kooshk, Pahlavan Pour Garden, Yazd Province, Iran

Market Overview _____ 2

With a 3.5% gain in the main index, October was the second best performing month of 2014 for the Tehran Stock Exchange (TSE) after July. A great number of earning reports were also released this month which mostly were in line with expectations. There were not many surprises in terms of positive adjustments for companies except for pharmaceuticals and the cement sector due to the approved permission by the government to increase prices. The cement sector index increased by 7 percent. The banks had the weakest reports as their cost of money rose faster than the revenues generated from loans. However, its index grew by 7 percent due to the political optimism of investors.

Country Highlights _____ 5

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

Economy _____ 6

Money market developments, housing market developments, and government fiscal performance will be covered in this section.

With a 3.5% gain in the main index, October was the second best performing month of 2014 for the Tehran Stock Exchange (TSE) after July. The relative turnaround in the market largely occurred in the second half of the month after some positive political news from the negotiations regarding Iran's potential nuclear deal. The fact that the previous round of negotiations took place in Oman was considered a potential breakthrough for both parties due to Oman having a good track record in terms of acting as a mediator between Iran and the US. Having said that, political events in November showed that investors had been too optimistic about political developments and the upward trend of the market reversed as investors faced an extension over the nuclear negotiations.

Some of the key events and sectors of the market will be analyzed below:

Earnings reports

By the end of October, almost all Iranian listed companies released their performance reports for the summer. The results of the majority of companies came in line with expectations meaning that there were not many surprises in terms of positive adjustments for companies except for pharmaceuticals and the cement sector.

Pharmaceuticals reported a positive performance with a 54% rise in profitability compared to the same period last year. However, despite these positive results, stocks within the sector were unable to grow, with the index of these companies facing a 2% decline in the month of October. This is partially due to the fact that the historical correlation between the performance of this industry with the overall market is negative as pharmaceuticals are known as a defensive and conservative choice of investment.

The cement sector also gained 7 percent in October due to the approved permission by the government to increase prices by 15% from the beginning of the summer. As a result, the earnings projections for this sector have increased 22% compared to the past fiscal year.

Banks had the weakest reports as their cost of money rose faster than the revenues generated from loans. Analysts believe that the tight monetary policy implemented by the government has caused an increase in the cost of money while the interest rates on loans have not been compensated for. According to a rough estimate, the total earnings of the banking sector seemed to decrease by around 20% in the first half of the Iranian year compared to the same period of the previous year. Having said that, given that Iranian banks would benefit hugely from a possible relief of banking sanctions, the performance of banks in the stock market did not correspond to their reports. As a result, the index of banks surged by 7% in the stock market due to the political optimism of investors.

Automotive

Amongst the 10 largest industries in terms of market cap, the auto industry was the best performing sector in October with a jump of 13%. The automotive sector is going through a positive period with production rising 74% in the past 6 months compared to the same period last year. Having said that, the industry still only produces at 70% of its full capacity and almost half of the production by type in Iran with the current level of productivity is loss making. On the other hand, filed research shows that the ambition of Iranian customers to buy passenger cars has cooled significantly in the past couple of months, resulting in a sharp increase in stockpiling of factories. That said, the optimism of investors regarding a possible comprehensive nuclear deal outweigh any short term difficulties and auto stocks did very well, in the hopes of a boost coming from foreign financial inflows as well as possible occurrence of international joint ventures which would probably turn around the circumstances of the whole industry.

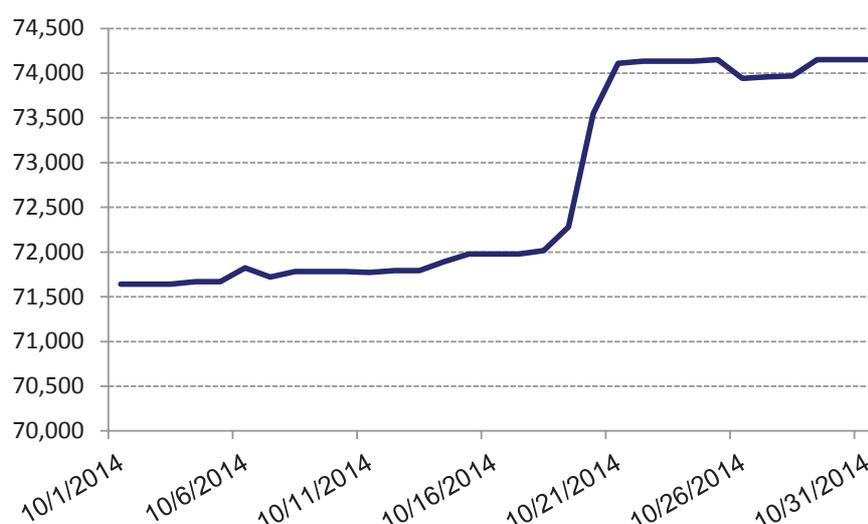
Petrochemicals

The petrochemical sector which contributes to more than 22% of total market cap of the TSE was the worst performing group in October with a loss of 7%. The weak performance of these

stocks occurred as the positive political sentiment of investors increased the possibility of Rial appreciation in the short run. According to the Turquoise financial database, the profitability of petrochemical companies is more sensitive to exchange rate fluctuations than any other listed sector. A 10% change in the Rial value result in an 18% swing in the sector's profitability. In conclusion, positive political developments aren't good news for shareholders of this industry in the short term, although the sector is one of the main candidates for attracting foreign capital in the post sanctions period.

Overall, the TSE had an outstanding performance in October, with the TSE All-Share Index gaining 3.5%. Trade volumes stood at \$1.1 billion, showing a significant increase of 29% compared to prior month.

Performance of TSE ALL-Share Index (October)



Market Statistics (October)

| | |
|--------------------------------|-----|
| Average P/E | 5.5 |
| Trade Volume (\$ Billion) | 1.1 |
| Trade Value Monthly Change (%) | 29 |
| Market Cap (\$ Billion) | 127 |

Top 5 Traded by Value (October)

| Rank | Company Name | Turnover Value (\$Million) | % of Total Turnover |
|------|-------------------------------------|----------------------------|---------------------|
| 1 | Iran Khodro Industrial Group | 55 | 5 |
| 2 | Mellat Bank | 40 | 4 |
| 3 | MAPNA Group | 39 | 3 |
| 4 | Persian Gulf Petrochemical Industry | 31 | 3 |
| 5 | Oil Industry Investment Co. | 27 | 2 |

Top 5 Companies by Market Cap (October)

| Rank | Company Name | Market Cap (\$Million) | % of Total MC |
|------|-------------------------------------|------------------------|---------------|
| 1 | Persian Gulf Petrochemical Industry | 11,768 | 9 |
| 2 | Bandar Abbas Oil Refining Co. | 5,551 | 4 |
| 3 | Esfahan's Mobarakeh Steel Co. | 4,931 | 4 |
| 4 | Ghadir Investment Co. | 4,660 | 4 |
| 5 | Telecommunication Co. of Iran | 4,617 | 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 26,701 as at 31 October 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.

➤ The latest round of talks between Iran and the P5+1 in regards to Iran's nuclear program ended on November 24, the day the negotiating parties had set as a deadline to reach a comprehensive agreement. This latest round of negotiations started on November 18 in the Austrian capital city of Vienna. There was a lot of anticipation by stakeholders regarding the potential positive outcome of the talks. Leading to the talks in Vienna, the negotiating parties had stated that significant gaps still remained between their respective positions. The US Secretary of State, John Kerry, had travelled to London and Paris before the start of the negotiations in order to discuss the Iranian nuclear negotiations with other members of the P5+1. During the negotiations, the Iranian delegation, being lead by the Iranian Foreign Minister, Javad Zarif, had multiple bilateral and trilateral meetings with the other negotiating parties. Mr. Zarif and Mr. Kerry met multiple times in trilateral meetings with the EU representative, Mrs. Catherine Ashton in order to try and close the remaining gaps preventing a comprehensive deal. Mr. Zarif and Mr. Kerry also held a bilateral meeting in order to try and reach an agreement before the deadline. Another development was the surprise trip by the Saudi Foreign Minister, Saud al-Faisal, to Paris and Moscow and later to Vienna to discuss the talks with his counterparts from France, Russia, and the US. Analysts believe the Saudi government is weary of the potential positive outcome of negotiations as a comprehensive deal could change the economical and geopolitical dynamic of the Middle East. As the discussions progressed, foreign ministers from all the P5+1 countries travelled to Vienna to hold meetings on the ministerial level in order to have a final push for a comprehensive solution. The talks, however, ended with the sides coming to an agreement on extending the accord (Joint Plan of Action), which was reached last year in the Swiss city of Geneva, for 7 months. Official statements from the negotiating parties mentioned that the sides will push to reach a political agreement by March and a final comprehensive deal by June 10, 2015.

➤ The Iranian Parliament held a session on November 26 in order to discuss the nomination of Mr. Mohammad Farhadi, by President Rouhani,

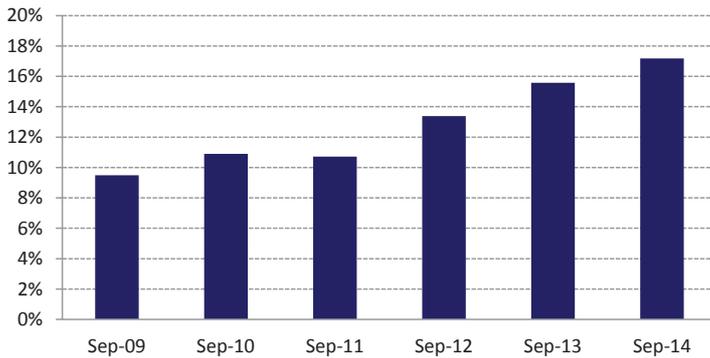
for the position of Minister of Science, Research and Technology. The parliament had voted against the previous 2 nominations for this post after the previous minister, Mr. Faraji-Dana, was impeached on August 20th. The MPs had stated the previous candidates' connection to the 2009 protests against the election of the former President Ahmadinejad as the reason behind their disapproval. Mr. Farhadi who was Mr. Rouhani's fifth nomination for the post of Science Minister since the current administration came to power in August of 2013, received the parliament's vote of confidence. The Iranian MPs voted 197 in favour, 28 against and 10 abstained in regards to Mr. Farhadi's nomination.

➤ Organization of the Petroleum Exporting Countries (OPEC) held its 166th ordinary meeting on November 27 in Vienna. The meeting was of significance as oil prices had experienced a major decline in previous weeks and the cartel's decision on level of production output could potentially affect global crude oil prices. As some members of OPEC rely on higher crude prices to balance their national budgets, while other members can live with lower prices, this meeting was widely watched by analysts globally. While countries like Venezuela, Libya and Ecuador had called for a reduction in production, Persian Gulf littoral states such as Saudi Arabia, Kuwait and the UAE sought to keep production at current levels of about 30 million barrels a day. The meeting finalized by the OPEC countries not being able to reach a conclusion on production cuts and decided to keep the cartel's production output at previous levels. After the meeting in Vienna, Iranian Oil Minister, Bijan Zanganeh stated that he believes that high crude prices are a threat to OPEC's market share, however, "shock therapy" is not the solution. Mr. Zanganeh further stated that he does not support discord among group members even as the result of the meeting was not in line with what Iran wanted. He also stated that Iran can boost exports by an extra 1 million barrels a day within two months after international sanctions on Iran have been removed. Crude oil prices declined further with the news of OPEC's decision on keeping production at the 30 million barrel a day level.

Money Market Developments

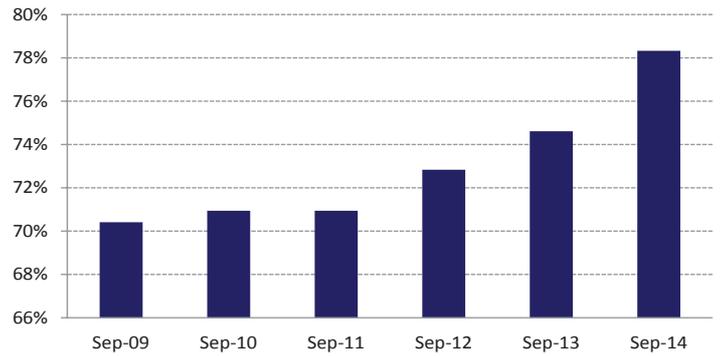
The Central Bank of Iran (CBI) recently published a report on monetary and credit aggregates, and on assets and liabilities of banks and financial institutions as of September 2014. On the asset side of the banks and financial institutions, total claims on the public sector (government and governmental institutions) amounted to 929 trillion IRR (\$34.8 billion), and total claims on the non-public sector amounted to 5412 trillion IRR (\$203 billion). The ratio of the claims on the public sector to the claims on the non-public sector was 17.2% in September 2014, 15.6% one year before, and 13.4% two years before. This trend suggests that the government is using more bank resources than it was previously, and that banks are getting more dependent on the government’s solvency.

Ratio of Claims on the Public Sector to Claims on the Non-public Sector

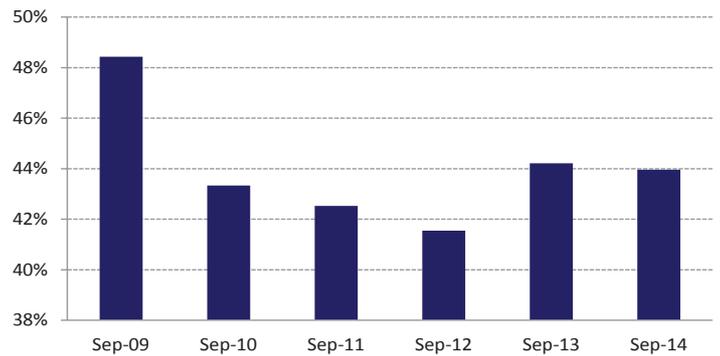


On the liability side, deposits of the non-public sector amounted to 6245 trillion IRR (\$234 billion) of which 78.4% is term deposits; this number was 74.5% one year before and 73% two years before. As these numbers suggest, the trend is towards more term deposits and less sight deposits which could be a result of the higher cost of money, the downward trend in the inflation rate, and the stability in the economy. The breakdown of term deposits shows that 44 percent of term deposits are short-term and the rest are long-term. In line with these changes, taking a look at the yield curve for the last 5 years shows that the right side of the curve has moved upward significantly and the left side has become steeper, making long-term deposits more attractive.

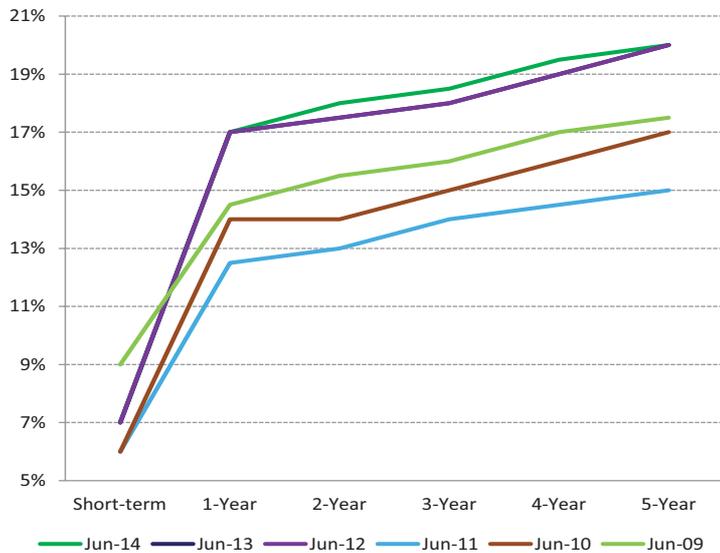
Ratio of Term Deposits to Total Non-public Deposits



Ratio of Short-term Deposits to Total Term Deposits



Yield Curve (Minimum deposit rate of private banks)



Housing Market Developments

Minister of Roads and Urban Developments, Mr. Akhondi, together with the governor of the Central Bank of Iran, Mr. Seif, have been working to find a solution to overcome a deep recession in the housing sector. The continuing downward trend in the number of construction permits issued in urban areas since last year, the significant decrease in the number of transactions in the housing sector in the last three years, the current mismatch between housing costs and household

income, and the decreasing share of the housing sector in the credit market show a deep recession in this sector, according to a letter sent by Seif and Akhondi to President Rouhani. The letter adds that the housing sector plays an important role in Iran's economy; it has links with 130 economic sectors, contributes to more than 20 percent of fixed capital formation each year, constitutes 25 percent of the balance of loans in the banking sector, 33 percent of household expenses are housing expenses, and the housing sector contributes around 12 percent of employment to the economy.

It is estimated that 4 million units of new and affordable homes are needed for the next 5 years but currently supply is fairly weak as well as demand. Seif and Akhondi mentioned in the letter that the solution is to develop mortgage markets and housing funds in order to increase demand as they have been trying to do, but the problem is that interest rates are so high that the demand side cannot afford to pay. It is planned that loan facilities of 50 percent of house values be provided to first-time home buyers at a rate of no higher than 14 percent which is lower than bank deposit rates. The letter proposed that the government pay the difference between the two rates.

Furthermore, the government has been concerned about aging urban areas and urban decay and has been trying to execute renovation plans and find a solution for this phenomenon. Therefore, in order to stimulate the construction sector and speed up renovation projects, the government has decreed that \$18,700 of construction loans be provided in big cities, \$11,200 in towns, and \$7,500 in rural areas. The interest rate on these loans is 9 percent, and low income people and newly established families have priority in receiving these loans. The plan is to provide a number of 1.8 million loans over a period of 6 years.

Government fiscal performance for the first half of the year

During the first half of the current Iranian year (ending on September 2014), the total revenues of the government amounted to \$15.3 billion of which 77% was tax revenues. Total revenues in-

creased by 43% compared to a year before, and tax revenues increased by 55%. Government current expenses during this period were \$25.7 billion, showing an increase of 34%. Even though revenues grew at a higher rate than expenses, the operating deficit increased from \$8.9 billion to \$11 billion in the first half of the current year.

The government uses resources from sale of crude oil and oil products to cover its operating deficit and to pay for development expenditures. The government also raises money through disposal of financial assets when needed. During the specified period, the sale of oil and oil products amounted to \$13.5 billion, development expenditures was \$4.2 billion, and the net disposal of financial assets was \$1.6 billion.

During the last three years there have been differences between the fiscal performance of the government and the approved budget, but coverage ratios were in the range of 85 to 96 percent for most items in the budget; however, capital expenditures experienced coverage of less than 40 percent of the approved budget for the last two years. A comparison of the government fiscal performance during the first half of the year with that of the last two years shows that the government could catch up with the approved budget better than in recent years. In the last two years, 40 percent of revenues were earned during the first half of the year which is the same as the coverage of the approved budget for this year. The same conclusions can be made regarding current expenses and disposal of non-financial assets, though the latter could be affected by the result of nuclear negotiations and the removal of sanctions. Regarding development expenditures, which can have a great impact on construction activity and activities in related sectors, the government has performed better than the last two years and it could cover the approved budget.

| 6-month government fiscal performance as a percent of approved/realized annual budget | | | |
|--|-------|-------|-------|
| | 2014 | 2013 | 2012 |
| Total Revenues | 40.6% | 39.6% | 39.8% |
| Tax Revenues | 44.7% | 41.1% | 42.8% |
| Current Expenses | 46.0% | 42.9% | 45.8% |
| Disposal of non-financial assets | 45.2% | 36.1% | 47.9% |
| Development expenditures | 27.0% | 16.3% | 20.7% |

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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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