



Implementation day, January 16th, 2016, Vienna

Market Overview 2

The Tehran Stock Exchange ended down 1.5% for the month of December and 10.6% over 2015. This is the second consecutive year that the market has fallen, recording a total loss of 30% over the past two years – the most severe decline ever. This negative trend and the bear market are, however, likely to be coming to an end with the hope of economic relief from the removal of sanctions in January. Iranian stock valuations have become reasonably attractive as stocks traded 5.5 times higher than their projected earnings as of December 31st. This is 10% lower than the average valuation of the market over the past two decades. This being said, declining oil and commodities prices weighed heavily on the market in December.

Country Highlights 4

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

Economy 6

This issue reviews both the Iranian government's new budget and five-year development plan in addition to identifying the strongest sectors in the country's post-sanctions economy.

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Some significant events in different sectors are analysed below:

Sugar

Sugar companies had a very good month in December and the sector index appreciated 11% in value. After a long debate between the government and companies in the industry, they agreed to increase domestic sugar prices by 10%. The ban on imports will also remain in place, which is welcome news for the sector. As it stands, sugar is sold at a 50% premium to the global price as a result of government policy to protect domestic players.

Food & beverage

Both dairy and cooking oil producers were amongst the few positive performers on the Tehran Stock Exchange over the month of December. This is the result of investors rushing into safe assets which are uncorrelated with global commodities. The sector index rose by 2.5% and some dairy companies rallied more than 10%. Taking into account the size of the industry, which is less than \$1bn, stocks within this sector are suitable for speculative trades. This seems to be one of the main factors in the sector's good performance, as there was little development in commercial fundamentals.

Cement

Given the weak construction sector throughout the country, cement companies have been facing a very tough time meeting projected sales and profit targets. Oversupply of cement is a persistent problem for Iranian producers, which has worsened over the past few months. As the amount of unsold cement in warehouses reached 20 million tonnes, cement producers have begun to curb their production for the first time in the history of the industry. The utilization rate fell to an all time low of 70% in December. At one time, Iran had the capacity to produce 80 million tonnes of cement annually, now it produces at 56 million tonnes. This news caused the sector index to fall by 24% in 2015, the steepest annual decline ever. A turnaround in the sector could be expected once the economy starts to improve and once government spending on infrastructure and construction projects picks up. This, however, mainly depends on whether oil prices will rebound or the Iranian government will be able to boost the economy by using its billions of offshore dollars which are going to become accessible post sanctions.

Chemicals

The largest listed industry of the TSE continued its mild depreciation and lost 1.3% in value over the month. Disputes over natural gas feedstock prices picked up again in December after the petroleum minister announced that the government would refuse to consider any significant discount in natural gas prices. This was in contrast to the demands of petrochemical companies who were hoping to reduce the price of feedstock from 13 cents per cubic meter to 8 cents. In 2013, the Iranian parliament increased gas prices by 5 times to 13 cents and then went back on its decision after facing resistance from the petrochemical industry. Since then, global energy prices have fallen significantly, boosting the case for petrochemical companies to increase pressure on the government to offer some discounts. There are rumors that the government will come to a compromise in the coming weeks but perhaps not as much as companies might wish. The petrochemical sector is currently projected to have \$4.7bn of net earnings. According to the Turquoise financial database, this industry will grow net profits by 5% for every 1 cent deduction in the current feedstock price, assuming sales prices remain constant.

Performance of TSE All-Share Index (December)



Market Statistics (December)

Average P/E	5.7
Trade Value (\$ Billion)	0.5
Trade Value Monthly Change (%)	-24.6
Market Cap (\$ Billion)	88.5

Top 5 Traded by Value (December)

Rank	Company Name	Turnover Value (\$Million)	% of Total Turnover
1	Mellat Bank	47	10
2	Azarab Industries Co.	21	4
3	Electricity Meter Manufacturing Co.	19	4
4	Saderat Bank	14	3
5	Polyacryl Iran Public Corporation	12	2

Top 5 Companies by Market Cap (December)

Rank	Company Name	Market Cap (\$Million)	% of Total MC
1	Persian Gulf Petrochemical Industry	8,777	10
2	Mobile Communications of Iran	3,864	4
3	Telecommunication Co. of Iran	3,573	4
4	Parsian Oil & Gas	3,410	4
5	Tamin Petrochemical Co.	3,143	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 30,130 as at 31 December 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 nuclear agreement, known as the Joint Comprehensive Plan of Action (JCPOA), was signed between Iran and the EU3+3 in July 2015 and finally took effect on January 16, 2016. The so called 'implementation day' was announced by the Iranian Minister of Foreign Affairs, Javad Zarif, and the EU High Representative for Foreign Affairs and Security Policy, Federica Mogherini in the Austrian capital city, Vienna. The US Secretary of State, John Kerry, also travelled to Vienna to have discussions with his European and Iranian counterparts before the announcement. In a news conference, Mr Kerry stated that the nuclear accord was proof that diplomacy can solve some of the world's most difficult issues peacefully. According to the agreement, all nuclear related sanctions which were placed on Iran by the United Nations, European Union and the United States were lifted or suspended on implementation day. Earlier, the International Atomic Energy Agency (IAEA) had made an announcement stating Iran's full compliance to its commitments under the nuclear accord. The IAEA's verification paved the way for the removal of sanctions. The implementation of the nuclear deal concludes more than 12 years of on and off negotiations and more than two years of intense diplomatic efforts by Iran and the EU3+3 to resolve the standoff. The Iranian president, Hassan Rouhani, had made the nuclear agreement one of his top priorities and promised to resolve the issue and have the sanctions lifted in his election campaign. Hours before the lifting of sanctions were announced, there was news of senior executives from European oil companies visiting Tehran and having meetings with top Iranian oil officials. At the same time, Iran announced its intent to purchase more than 100 airplanes from the European airplane manufacturer, Airbus Group SE. US sanctions on the purchase of commercial aircraft and spare parts, dating back to the 1980's, have also been lifted.

➤ Saudi Arabia severed its ties with Iran after demonstrators in Tehran stormed the Saudi embassy and protestors in the city of Mashhad attacked the Saudi consulate. This comes after the execution of a prominent Shia cleric in Saudi Arabia which caused outrage in Iran. The execution of Nimr Al-Nimr was carried out along with 46 other

individuals in the oil rich kingdom and was met with wide condemnation across the globe. American and European officials condemned the execution of the outspoken Ayatollah at a time when sectarian conflict rages in the Middle East and the execution of a Shia cleric could trigger further violence. Sheikh Nimr Al-Nimr had called for free elections in the kingdom and was critical of the Saudi royal family. His execution was also significant as Saudi Arabia hosts a minority Shia population mostly in its oil rich eastern provinces. The storming of the Saudi Embassy was widely criticized at all levels of the Iranian government. Iranian officials stated that more than 100 people had been arrested in connection with the incident and an ongoing investigation is in progress. However, increased tensions between the two countries failed to dissipate and finally led to a full cut in diplomatic ties, initiated by Saudi Arabia. Some of Saudi Arabia's regional allies followed the kingdom's decision by downgrading or cutting diplomatic ties with Iran. Bahrain, Sudan, Djibouti and the Comoro Islands cut their diplomatic relations with Iran, while the UAE downgraded ties.

➤ In a surprise announcement, the United States and Iran announced a prisoners exchange arrangement on the same day as the implementation of the Joint Comprehensive Plan of Action. Seven Iranian-Americans held in US prisons were released, while Iran released four Iranian-Americans. Among those being released to the US was the Washington Post journalist, Jason Rezayian, who was arrested in Iran more than a year ago on security charges. The Iranians who were freed in the US had been convicted of violating sanctions-related laws against Iran.

➤ American naval personnel were apprehended by Iranian naval forces after their boats strayed into Iranian territorial waters in the Persian Gulf. Naval forces of the Islamic Republic Revolutionary Guard apprehended two US navy boats that had entered Iranian waters. Both American and Iranian officials acknowledged that the violation of Iranian waters was due to a mechanical problem on one of the boats. The incident was discussed in a phone call between the US Secretary of State,

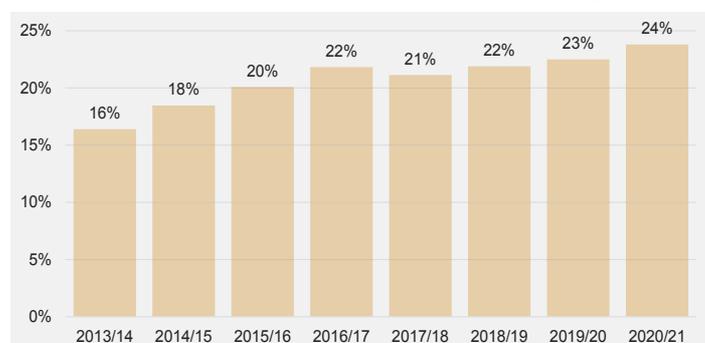
John Kerry, and his Iranian counterpart, Javad Zarif. The American sailors and their equipment were freed within 24 hours of Iranian navy officers concluding that the violation had been unintentional.

➤ The Iranian Minister of Roads and Urban Development, Abbas Akhoundi, stated that Iran needs around 500 new aircraft in the next decade as part of plans to develop its air transportation industry. Mr Akhoundi also stated that an initial agreement had been made with Airbus Group for the purchase of 114 airplanes for the national carrier, Iran Air. Officials at the Ministry stated that the list of aircrafts to be purchased from Airbus include the A380, as well as the A350, A330, A321 and A320. The delivery of these new airplanes is expected to begin before the Iranian New Year on March 20, 2016, and will continue up to 2020. Mr Akhoundi further explained that Iran will also enter negotiations with the US aircraft manufacturer, Boeing Co., as part of its plans to expand its commercial fleet of aircraft. According to Mr Akhoundi, Iran is also planning to develop and renovate its airports and will also re-activate some smaller regional airports. The statements were made at an international aviation conference in Tehran which was attended by more than 300 airlines, lessors, suppliers, banks and aviation service companies.

After sanctions were lifted on January 17th 2016, the Iranian government submitted two important draft bills to parliament: the budget for the upcoming fiscal year, 1395 (2016/17) and the next five-year development plan (2016/17 – 2020/21). The national development plan is submitted by the government every five years to work towards a 20 year strategic development milestone. According to the government and IMF staff recommendations, the link between the annual budget framework and the five-year development plan has been improved and many financial projections in the government budget have been estimated based on the overview of the next five years ahead.

The government's general budget, not including state-owned enterprises, totals 2,670 trillion rials (\$73.3 billion). Having had a successful budget last year, the upcoming budget has been carefully planned in order to avoid inflationary pressures on the economy. The investment expenditure share of total revenue remains stable at 22% – similar to last year – and will grow smoothly to 24% up to 2020/21.

Investment Expenditure Share in Budget



New Budget Key highlights:

➤ Share of oil revenue in the budget is planned to stabilize at c.50% in the medium term assuming oil prices are around 43-45 USD mb/d.

➤ With the continued decline in oil prices in the near term, the government is committed to fiscal consolidation by focusing on reducing the non-oil deficit. Non-oil sector net borrowing is expected to decline to 7.1% in 2016/17 from 8.2% in 2014/15 and 7.2% in 2015/16. According to the five-year development plan and IMF recommendations, the

non-oil fiscal deficit will reach 6.5% of non-oil GDP over the medium term up to 2020/21. Increasing tax revenue through reducing exemptions for large taxpayers, especially semi-large entities, is intended to help the government achieve fiscal sustainability and make room for public investment. Under the five-year plan, the government goal to finance its current spending with tax revenue will reach approximately 80% by 2020/21 (currently at 60%).

➤ The Targeted Subsidies Organization's (TSO) overall budget will be better balanced due to increasing domestic fuel prices, cutting subsidies on other public goods and excluding transfer recipients from the high income segment.

➤ The government plans to improve the public debt market through a debt management unit within the treasury, established in early 2015. This unit's responsibility is to identify government debt and issue treasury bonds as well as Sukuk and other Islamic debt instruments, to finance all governmental debt up to 2020/21. A developed public debt market, will allow the government to help the banking sector improve its balance sheet and capitalization through sales of assets and shares. Establishing a strong regulated debt market, enabling banks and private corporations to issue bonds to finance their projects, was recommended by many senior economists when the government was drafting the budget and five-year plan.

➤ The government has increased the central bank's independence in supervising the banking sector and issuing penalties for banks who do not meet financial management standards – up to one per cent of their registered capital. The central bank's role in supervising banks' restructuring and resolution of nonperforming loans has been highlighted in the new budget and five year plan. In addition, the government's new Money and Banking Law, which is currently going through parliament, will strengthen the central bank's ability to create a strategic plan for monetary policy and harness technical expertise to support its decision-making process.

➤ The other important parts of the budget involved spending on infrastructure in the following sectors;

- Developing the national rail network, especially in less developed areas.
- Developing information and communication technology (ICT) infrastructure, especially in less developed areas, through the Ministry of Communication and Information Technology, and the removal of existing monopolies in supplying ICT services and facilities.
- Agricultural reform, with particular focus on the water crisis and the water supply. The plan is to increase the country's total reserves to 11 billion cubic meters in line with the reduction in annual water consumption. The Ministry of Energy will be required to set new pricing rules on water for non-residential use (industry, services, and agriculture) within six months of the budget being passed. The new pricing schedule will be based on the 'economic value of water'.
- Improving women's working conditions and gender equality in the private and public sectors.
- Improving the ease of international trade by developing free trade zones and ports, in coordination with international consultants and experts.

Based on our analysis of the budget and the five year development plan, the sectors that will benefit most from the lifting of sanctions in the near to medium term are as follows.

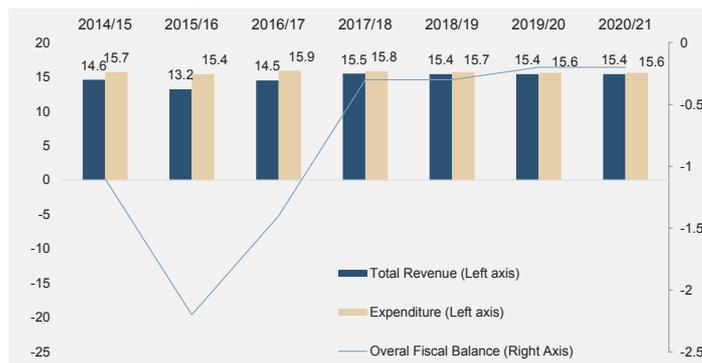
1- Oil, Gas and Petroleum Refined Products: In line with the investment ramp-up and ease of trade in the oil and gas sectors, oil production is expected to grow from 1.24 mb/d in 2016 to 1.81 mb/d in 2017 – an increase of 500kb/d. The IMF expects Oil GDP to grow by 16% in 2016.

2- Banking and Financial Sector: Infrastructure such as network systems, legal frameworks and security management systems are already established and have performed well in meeting domestic demand. The government is also planning to increase the central bank's authority to regulate financial institutions independent from government, broadly in line with advanced economies. With increasing demand from many corporates to finance projects from non-banking sources and to access international finance options, a regulated debt market is expected to develop in the near term. This is in line with the government's aim to establish a regulated independent debt market in its five-year development plan.

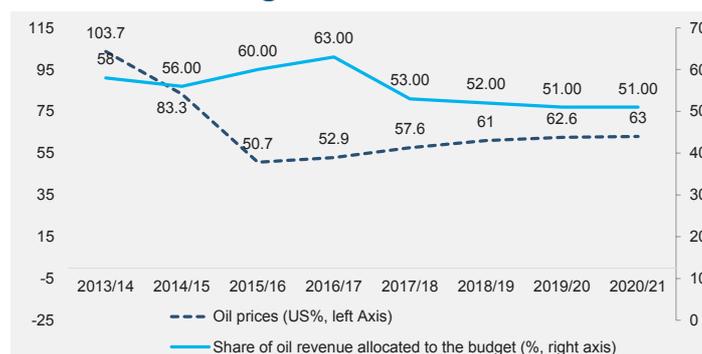
3- FMCG, Pharmaceutical & Retail Sector: Many factories, especially in the FMCG sector, are seeking joint ventures with foreign brands to increase the quality and international competitiveness of their products. Additionally, the government is supporting non-oil sectors by providing low cost finance options or tax incentives. For example during the sanctions, Iranian pharmaceutical companies developed production lines producing key medicines. Many of these well-branded companies are interested in expanding their production lines into the biotech industry, home remedy products, etc. Investment and support from foreign brands would help them to meet international quality standards.

4- Export Driven Industries: Auto manufacturing, mining and many processing industries for building materials, auto parts and industrial manufacturing are expected to grow in line with increasing

Overall Budget (% GDP)



Oil Share in Budget



international trade. For example, many Iranian industries are currently producing below capacity due to difficulties in sourcing raw materials. The mining sector needs investment in order to explore reserves in gold and basic metals such as zinc, copper, aluminum and iron.

Resources:

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About Turquoise

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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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