

Q1 2014

www.businessmonitor.com

IRAN

AUTOS REPORT

INCLUDES 5-YEAR FORECASTS TO 2017



ISSN 1748-9962

Published by: Business Monitor International



Iran Autos Report Q1 2014

INCLUDES 5-YEAR FORECASTS TO 2017

Part of BMI's Industry Report & Forecasts Series

Published by: **Business Monitor International**

Copy deadline: December 2013

Business Monitor International

Senator House
85 Queen Victoria Street
London
EC4V 4AB
United Kingdom
Tel: +44 (0) 20 7248 0468
Fax: +44 (0) 20 7248 0467
Email: subs@businessmonitor.com
Web: <http://www.businessmonitor.com>

© 2013 **Business Monitor International**

All rights reserved.

All information contained in this publication is copyrighted in the name of **Business Monitor International**, and as such no part of this publication may be reproduced, repackaged, redistributed, resold in whole or in any part, or used in any form or by any means graphic, electronic or mechanical, including photocopying, recording, taping, or by information storage or retrieval, or by any other means, without the express written consent of the publisher.

DISCLAIMER

All information contained in this publication has been researched and compiled from sources believed to be accurate and reliable at the time of publishing. However, in view of the natural scope for human and/or mechanical error, either at source or during production, **Business Monitor International** accepts no liability whatsoever for any loss or damage resulting from errors, inaccuracies or omissions affecting any part of the publication. All information is provided without warranty, and **Business Monitor International** makes no representation of warranty of any kind as to the accuracy or completeness of any information hereto contained.

CONTENTS

BMI Industry View	7
SWOT	9
<i>Political</i>	<i>10</i>
<i>Economic</i>	<i>11</i>
<i>Business Environment</i>	<i>12</i>
Industry Forecast	13
<i>Production</i>	<i>13</i>
<i>Table: Iran Automotive Production, 2010-2017</i>	<i>13</i>
<i>Table: Iranian Vehicle Production By Model</i>	<i>16</i>
<i>Sales</i>	<i>17</i>
<i>Table: Iran Automotive Sales, 2010-2017</i>	<i>17</i>
<i>Trade</i>	<i>18</i>
Macroeconomic Forecast	19
<i>Economic Analysis</i>	<i>19</i>
<i>Table: Iran - Economic Activity</i>	<i>25</i>
Industry Risk/Reward Ratings	26
<i>Middle East and North Africa - Risk/Reward Ratings</i>	<i>26</i>
<i>Table: BMI Industry Risk/Reward Ratings - Middle East And North Africa Autos</i>	<i>28</i>
Company Profile	29
<i>Company Monitor - BMW</i>	<i>29</i>
<i>Iran Khodro Company (IKCO)</i>	<i>31</i>
<i>Saipa Diesel</i>	<i>36</i>
<i>Societe Anonyme Iranienne de Production Automobile (Saipa)</i>	<i>37</i>
Regional Overview	38
<i>Middle East And North Africa Overview</i>	<i>38</i>
<i>Table: Middle East And North Africa Autos Production Investments</i>	<i>38</i>
Global Industry Overview	40
Demographic Forecast	44
<i>Demographic Outlook</i>	<i>44</i>
<i>Table: Iran's Population By Age Group, 1990-2020 ('000)</i>	<i>45</i>
<i>Table: Iran's Population By Age Group, 1990-2020 (% of total)</i>	<i>46</i>
<i>Table: Iran's Key Population Ratios, 1990-2020</i>	<i>47</i>
<i>Table: Iran's Rural And Urban Population, 1990-2020</i>	<i>47</i>
Methodology	48

<i>Industry Forecasts</i>	48
<i>Sector-Specific Methodology</i>	49
<i>Sources</i>	49
<i>Risk/Reward Ratings Methodology</i>	50
<i>Table: Automotive Risk/Reward Ratings Indicators And Weighting Of Indicators</i>	51

BMI Industry View

The medium-term outlook for Iranian auto production has improved significantly since our last quarterly update, reflecting the temporary deal reached between US and major powers over the future of its nuclear programme in November 2013.

Iran and the 5+1 powers (the United States, Russia, China, France, Britain and Germany) clinched an interim deal on the Islamic Republic's nuclear programme on November 24, following four days of negotiations in Geneva. Under the agreement, which will last for six months while a more permanent and comprehensive settlement is found, Iran will curb some of its nuclear activities in return for an immediate gain of approximately US\$7bn in sanctions relief. US President Barack Obama called the deal 'an important first step toward a comprehensive solution that addresses our concerns'.

Should a permanent deal be struck in 2014 - and there is no guarantee that this will happen - then there is scope for sanctions on Iran's key oil sector to be lifted, which would be a game changer for the domestic economy and, by extension, demand for new cars from Iranian citizens.

Already, French carmaker **Renault** has announced that it plans to resume the export of car parts to Iran. The company is awaiting clarification on the relaxation of trade sanctions against the country. Clarification of the rules is expected around January 2014. Moreover, while the details of a deal to ease sanctions on Iran are still to be finalised, we believe that fellow French carmaker **PSA Peugeot Citroen** is already in line to be a major beneficiary. Having been one of Iran's leading foreign brands before sanctions were tightened, a return to the market for Peugeot would help to offset the ongoing slump in the group's European business.

Among domestic automakers, **Iran Khodro Company** (IKCO) is also likely to benefit from the potential return of its former partner **Peugeot**, although the domestic carmaker had been making progress in producing its own components for models, such as the Peugeot 206, following the French firm's withdrawal. Local production of Peugeot models in September and October 2013 topped 10,000 units a month for the first time in three years. According to data from the Iran Vehicle Manufacturers Association, the Peugeot Pars claimed second place in terms of output in October 2013, with 10,533 units produced. In total, we still forecast a 50% decline in vehicle production in 2013, however.

Another positive response to the deal for the wider industry was the 2% appreciation of the rial on the news that an agreement had been reached. **BMI** has previously highlighted the weakness of the rial as another source of pressure on domestic vehicle sales, which means that any further strengthening in the currency

would be positive for consumers. That said, this initial strengthening is a drop in the ocean compared with the value lost over the last year or so and we would need to see further progress for this threat to sales to be totally overcome.

Indeed, there remains a great deal of 'wait and see' sentiment in the industry, until the full details of future operating in the Iranian market have been made clear. South Korea's **Kia Motors**, which had a partnership with domestic producer **SAIPA** until it withdrew from the market in 2010, said it will wait for more information before commenting. Germany's **Daimler**, which used to have a 30% stake in a diesel engine joint venture with IKCO before starting to cut back its Iranian business in 2010, said it will 'closely monitor' the situation, but has no plans to return to the market.

In a further encouraging development, in December 2013 it was reported that more than US\$1bn in foreign direct investment has been approved for Iran's automotive manufacturing industry, according to the head of the Organisation for Investment, Economic and Technical Assistance of Iran, Behrouz Alishiri. Some US \$300mn has already been invested. The government wants to turn Iran into an automobile production hub by extending legal support and special privileges to overseas investors. Alishiri says the government will provide a long-term plan to the Iranian automobile sector to help find reliable foreign investors.

SWOT

Iran Auto Industry SWOT

Strengths

- The largest car-producing market in the Middle East.
- Domestically developed engines, as well as vehicles, reduce the country's reliance on imports.

Weaknesses

- Local parts and components manufacturers face capacity constraints, which will mean greater reliance on foreign imports in car assembly.
- 2013 will have proved a tough year for the industry, with both production and sales set to fall sharply.

Opportunities

- Should a permanent deal on Iran's nuclear programme be reached and sanctions ended, then we would expect the domestic economy to grow rapidly over the medium term, which in turn would boost demand for new cars.
- As Iran's car sector grows, it will increasingly rely on outsourcing for parts and components.
- Agreements with Chinese manufacturers brings new business partnerships and uses for capacity.

Threats

- Reported ban on Iranian built cars by its biggest export market, Iraq, although this has not been borne out by recent export data.
- Should talks between Iran and the West collapse in 2014, then the country would remain subject to US trade sanctions, which would continue to cut the country off from international investment.
- Political instability remains a key concern for the whole Iranian economy.

Political

Political SWOT Analysis

Strengths	<ul style="list-style-type: none">▪ Since the overthrow of the Pahlavi family in 1979, there has been some reduction in the level of political corruption, while wealth distribution has improved marginally.▪ The Revolutionary Guard and Basij militia are fiercely loyal to the supreme leader, helping to maintain social stability.
Weaknesses	<ul style="list-style-type: none">▪ The country has one of the poorest human rights records in the region, and authorities do not hesitate to quell dissidents. A number of journalists and anti-government protesters are being held in custody.▪ While decision-making ultimately rests with the supreme leader, the regime is heavily fragmented, and consensus is hard to reach.▪ Widespread perceptions of electoral fraud during the course of June 2009's presidential elections have damaged the regime's legitimacy in the eyes of many Iranians.
Opportunities	<ul style="list-style-type: none">▪ The Majlis (parliament) is more than just a rubber stamp; the move by 150 parliamentarians (out of 290) to hold former president Mahmoud Ahmadinejad accountable for his handling of the economy in March 2012 is a positive indication that checks exist.▪ The victory of moderate cleric Hassan Rouhani in Presidential elections in June 2013 is leading to a gradual improvement in relations with the West.
Threats	<ul style="list-style-type: none">▪ Ongoing nuclear tensions raise the prospect of further US and EU sanctions and the possibility of a military strike by the US or Israel.▪ Youth unemployment is high.▪ The strong influence of the Revolutionary Guards within the political and economic arena may present a challenge to the status quo over the long term.

Economic

Economic SWOT Analysis

- | | |
|----------------------|--|
| Strengths | <ul style="list-style-type: none">▪ Iran has the world's second largest proven oil reserves after Saudi Arabia, and the world's second largest proven gas reserves after Russia.▪ Oil and gas aside, Iran is rich in other resources and has a strong agricultural sector. |
| Weaknesses | <ul style="list-style-type: none">▪ Local consumption of hydrocarbons is rising rapidly; this, coupled with ageing technology in the sector, will have a negative impact on its oil and gas exporting capacity.▪ International sanctions discourage foreign oil companies from bringing much-needed technical knowledge and equipment to maintain oil output levels. |
| Opportunities | <ul style="list-style-type: none">▪ The gas sector remains underdeveloped, and there is considerable room to maximise this source of revenue.▪ A growing population, combined with a shortage of housing, provide opportunities for investment in residential construction. |
| Threats | <ul style="list-style-type: none">▪ A decline in global oil prices would have a marked impact on the economy. Although an Oil Stabilisation Fund exists to protect the economy at times of weaker oil prices, it has increasingly been used to fund government overspending and could be close to empty.▪ Capital flight is likely to continue owing to high inflation and currency depreciation. |

Business Environment

Business Environment SWOT Analysis

- | | |
|----------------------|---|
| Strengths | <ul style="list-style-type: none">▪ The Foreign Investment Promotion and Protection Act gives some protection to foreign investors and now allows relatively good terms for the repatriation of profits.▪ Although stifled in the years since the Islamic Revolution, Iranians have traditionally been renowned for their entrepreneurial skills - a factor that is potentially a strong pull for foreign investors. |
| Weaknesses | <ul style="list-style-type: none">▪ Progress on the privatisation front remains slow despite some recent encouraging signs.▪ Foreign firms are currently unable to own Iran's hydrocarbon resources. The resultant 'buy back' deals offer less advantageous terms than those elsewhere, limiting hopes of new investment. |
| Opportunities | <ul style="list-style-type: none">▪ As part of the fourth five-year development plan 2005-2009, the government ended tax and customs concessions afforded to the country's quasi-statal bonyads, or foundations. |
| Threats | <ul style="list-style-type: none">▪ UN, US and EU sanctions on Iran's banking and energy sectors are making it very difficult for foreign companies to undertake financial transactions with Iranian entities, and much riskier to invest in the hydrocarbon sector.▪ Central bank supervision of charitable funds will be stepped up sharply after it emerged that a number of these funds had collapsed due to indiscriminate lending practices. |

Industry Forecast

Production

Table: Iran Automotive Production, 2010-2017

	2010	2011	2012f	2013f	2014f	2015f	2016f	2017f
PRODUCTION: Vehicles, units	1,599,454	1,648,505	989,110	501,611	546,339	642,816	786,893	859,472
PRODUCTION: Vehicles, units, % chg y-o-y	14.6	3.1	-40.0	-49.3	8.9	17.7	22.4	9.2
PRODUCTION: Passenger cars, units	1,367,014	1,413,276	848,000	424,000	466,400	559,680	699,600	769,560
PRODUCTION: Passenger cars, units, % chg y-o-y	0.6	3.4	-40.0	-50.0	10.0	20.0	25.0	10.0
PRODUCTION: Passenger cars, % of total domestic vehicle unit production	85.5	85.7	85.7	84.5	85.4	87.1	88.9	89.5
PRODUCTION: Commercial vehicles, units	232,440	235,229	141,110	77,611	79,939	83,136	87,293	89,912
PRODUCTION: Commercial vehicles, units, % chg y-o-y	547.4	1.2	-40.0	-45.0	3.0	4.0	5.0	3.0
PRODUCTION: Commercial vehicles, % of total domestic vehicle unit production	14.5	14.3	14.3	15.5	14.6	12.9	11.1	10.5

e/f = BMI estimate/forecast. Sources: OICA, UN Comtrade

The medium-term outlook for Iranian auto production has improved significantly since our last quarterly update, reflecting the temporary deal reached between US and major powers over the future of its nuclear programme in November 2013.

Iran and the 5+1 powers (the United States, Russia, China, France, Britain and Germany) clinched an interim deal on the Islamic Republic's nuclear programme on November 24, following four days of negotiations in Geneva. Under the agreement, which will last for six months while a more permanent and comprehensive settlement is found, Iran will curb some of its nuclear activities in return for an immediate gain of approximately US\$7bn in sanctions relief. US President Barack Obama called the deal 'an important first step towards a comprehensive solution that addresses our concerns'.

The interim Geneva agreement has rightly been hailed as a significant development in the negotiations between Iran and the West, and marks a further improvement in the Islamic Republic's international position since the election of Iranian President Hassan Rouhani in June 2013. That said, **BMI** notes the clear risk that the November 24 agreement could turn out to be the apex of the negotiations, with the next phase of talks - aimed at reaching a long-term deal on Iran's nuclear programme - likely to face significant opposition by hardline policymakers from all sides. As such, we retain our auto forecasts this quarter, as we see how negotiations towards a more permanent deal progress.

However, should a permanent deal be struck, then there is scope for sanctions on Iran's key oil sector to be lifted, which would be a game changer for the domestic economy and, by extension, demand for new cars from Iranian citizens.

Already, French carmaker **Renault** has announced that it plans to resume the export of car parts to Iran. The company is awaiting clarification on the relaxation of trade sanctions against the country. Clarification of the rules is expected around January 2014. Moreover, while the details of a deal to ease sanctions on Iran are still to be finalised, we believe that French carmaker **PSA Peugeot Citroen** is already in line to be a major beneficiary. Having been one of Iran's leading foreign brands before sanctions were tightened, a return to the market for Peugeot would help to offset the ongoing slump in the group's European business.

Indeed, looking to the longer term, the resumption of business in Iran could be a lifeline for the PSA Group. The country had been Peugeot's second-largest market after France before the sanctions. As a result of such a significant market being removed from its operations, CFO Jean-Baptiste de Chatillon said the company has been losing EUR10mn a month in operating profit. Combined with the slowdown in Europe, this saw the PSA group post an operating loss of EUR510mn in H113, following a EUR1.5bn loss in 2012.

Among domestic automakers, **Iran Khodro Company** (IKCO) is also likely to benefit from the potential return of its former partner, although the domestic carmaker had been making progress in producing its own components for models such as the Peugeot 206 following the French firm's withdrawal. Local production of Peugeot models in September and October 2013 topped 10,000 units a month for the first time in three years. According to data from the Iran Vehicle Manufacturers Association, the Peugeot Pars claimed second place in terms of output in October 2013, with 10,533 units produced. In total, we still forecast a 50% decline in vehicle production in 2013, however.

Another positive response to the deal for the wider industry was the 2% appreciation of the rial on the news that an agreement had been reached. **BMI** has previously highlighted the weakness of the rial as another

source of pressure on domestic vehicle sales, which means any further strengthening in the currency would be positive for consumers. That said, this initial strengthening is a drop in the ocean compared with the value lost over the last year or so and we would need to see further progress for this threat to sales to be totally overcome.

Indeed, there remains a great deal of 'wait and see' sentiment in the industry, until the full details of future operating in the Iranian market have been made clear. South Korea's **Kia Motors**, which had a partnership with domestic producer **SAIPA** until it withdrew from the market in 2010, said it will wait for more information before commenting. Germany's Daimler, which used to have a 30% stake in a diesel engine joint venture with IKCO before starting to cut back its Iranian business in 2010, said it will 'closely monitor' the situation, but has no plans to return to the market.

In a further encouraging development, in December 2013, it was reported that more than US\$1bn in foreign direct investment has been approved for Iran's automotive manufacturing industry, according to the head of the Organisation for Investment, Economic and Technical Assistance of Iran, Behrouz Alishiri. Some US \$300mn has already been invested. The government wants to turn Iran into an automobile production hub by extending legal support and special privileges to overseas investors. Alishiri says the government will provide a long-term plan to the Iranian automobile sector to help find reliable foreign investors.

Iranian vehicle production ended calendar year 2012 down 40% on the previous year, and registered a similar decline for the Iranian year ending March 20 2013. Although the latter months of the Iranian year showed signs of improvement with year-on-year declines shrinking, **BMI** believes there are still too many risks to manufacturing - not least the shortage of capital and Western sanctions - to expect a full recovery in the current year.

Indeed, output for the first four months of the Iranian year, which coincides with the four months ending July 2013, was down a further 47.0% y-o-y, according to data from the Iran Vehicle Manufacturers Association. Although production of the Peugeot 206 recommenced in December 2012, which was heralded as the beginning of an upturn for the more self-sufficient industry, output of the model is down 67.0% y-o-y for the four-month period to July.

Among the few models showing signs of growth are 'national models', such as the Runna from IKCO, which saw production increase over 2,000%, albeit from a low base as it is a new launch, and the SAIPA Tiba, which saw output more than double. However, outside of domestic brands, China's **Chery**, through a partnership with IKCO, increased production of the MVM315 by over 400%. Production of its other models slipped, however, with output of two of its models down by over 80% y-o-y each.

Table: Iranian Vehicle Production By Model

	July 2013	% chg y-o-y	4M13 (Iranian Year)	% chg y-o-y
Saipa Pride	24,620	3.0	73,565	-32.0
Peugeot Pars	6,252	-9.0	17,961	-23.0
Peugeot 405	5,383	-58.0	14,618	-69.0
IKCO Samand	4,566	-57.0	10,001	-74.0
Saipa Tiba	3,271	238.0	9,587	119.0
Renault Tondar 90	2,286	-69.0	9,654	-65.0
IKCO Runna	2,230	2086.0	5,313	2803.0
Peugeot 206	1,215	-73.0	6,732	-67.0
Renault Megane	567	-69.0	722	-87.0
Chery MVM315	337	27.0	2,379	484.0
Chery MVM110	221	-53.0	1,446	-18.0
Nissan Teana	112	30.0	424	-4.0
Chery MVMX33	83	-96.0	857	-87.0
Chery MVM530	73	-93.0	477	-88.0
Suzuki Grand Vitara	61	-81.0	309	-73.0

Iran Vehicle Manufacturers Association

With this performance for the year so far in mind, **BMI** recently revised its production forecast down further to a decline of 49.3% for 2013. There is reasonable upside potential for the remainder of the year, after Iran's Minister for Trade, Economic and Industrial Affairs, Mohsen Salehinia, announced in July 2013 that the country will produce 3,000 cars every day from August, despite international sanctions placed on the industry. IKCO and SAIPA are set to produce 1,500 cars a day each under the renewed push.

How successful this will be without backing from former foreign partners remains to be seen and even if achieved, it would leave output down on the previous year. However, new opportunities have arisen in the form of agreements reportedly reached in July between major Iranian manufacturers and Chinese carmakers. There are few details about the scale of the projects and we believe that the time required to start such projects would mean that any new models would not be contributing significantly to total industry output growth within the current year. Therefore, we retain our view that production will remain far below previous levels.

Further long-term upside potential comes from a new plant in the planning stages due to open in 2015. According to ISNA reports, the plant will have an annual production capacity of 5mn units and will produce the first fully national car to be sold for US\$10,000-12,000. If this projected capacity is correct, **BMI** believes it will be incredibly ambitious to achieve and as such we have not factored this full total into our forecasts. We have raised our outlook for 2015 and beyond to take new capacity into account, but await confirmation of the new plant's projected capacity.

In the shorter term, however, we believe the odds are still stacked against manufacturers. According to Gholamreza Shafei, chairman of the country's Industrial Development and Renovation Organisation, the industry is not being hit as much by sanctions as the lack of revolving capital. He added that this has left carmakers operating at around 50% capacity. While the banking sector looks poised to remain in the midst of a crisis, **BMI** sees little hope of this improving over the current year (*see 'Banking Sector: Crisis To Continue In 2013', April 18*). Indeed, the shortage of parts from former partners has increased production costs by around 40% according to industry estimates reported in July.

Sales

Table: Iran Automotive Sales, 2010-2017

	2010	2011	2012f	2013f	2014f	2015f	2016f	2017f
SALES: Vehicles, units	1,493,000	1,590,000	1,030,995	618,597	680,457	714,480	771,638	841,085
SALES: Vehicles, units, % chg y-o-y	10.7	6.5	-35.2	-40.0	10.0	5.0	8.0	9.0

Source: BMI

Information on latest sales data is more difficult to obtain. However, **BMI** surmises that sales will move largely in line with domestic production over the forecast period, ending at around 840,000 units by 2017. Much will depend on how the talks between Iran and the major powers progress over early 2014. Should sanctions be permanently eased, then there is scope for more rapid growth in new car sales as the Iranian economy - especially its key oil sector - regains access to the world's markets.

However, if the talks fail and new sanctions are imposed, then the future of the few remaining international carmakers - such as Renault - still operating in Iran would be called into question.

Trade

Vehicle exports from Iran fell 94.3% y-o-y for the first five months of the Iranian year, which started March 21 2013, according to Iranian news agencies. **BMI** believes there are a number of reasons for this, making it difficult for domestic producers to rectify the situation in the near term. The biggest cause is the parallel slump in production, brought about by the withdrawal of several international carmakers from their local assembly agreements.

The decline in production outlined above is perhaps the biggest driver of the decline in production. Combined with this is the fact that sanctions are also hitting imports, which means more output is required to accommodate the domestic market. Although imports of fully built cars are not actually included in the latest round of US sanctions, which took effect in July, carmakers have still chosen to suspend exports to the country. However, a lack of reliable sales data makes it hard to judge to what extent domestic models are filling the void left by imports.

Iran's major export market for its cars remains Iraq, despite occasional reports of Iraq trying to ban Iranian-built cars on sometimes spurious grounds, such as poor quality standards. Indeed, Iraq was the largest market for Iranian cars in the six months of the current Iranian year started March 21, according to a report by the Iraqi Customs Department in October 2013. The report showed that the Iraqi share of Iranian sedans equalled 59.2% in the reported period, while Azerbaijan and Egypt were second and third with a share of 13.5% and 9.2% respectively, ISNA reported. Iran exported 2,218 sedans worth US\$16mn during the period.

While this may have contributed to the drop in exports, the decline is not totally negative. IKCO has turned to a domestic assembly line in Iraq, which is due to have an annual production capacity of 30,000 units, reducing the need to export to the country. Industry-wide, however, Iraq accounted for over 90% of exports in the previous Iranian year and this will be a big loss to offset.

Carmakers have sought new markets to expand their export operations, however. In September 2013, IKCO announced it will begin exporting the Samand, Runna and Soren models to Tunisia. The company plans to ship 100,000 units by 2014 and will use the country as a base for exports to Libya and Algeria.

IKCO has already expanded exports to Ukraine and Kazakhstan in the current year to date. According to CEO Javad Najmeddin, after shipping 95% of exports to Iraq in the last Iranian year, Kazakhstan, Venezuela, Turkmenistan and Ukraine were the main export markets for the first quarter of the current year.

Macroeconomic Forecast

Economic Analysis

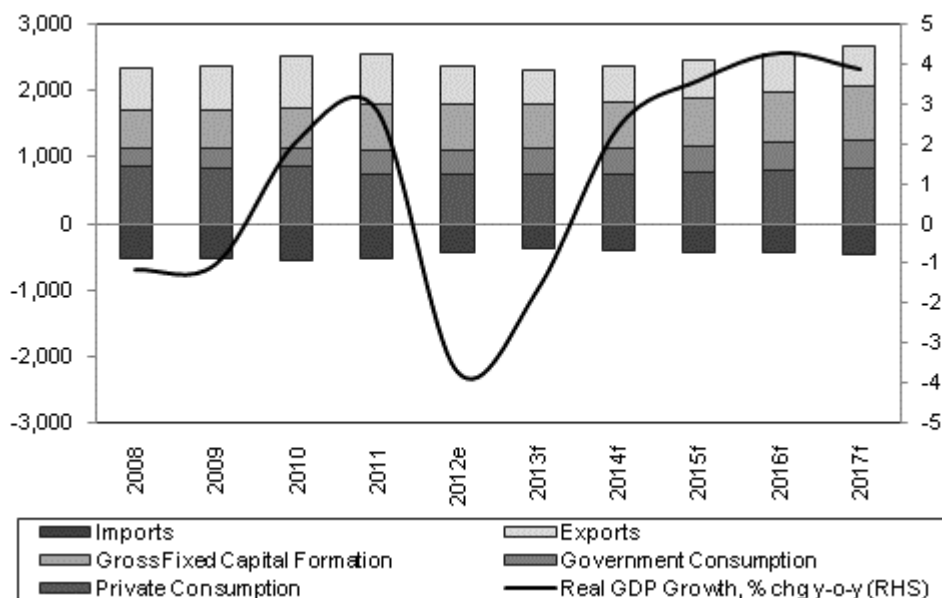
***BMI View:** We project Iran's economy to contract by 1.6% and then grow 2.4% in real terms in 2013 and 2014, respectively, and we expect economic growth to accelerate significantly over the medium term. The macroeconomic outlook will be significantly influenced by developments in negotiations with the West over the country's nuclear programme, with risks elevated both to the upside and the downside.*

We forecast Iran's economy to contract by 1.6% in real terms in 2013 and expand by 2.4% in 2014, from a 3.7% contraction in 2012. Low base effects and a rebound in oil exports, coupled with improving business and consumer confidence following the victory of moderate cleric Hassan Rouhani in Presidential elections on June 14, will ensure that growth returns to positive territory in 2014.

The macroeconomic picture will likely improve over the medium term. In particular, we expect macroeconomic management to improve significantly under Rouhani's presidency, which will lead to an acceleration in the headline growth figure over the coming years. We forecast real GDP growth averaging 2.5% over the 2013-17 period.

Medium-Term Outlook More Promising

Iran - Components of GDP (IRRtr) & Real GDP Growth



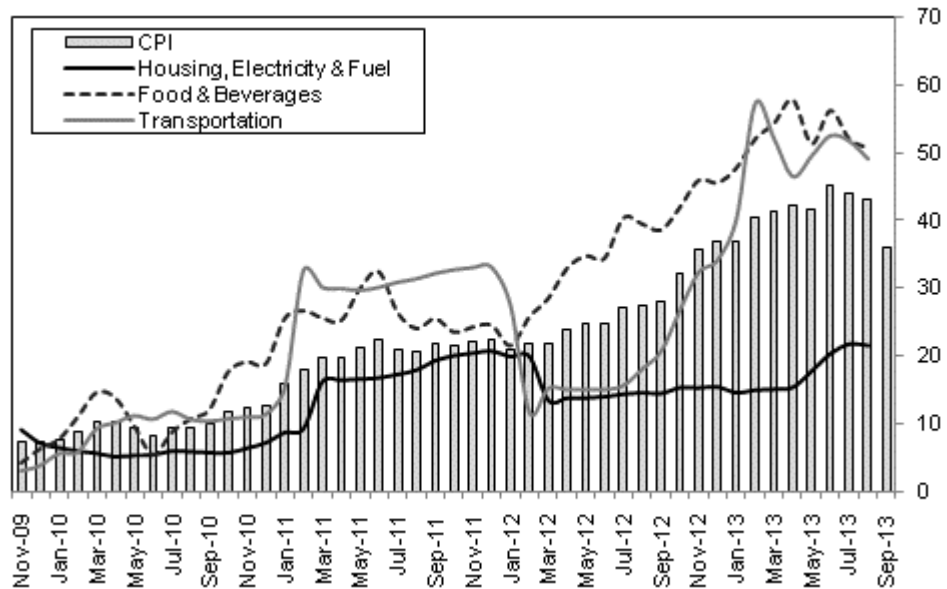
Source: BMI, United Nations. F=BMI Forecasts

Private Consumption Outlook

Iranians' purchasing power will remain low over the coming quarters. According to official data, consumer price inflation reached 36.0% in September, having averaged 41.8% y-o-y over the first eight months of 2013. Although we expect inflationary pressures to gradually decline, CPI will remain elevated, which we project averaging 35.0% in FY2013/14 (fiscal year running from 21 March 2013-20 March 2014) and 25.0% in FY2014/15, compared to average inflation of 31.6% in FY2012/13 (see *'Inflation Declining Modestly In 2014'*, October 7). In addition, while we expect macroeconomic policy to improve significantly under Rouhani's presidency, we expect the impact on the economy to be felt only over the medium term. This will ensure that unemployment levels - which currently stands around the 20% level according to unofficial estimates - will remain elevated. Finally, despite improving relations with the West, sanctions against the country's hydrocarbon and banking industry will remain in place at least until the end of 2014 in our view.

Inflation Still Elevated

Iran - Components Of CPI, % chg y-o-y



Source: BMI, Central Bank of Iran

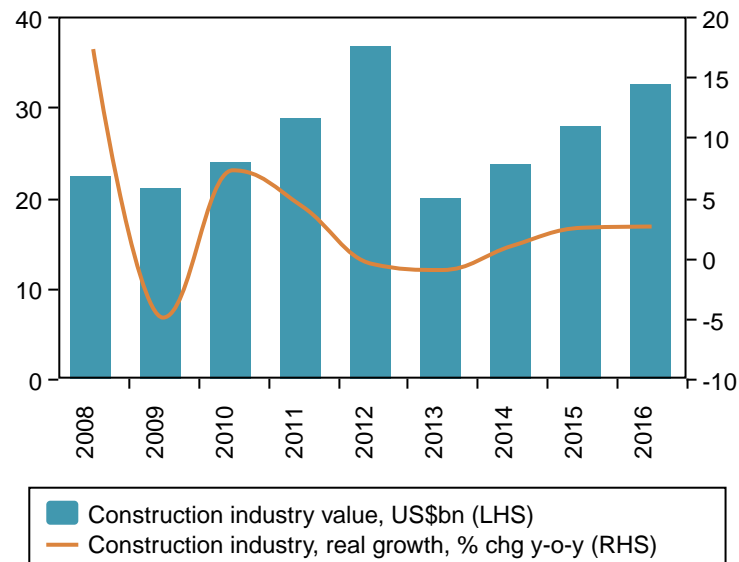
Although Rouhani's elections will improve confidence among investors and consumers, we expect consumer demand to remain relatively subdued over the coming quarters. We forecast private consumption expanding 0.5% in 2013 and 1.0% in 2014.

Government Spending Outlook

Given our view that Iran's budget deficit will come in at 7.4% and 6.1% of GDP in FY2013/14 and FY2014/15, respectively, we expect Rouhani to undertake a tighter fiscal policy compared to former President Mahmoud Ahmadinejad. As a result, fiscal spending in areas such as healthcare, public services and education will be relatively low over the coming quarters. We forecast government spending to increase by 1.0% and 1.5% in 2013 and 2014, respectively.

Growth To Resume

Iran - Construction Industry



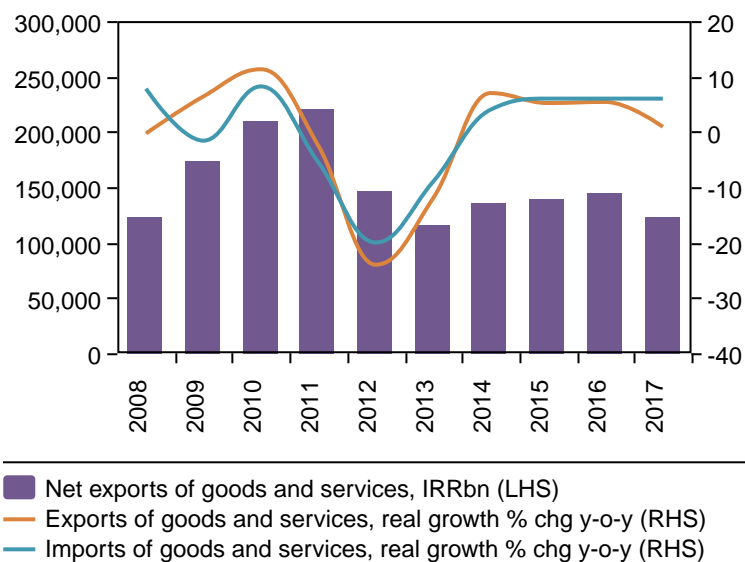
Source: BMI. F=BMI Forecasts

Fixed Investment Outlook

Growth in gross fixed capital formation has been significantly hampered by international sanctions, an opaque business environment and a challenging macroeconomic picture over the past few years. According to a recently released report from the Central Bank of Iran (CBI), the industrial sector expanded by 10.0% in year-on-year terms as of Autumn 2010, before contracting by 0.6% and 13.7% y-o-y as of Autumn 2011 and Autumn 2012, respectively. Although Rouhani's victory bodes well for business confidence, we expect foreign and domestic investment to remain limited over the coming months. We retain a broadly bearish outlook for the Iranian construction sector in 2013 and forecast a 1.0% contraction in real terms, compared to a decline of 0.5% in 2012. We expect the sector to expand by 1.0% in 2014, and see growth accelerating at a more rapid pace over the medium term (see *'Infrastructure & Construction - Q4 2013'*, July 31). We forecast fixed investment contracting 1.0% in 2013 and expanding 1.5% in 2014.

External Position Improving Gradually

Iran - Exports & Imports



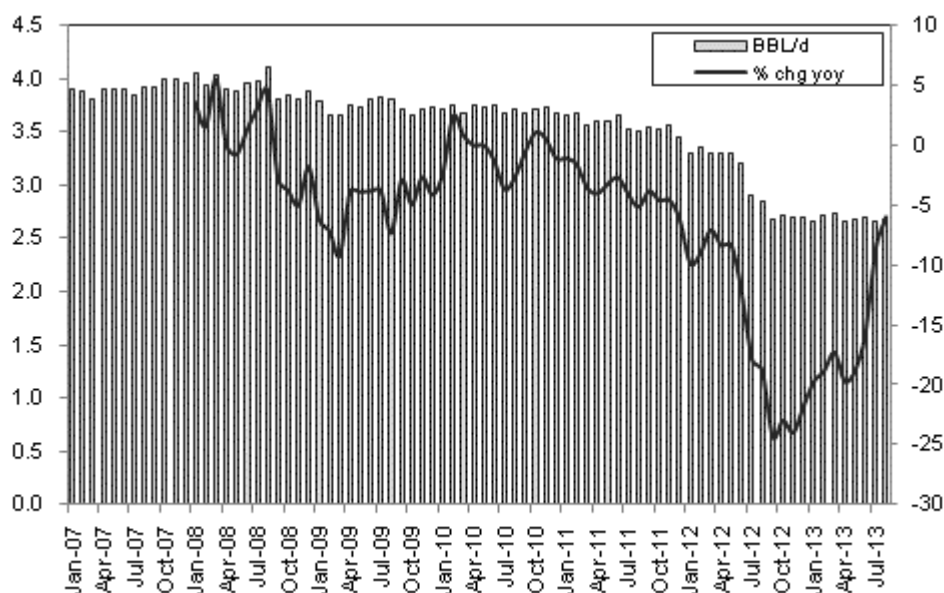
Source: BMI, United Nations. F= BMI Forecasts

Net Exports

Iran's external position will gradually improve over the coming quarters. We see total exports declining by 12.0% in 2013 before returning to growth of 7.0% in 2014, mostly as a result of fluctuations in oil exports - which accounted for 85.0% of total exports in 2010. According to the International Energy Agency, oil production fell by 6.8% y-o-y to 2.68mn bbl/day in August. The decline in production has slowed significantly in year-on-year terms in August, largely as a result of increasing purchases from India, China and Japan after payment problems stalled liftings in July. Although sanctions on the hydrocarbon industry will remain in place, Asian importers are unlikely to cut imports much further, and low base effects will ensure a rebound in exports in 2014.

The Worst Is Over

Iran, Oil Production, Million Barrels per Day (LHS), % chg y-o-y



Source: IEA, BMI

The fall in value of the rial and international sanctions have resulted in a sizeable decline in total imports over the past few quarters. As an illustration, the number of mobile phones coming into Iran during the first five months of FY2013/14 reportedly fell by between 40-48%, resulting from instability in the price of foreign currencies in open market transactions. Although we expect the rial to appreciate slightly over the coming quarters in the open market, volatility will remain significant, which will continue dampening imports going forward (*see 'TRR: Volatility On The Cards', October 4*). This is not to say, however, that imports will be completely muted. For instance, Iranian oil minister Bijan Zanganeh said on September 18 that Iran is currently taking measures to import several million litres a day of gasoline in order to fill the gap between domestic supply and consumption, a trend which we expect to continue in the near-to-medium term. We forecast imports contracting by 9.0% in 2013 and increasing by 4.0% in 2014.

Risks To Outlook

The macroeconomic outlook will be highly influenced by developments in negotiations with the West on the country's nuclear programme over the coming years. We see three potential scenarios in negotiations.

One sees talks continuing without key developments over the next 24 months, another a major breakthrough within 6 to twelve months, and a third a breakdown in talks within the same time frame (*see 'US - Iran Talks: Three Scenarios', October 1*). Should the second or third scenario play out, this could prompt us to significantly revise our forecasts.

Table: Iran - Economic Activity

	2010	2011e	2012e	2013f	2014f	2015f	2016f	2017f
Nominal GDP, IRRbn 1,2	4,398,628	5,539,959	7,160,525	9,590,307	12,163,482	14,334,814	16,839,482	19,049,303
Nominal GDP, US\$bn 1,2	436.7	521.8	587	467,819.90	486.5	551.3	701.6	865.9
Real GDP growth, % change y-o-y 1,2	2.1	2.8	-3.7	-1.6	2.4	3.6	4.3	3.9
GDP per capita, US\$ 1,2	5,865	6,918	7,681	6,040,503	6,200	6,937	8,720	10,634
Population, mn 3	74.5	75.4	76.4	77.4	78.5	79.5	80.5	81.4

Notes: ^e BMI estimates. ^f BMI forecasts. ¹ Year Begins in March (Iranian calendar). Sources: ² UN/BMI; ³ World Bank/UN/BMI.

Industry Risk/Reward Ratings

Middle East and North Africa - Risk/Reward Ratings

The aim of BMI's industry risk/reward ratings system for the automotive industry is to show the rewards and the risks that carmakers operating in a particular region - in this case Middle East and North Africa (MENA) - may face. The unique system assesses crucial factors, such as sales and output growth, international trade, market size and location, and the level of market competition, in addition to taking into account a country's economic and political backdrop. The ratings system allows analysts to fully expound the potential advantages and disadvantages of investing in MENA car markets, and offers an overall comparison of the key markets in the region.

Our latest ratings take on a new look as we integrate additional countries for which we now produce reports - Oman, Tunisia, Iraq, Jordan, Lebanon, Libya and Syria. While there has been movement in our rankings, the new countries are still following the geographical trends we have observed previously, with Oman entering nearer the top among fellow Gulf Co-operation Council (GCC) states and the riskier North African markets ranking lower, while Syria, perhaps unsurprisingly, has taken last place with the lowest score for the Risks components, given the heightened risk in the country.

Within the Gulf states, there is little to distinguish between them in terms of regulation of the automotive market, with the GCC determining customs regulations. Consequently, this relative market openness and strong rates of new car sales growth ensure that GCC member states still occupy four out of the top five positions in BMI's risk/reward ratings table, largely because they do not have domestic producers to protect and only lightly regulate their respective auto markets.

However, with the beginnings of domestic production and an increasingly favourable business environment aimed at diversifying the economy, Saudi Arabia has taken the lead in this latest round-up. It is closely followed by Kuwait, which scores highly for demand and a stable market, but still lacks production.

Israel is the only non-GCC market in the top five, ranking third. While it is also lacking large-scale production, it scores highly for its business environment and is also gaining a reputation for innovation in the industry.

Qatar and the UAE round out the top five, with little between them in terms of their overall ratings. Both are highly attractive autos markets, with some of the strongest demand for new cars in the region over recent

years. Moreover, demand in these markets is weighted towards high-end models, boosting the overall value of new cars sold.

Lebanon is the next new entrant, coming in at sixth. Although the market has been hit by a weak economy, there are still opportunities to be had for manufacturers at in the smaller entry-level segment. It is followed very closely by another newcomer to the table, Oman, which like other GCC states, offers strong demand and relative stability but no domestic production.

Bahrain is the last of the GCC states in eighth. While Bahrain's automotive market is small, it is open and highly competitive, with high levels of car ownership. This does mean it is likely to enjoy lower levels of growth than some of the markets coming from a lower base, however.

Iran moves up the table to ninth, largely by virtue of its production industry. It is still a risky market owing to fresh sanctions aimed directly at the auto sector. However, for companies in countries not covered by the sanctions, the Iranian industry's export ambitions create partnership opportunities. For doing business in Iran, however, its Country Risk score is still among the lowest in the matrix.

Tunisia and Egypt are the first of the North African markets at 10th and 11th, with similarities in terms of their risks created by political tension. While Egypt scores higher for its more developed industry, its risk scores are lower, given the recent increased instability.

Iraq follows with reasonable potential for its autos market, as a relative improvement in stability as encouraged sales. This in turn has brought investment back to the market, which has led to improved regulation in order to protect the domestic industry. However, there are still risks to be taken into account, which is reflected in its lower Country Risk score.

Table: BMI Industry Risk/Reward Ratings - Middle East And North Africa Autos

	Rewards			Risks				
	Autos Market	Country Structure	Industry Rewards	Market Risks	Country Risk	Risks	Autos BE Rating	Regional Ranking
Saudi Arabia	41.7	67.2	50.6	75.0	69.1	72.0	57.0	1
Kuwait	33.3	88.1	52.5	75.0	59.1	67.1	56.9	2
Israel	28.3	84.0	47.8	85.0	68.6	76.8	56.5	3
Qatar	28.3	89.5	49.7	75.0	67.8	71.4	56.2	4
UAE	33.3	80.4	49.8	75.0	64.0	69.5	55.7	5
Lebanon	21.7	84.0	43.5	80.0	68.6	74.3	52.7	6
Oman	25.0	76.5	43	85.0	64.2	74.6	52.5	7
Bahrain	21.7	73.4	39.8	75.0	70.2	72.6	49.6	8
Iran	48.3	42.6	46.3	75.0	31.1	53.0	48.3	9
Tunisia	21.7	61.5	35.6	85.0	50.5	67.7	45.2	10
Egypt	41.7	31.8	38.2	75.0	45.3	60.1	44.8	11
Iraq	26.7	64.0	39.8	60.0	49.8	54.9	44.3	12
Jordan	18.3	64.0	34.3	70.0	53.2	61.6	42.5	13
Algeria	35.0	36.6	35.6	65.0	50.6	57.8	42.2	14
Morocco	33.3	25.2	30.5	75.0	52.2	63.6	40.4	15
Libya	6.7	69.0	28.5	85.0	43.8	64.4	39.3	16
Syria	16.7	54.0	29.8	50.0	44.0	47.0	34.9	17

Source: BMI. Scores out of 100, with 100 highest.

Company Profile

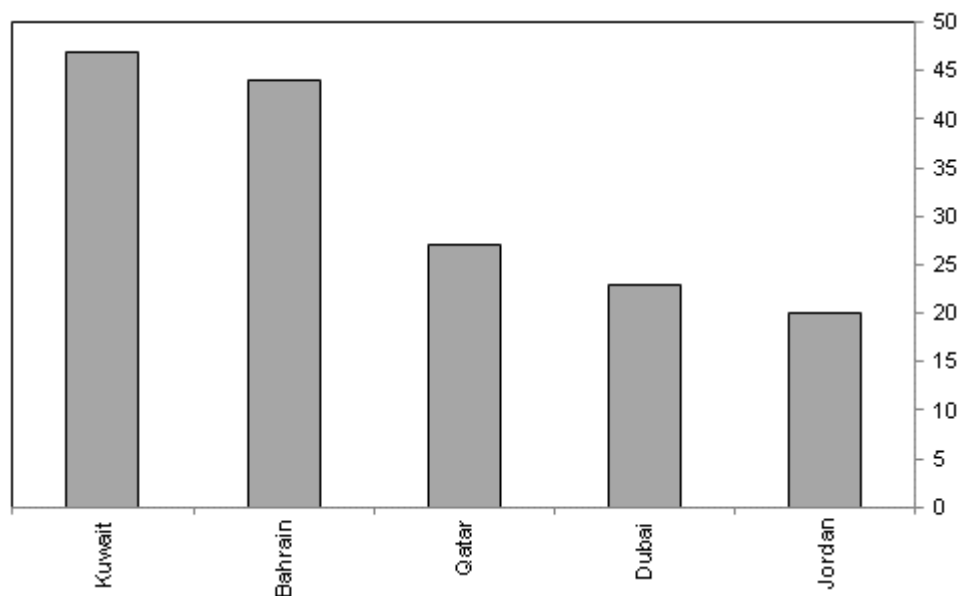
Company Monitor - BMW

In line with **BMI**'s view that Europe will no longer be the primary growth driver for premium brands, **BMW** has reported record sales and double-digit growth for its Middle East division in H113, helping to offset a 0.1% year-on-year (y-o-y) contraction registered in Europe. Combined with other growth markets such as the US and China, the Middle East has contributed to record sales on a global level for BMW, underlining the region's importance in the premium segment.

Several individual markets reported double-digit growth, emphasising the strength of the premium segment throughout the region. However, our view that the UAE and Saudi Arabia will be the two leading markets for stable growth and volumes was reflected in BMW's sales. The UAE accounted for 49% of all BMW and Mini sales, while sales in Dubai alone grew 23.0% y-o-y. Saudi Arabia was the second-best selling market, although figures were not provided.

GCC Dominates Growth

BMW Sales Growth By Country, H113 (% change y-o-y)



Source: BMW

While new models have undoubtedly contributed to the performance, with the revamped 3-Series achieving growth of 87.0% y-o-y in H113, BMW has also tailored its local marketing. It recently announced that its efforts to step-up its digital marketing had resulted in becoming the first automotive brand to reach 1mn Facebook fans. This has been a highly localised strategy, as Michael Keller, BMW Group Middle East's marketing manager, said that 'people in the Arab world trust news shared by peers on social media platforms such as Facebook over mainstream media reports. We recognise the significant social and cultural impact of digital networks and the importance of including it within our marketing strategy'.

Other areas of localisation include moves to increase the domestic workforce, particularly in Saudi Arabia, where the government is promoting 'Saudisation', with the auto sector featuring as a key industry in this strategy. BMW's local dealer, Mohammed Yusuf Naghi Motors, has signed an agreement with the Technical and Vocational Training Corporation (TVTC) to train Saudi Arabians as BMW technicians as part of an in-house training programme. The graduates will be awarded the TVTC automotive maintenance certification and the UK-based Institute of Motor Industry's certificate in light vehicle maintenance.

These strategies have resulted in the Middle East becoming one of BMW's outperforming regions in H113. While European sales contracted, the US and China, also key markets for premium brands, reported growth of 9.0% and 15.0% y-o-y respectively, compared with 22.0% for the Middle East. This is a trend reported by other premium brands as Porsche saw double-digit growth in its other regions offsetting growth of just 2.1% y-o-y in Europe.

Iran Khodro Company (IKCO)

Company Overview Iran Khodro (IKCO) (formerly called Iran National) was established in 1963 and is Iran's largest industrial conglomerate. The firm also has foreign production facilities, including sites in Venezuela and Belarus.

When production of the Hillman Hunter ceased in the UK in 1979, Peugeot Citroën, by then in control of Chrysler's former operations in Europe, began negotiations to sell the rights of the brand and the manufacturing plant to IKCO. The agreement was sealed in 1985 and the production line at Linwood, Scotland, was dismantled and shipped to Iran. As part of the deal, Peugeot Citroën also sold 65,000 engines to Iran.

The company's product line is at present complemented by the Peugeot 405 model in a number of variants and the 206, launched in 1990 and 2001 respectively. The former has local parts integration close to 80%, while the 206 is exported by Peugeot in CKD form. An indigenous version of the 405, the model RD, a 405 body fitted with the Paykan engine and drive-shaft, is also being assembled. The range was further enhanced in 1997 by the Pars model, a revamped 405, and later in 2001 by the Samand, another local project, also known as the national car or X7, which uses the 405 Powertrain.

In 1992, IKCO bought from Volkswagen (VW) Argentina machinery to build the Avenger 1.6-litre engines, which powered the Argentine version of the Avenger as well as VW's 1,600 and 1,800 models, up to 1990.

IKCO separated its commercial vehicle division from the passenger car unit, creating IKCO Diesel. The unit, formerly Khavar Industrial Group, began its activities in 1959 assembling Mercedes-Benz trucks under licence and is now in charge of the production of IKCO's heavy industrial vehicles, trucks, buses, and minibuses, as well as the Paykan light utility vehicle (LUV). In 2002, Russia's GAZ exported a batch of 500 CKD-kits of the GAZel truck model in seven variants for assembly by the unit, thus resuming a cooperation project, which included the construction of an assembly line in Tehran's suburbs, which was suspended in late 1999.

IKCO is working intensively to expand its foreign markets, which bring in much-needed hard currency. It opened production lines in Azerbaijan, Belarus and Syria in 2006. Production lines are also expected in China, Venezuela and Senegal, with India and Bangladesh also mooted as potential production sites.

IKCO has concentrated on expanding its own ranges, as opposed to those it produces under license to other manufacturers. The latest models unveiled include a new version of the Samand, a wheelchair-accessible Samand, the R90 station wagon, and a next-generation minivan powered by LNG.

Strategy In November 2013, IKCO said that it had registered a 53% increase in production during September 23-November 21. The company's average daily output reached

1,530 cars in the reported period, compared with the average output of 1,000 vehicles a day in the first half of the current Iranian year started March 21, according to a report on the Islamic Republic News Agency. From October 23 to November 21, IKCO's production jumped 25% year-on-year to 35,000 vehicles. Growth in production is expected to continue and is likely to touch an average of 1,800 cars daily. The increase in production was attributed to the government's ongoing efforts to revive the auto industry.

In September 2013, it was reported that IKCO is looking to increase production of the nationally developed Runna model, which has been one of its best-sellers since its launch in late 2012. The Runna is one of only three models to have increased output on a year-on-year (y-o-y) basis this year, as the industry tries to cope with the withdrawal of international partners, a shortage of components and the need to satisfy more domestic demand as imports drop.

Production of the Runna rose 728% y-o-y in August and 1607% y-o-y in the first five months of the Iranian year starting March 21, although the model is relatively new and still building volumes. Nevertheless, as a national model it is less reliant on input from international companies and is demonstrating the self-sufficiency required of such models. Indeed, the only other model to register positive growth in production for the five-month period is the Saipa Tiba.

Although exact figures are not available, reports from the Fars News Agency suggest that the Runna accounted for 35% of IKCO's sales in August, but only 8% of production over the first five months, and this has prompted an increase in production of the model. Despite BMI's forecast for a 49% decline in industry-wide production in 2013, IKCO's goals should be aided by the fact it also plans to produce the model at its overseas plants in Belarus, Azerbaijan, Egypt, Syria, Senegal and Venezuela.

Having a model in demand could help IKCO's domestic targets, however, as it is aiming to produce 1,500 cars a day, as is fellow automaker Saipa, according to the Ministry of Industry, Mines and Trade. How successful this will be without backing from former foreign partners remains to be seen and even if achieved for the remaining months of the year, it would leave output down on the previous year. Focussing on 'national cars' with largely domestic content does provide upside potential, however.

In August 2013, IKCO stated that it is to design and develop two of five new platforms to be built as part of a 15-year vision for the development of the Iranian car industry, according to Javad Soleymani, the company's vice-president in product and quality. Soleymani said the company would start working on one of the platforms in 2013. The company would manage the process with support from the technology employed in the existing platforms, while IKCO engineers would be in charge of the design and development, Soleymani said.

In April 2013 IKCO announced it is planning to manufacture 550,000 cars in the current Iranian year without support from foreign sources. The company plans to manufacture passenger cars, such as the Runna and Samand cars and the Bardo pick-up. The

company has put the daily production of 2,000 sets of cars on its agenda, with parts and components from Iranian part makers, said Hossein Najari, IKCO's vice-president for production.

In March 2013, IKCO, together with Saipa, pledged to reduce prices 10-22% after President Mahmoud Ahmadinejad ordered Iran's two major domestic carmakers to reduce end prices, otherwise car import duties will be cut by 10%.

In February 2013, IKCO announced it is planning to design and manufacture 1,600cc versions of the XUM engine in the near future. The move is in line with the carmaker's aim to improve the performance of its cars. The fuel economy of the engine would increase to 6 litres/100km, according to IKCO Vice President for Quality and Product Development Mir Javad Soleimani. Soleimani said that the current XUM, which has a capacity of 1,900cc, would power Peugeot Pars sedans soon, as well as the Peugeot 405 and some other IKCO products.

Soleimani said that production of IKCO brand cars had accelerated 30% this year, compared to a rise of 17% when the company first laid out its strategic plan four years ago. He said: 'We have focused on IKCO brand and at the same time have planned talks with foreign partners for some new cars to be produced beside IKCO cars,' adding that Tondar 90 pick-up, Tondar passenger car enjoying automatic transmission and Tondar facelift would be produced following the recent talks held between IKCO and Renault.

He said establishing new ties with new partners is a crucial strategy for IKCO. 'Two years ago, IKCO studied 20 foreign carmakers to see the possibility of building up new ties to produce SUV and A, B, C and D segment cars, however, three of them have been elected and discussions are going on in between.'

He added: 'These cars will be locally assembled from CKD packs, however local part supply is our priority and for this we have held talks with Asian and European partners which is close to be a deal.'

IKCO ranked second among Iran's top 400 companies this year, which ends on March 19 2012, according to the Industrial Management Institute in February 2013. It is the top employer in Iran, with 53,806 workers.

IKCO expects sales and exports to its main markets in Russia, the Middle East, South America and Africa to 'boom' 45%, reported to RFE/RL in August 2012. This is thanks to interest in its domestically made and designed 'national' car, the Runa, unveiled in 2009. IKCO is also confident about its revamped sedan model, the Samand, which is exported to Russia via an assembly plant in Belarus and also made in Iraq. IKCO intends to adopt new marketing strategies in an effort to export 16% of its output in the coming three years and enhance its global market share. IKCO's ambitious export plans could be buoyed by the rapid development of alternative fuel vehicles, which may find a niche in markets where there is demand for green cars.

IKCO plans to make and sell 50,000 units of the Samand sedan, equipped with its 'national diesel engine', by 2013, according to Iran Khodro Powertrain's CEO

Mohammad Zali. The engine meets Euro-V standards, and will enter large-scale production in 2013. The carmaker has manufactured 23 units of the engine until now and fitted three of the manufactured engines in its own cars for necessary tests.

IKCO intends to export 10,000 units of the Samand sedan to Russia. The domestically designed Samand will be equipped with engines that meet Euro IV emissions standards, according to the company's vice-president for exports, Abdulazim Sa'dian. Cargoes of Samand completely knocked-down parts will be transported to the company's assembly line in Belarus from July 22 and will then be exported to Russia.

IKCO is likely to export 15,000 cars to Russia, Kazakhstan, Turkmenistan and Belarus by the end of the current Iranian calendar year, said the company's managing director, Javad Najmeddin, in March 2012. He said 2,000 cars out of its export target are expected to be manufactured at a production facility in Belarus. IKCO aims to export 12% of its total output to various countries in the next Iranian calendar year and eventually export 20% of its output. IKCO currently exports 7% of its total production.

IKCO is also stepping up production of its own engines as it claims to be nearer self-sufficiency. IKCO currently produces 300 units a day of the EF7 engine, which is available in dual-fuel, petrol and diesel. It hopes to increase this to 500 units a day and according to IKCO's vice-president of production, Hossein Najari, total production should have reached 120,000 units by the end of the Iranian year ending March 2013.

The engines are also geared toward the availability of compressed natural gas in the country, with 70% of the engines compatible with the gas. IKCO has also been improving the fuel-efficiency of its vehicle range to help its export strategy.

According to Iran's Minister of Industries, Mining and Trade, Mehdi Ghazanfari, Iran intends to manufacture around 3mn cars and plans to export 1mn of them by 2025. Ghazanfari revealed that Iran produced approximately 1.6mn cars in the last Iranian year ended March 19 2012 out of which 55,000 cars were exported in the same period. IKCO will be a big part of this push as one of the country's largest manufacturers.

IKCO has also worked on its self-developed vehicle range. In June 2012, it launched the Runna, which is the company's second 'national car' model and follows the Samand, launched in 2003. It will also unveil the country's first domestically made diesel car in 2012. The car's diesel engine meets Euro V standard requirements and would be suitable for D-segment cars like the Samand, Soren and Dena. The company intends to mass produce diesel passenger cars in less than two years.

IKCO plans to enter the Tunisian auto market by exporting 700 units of the Runna, Soren and Samand sedans to the country. The move follows a series of agreements reached by the Iran-Tunisia Joint Economic Cooperation Commission, according to Abdulazim Sadian, IKCO deputy CEO for export and international affairs. The company has exported more than 6,000 units of the Peugeot 206 SD to Tunisia through the sales network of Peugeot in recent years.

IKCO is negotiating with design consultant companies for its first B segment platform, with an agreement expected to be finalised soon, according to IKCO CEO

Javad Najmeddin. He added that the platform's primary components will be designed and developed by IKCO, while the company's parts manufacturers will be responsible for the smaller components. Production of the first car on the new platform is scheduled in 2014, Najmeddin added. IKCO plans to develop two new platforms for the B and D segments at a cost of about US\$6.5mn. IKCO is expected to manufacture 10 new cars on the platforms by 2021.

Saipa Diesel

Company Overview Saipa Diesel is Iran's second-largest commercial vehicle manufacturer, 79.3% owned by Saipa Automobile Manufacturing Company. It began operations in 1963 under an agreement with the US's Mack Trucks, but the licence came to an end following the revolution of 1979. It signed a licence agreement to produce Volvo trucks in 1985, which revived the company's fortunes after years of uncertainty. It has since signed an agreement with Renault Trucks. Among its subsidiaries are Iran Kaveh Saipa - which manufactures trailers and truck bodies - and Kavek Khodro Saipa, a parts and components supplier.

The firm plans to increase truck exports to Angola in the near future. Iraq remains one of the country's main target markets. New export markets for the company include Algeria, Ukraine, Yemen, Turkmenistan, and Azerbaijan.

Operational Data ■ Year established: 1963

Societe Anonyme Iranienne de Production Automobile (Saipa)

Company Overview Saipa was founded in 1966 as the Citroën Production Association, and in 1968 began to manufacture the Citroën Dyane model, a replacement version of the popular 2CV. In 1977, Saipa introduced the Renault 5 model in two and four-door variants. By 1985, Saipa also produced the Nissan Junior LUV equipped with a 2.0-litre engine, complemented in 1990 by a 2.4-litre model. This was followed, in 1993, by the Renault 21 mid-range passenger car.

Some years later, Saipa concluded an agreement with Kia Motors to manufacture the Pride in four models, and in 1999 sealed a deal with PSA Peugeot Citroën to produce the Xantia. In 2002, an indigenous redesign of the Pride was launched, known as the 141 model. By that time, local parts integration reached 85% for the Junior LUV and 81% for the Pride. In the 1990s, Saipa merged with Iran Kaveh, since then renamed Saipa Diesel, and Zamyad, and in 1999 acquired a majority stake in Pars Khodro.

The Iranian government has control over the company through IDRO, an agency of the Ministry of Industry and Mines. In 1998, Saipa listed on the Tehran Stock Exchange as a first step towards privatisation. The majority 14.3% stake in private hands belongs to the Bahman Group, which is also engaged in autos manufacturing, under licence from Mazda, through Bahman Auto.

Exports represent a small stream of income. Azerbaijan, Iraq, Egypt, Syria, and Sudan were the group's main export destinations. The company's commercial vehicle subsidiary Zamyad is one of Iran's largest truck producers. The Saipa Group is Iran's largest vehicle manufacturer. Its most popular passenger car is the Pride, which was developed by South Korea's Kia.

Saipa has also opened a new car assembly line in Homs, Syria, where the Saipa 132 model will be manufactured under the name Emesa. The total investment for the project was US\$46mn, of which 85% was contributed by Saipa and the remaining 15% by a private company, Hamshoo.

In May 2011, Saipa launched a new US\$350mn facility in Kashan. The factory will have an annual production capacity of 150,000 vehicles. It will make the Tiba range, Iran's first domestically designed and built vehicles.

The Iranian Privatisation Organisation reportedly sold 260mn shares in the company in May 2011, representing a 2.5% divestment.

In March 2013, Saipa, together with IKCO, pledged to reduce prices 10-22% after former President Mahmoud Ahmadinejad ordered Iran's two major domestic carmakers to reduce end prices, otherwise car import duties would be cut by 10%.

Saipa is the second-largest employer in Iran, with a workforce of 43,000, according to the Industrial Management Institute in February 2013.

Regional Overview

Middle East And North Africa Overview

In **BMI**'s monthly round-up of production investments, we track the latest projects from the production side of the industry and analyse trends that we see developing on a regional basis. In doing so, we hope to build a picture of any potential hubs that may be developing, as well as company strategy in terms of production bases and export programmes.

Table: Middle East And North Africa Autos Production Investments

Date announced	Country	City/state/ region	Company	Value, US\$m	Brief description	Date onstream
May 2013	Iraq	Iskandariya	Iran Khodro	na	New plant for production of 30,000 SKD cars a year	2013
July 2013	Iran	na	Iran Khodro	1	Addition of a new vehicle platform at IKCO's R&D centre	2013
July 2013	Iraq	Iskandariya	Volvo	na	New truck production plant in cooperation with local partner ZamZam Spring, which funded and will operate the 5,000-unit-a-year facility	2013
July 2013	Iraq	Iskandariya	State Company for Automotive Industry	13.8	New production plant to produce cars under licence for foreign brands, including BYD and Renault Trucks, with a capacity of 120,000 units a year	2013
October 2013	Morocco	Tangier	Renault	540	Second production line to add new models to the Dacia range, resulting in a total annual capacity of 340,000 units	2013

na = not available. Source: BMI

As with our last update, the smaller number of projects in the Middle East and North Africa is offset by their significance and the most notable trend in this round-up is the momentum of investment in Iraq. The significant headway the industry has made in terms of domestic production was underlined by the announcement by the **State Company for the Automotive Industry** (SCAI) that the country's first domestic production plant is complete. As part of its plan to have agreements with 15 international

carmakers, SCAI already has an agreement with Chinese carmaker **BYD**, which will open two production lines at the plant. However, **BMI** sees the real interest in the fact that it is also due to begin assembly of **Renault** trucks in 2014.

This is because we have seen the bulk of recent investment projects in the commercial vehicle segment, and believe this will intensify competition in the truck market. In addition to the upcoming Renault production line, other substantial investment projects have come from Sweden's Volvo Trucks. As part of its regional strategy to increase Middle East sales by 30% by 2020, Volvo has opened two service centres in cooperation with its local distributor **ZamZam Spring**. The two centres will be followed by a production line in Iskandariyah with an annual production capacity of 5,000 units.

IKCO's investment in local production carries its own significance, as the Iranian auto sector looks beyond the domestic market to overcome the impact of sanctions. The plant also addresses the news that Iraq would ban imports of Iranian built cars, threatening a large proportion of Iranian exports. Indeed, Iraq accounts for 40% of **IKCO's** global sales.

Finally, **BMI** believes Renault's second assembly line in Morocco, which has doubled its domestic production capacity, has great significance for its global production strategy. Following the EUR400mn (US \$540.9mn) investment, the group's total annual production capacity at the plant will be 340,000 units, not only enabling it to produce more of its popular Dacia models, but also, **BMI** believes, providing options when an alternative to other export-oriented plants is required. In March 2013, a wage dispute at the Dacia plant in Romania forced a temporary stoppage in production. At the time, the Tangier plant was suggested as an option if the labour action became protracted. We believe this is a necessary element of flexibility for the Renault group to have on standby, as the downturn in Europe has weighed on its performance and overcapacity has been an issue industry wide.

Global Industry Overview

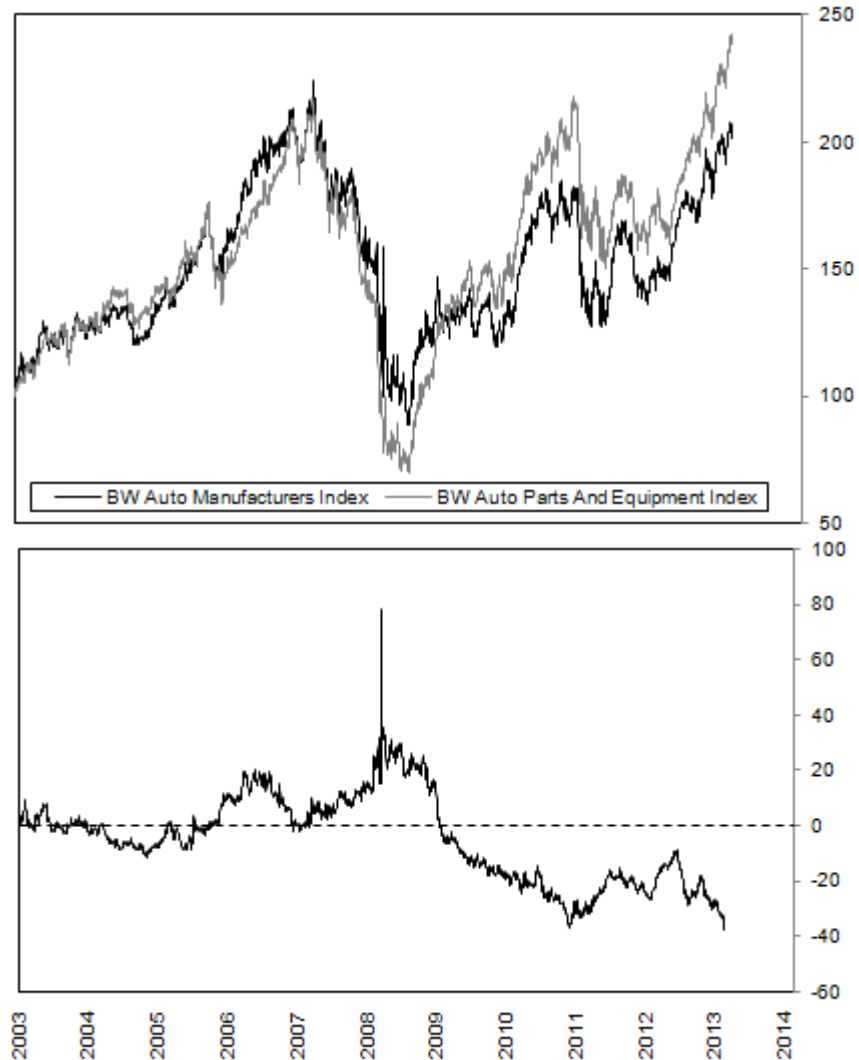
***BMI View:** The global auto supplier and equipment index has outperformed the global auto manufacturers' index since the global financial crisis. We believe possible reasons for this include the greater flexibility of EU suppliers, the rise in the average age of US cars and trade protectionism. Two future developments which may cause a reversal in fortunes in favour of original equipment manufacturers are a pick up in the European auto market and the forming of the ASEAN Economic Community (AEC) in 2015.*

We recently highlighted original equipment manufacturer (OEM)'s greater bargaining power versus auto suppliers (*see 'Illegal Cartels Highlight Low Supplier Power', October 1 2013*). However, this does not always translate into automakers' share prices outperforming. Indeed, when we chart the performance of the Bloomberg World Auto Manufacturers Index and Bloomberg World Auto Parts And Equipment Index over the past 10 years, it is clear that both suppliers and automakers have their own periods of outperformance.

While suppliers' margins on the parts they sell are usually lower than the margins which OEMs enjoy on their cars, there are other dynamics at play that determine the actual financial results of firms and ultimately their share price performance. The accompanying chart illustrates the outperformance of suppliers versus carmakers since the global financial crisis in 2008-2009. Below, we explain this phenomenon and give our thoughts on changing industry trends, which may cause a reversal.

Suppliers Outperforming Since Global Financial Crisis

BW Auto Manufacturers And Parts And Equipment Indices (top) And Spread (bottom)



NB Indices are rebased to 100 from August 2003; * BW = Bloomberg World. Source: BMI, Bloomberg

EU Suppliers More Nimble Than Carmakers

Vehicle sales in the EU have been contracting since 2008 and sales declines in some markets intensified when the eurozone crisis hit the region in 2010. This has led to heavy losses for European carmakers in the past few years. Further compounding their problems is their inability to shed large proportions of their

workforce, or expediently close underperforming factories, due to political pressure on some national carmakers to retain workers.

European suppliers, on the other hand, are less in the political limelight due to their smaller size, and they have therefore been able to rationalise their European operations faster. This has allowed them to be more nimble and re-orientate their businesses to find new growth opportunities in emerging markets in Asia, Eastern Europe and Latin America, which are increasingly making up a bigger share of their sales (*see 'Suppliers Continue To Shift Strategic Focus', June 24 2013*).

Therefore, it is no surprise that the share prices of European suppliers have recovered much faster and more strongly than their carmaker counterparts since the global financial crisis.

Ageing US Fleet Makes Market Attractive For Suppliers

The American consumer has deleveraged significantly since the financial crisis. However, the bumpy economic recovery has resulted in consumers holding on to their set of wheels longer and has also given rise to strong used car sales. Therefore, while new vehicle sales have been growing at a strong clip since 2009, the average age of the US vehicle fleet has climbed to an all-time high of 11.4 years.

In such an environment, suppliers would naturally perform better, as they are able to sell parts to OEMs for the production of new cars as well as sell replacement parts directly to the end consumers. As the vehicles on the road get older, it is reasonable to assume that spending on replacement parts has to rise to keep them in a roadworthy condition.

Trade Protectionism Puts Vehicle Imports At A Disadvantage

In recent years, trade protectionism, especially in emerging markets, has been on the rise. Many of these countries have nascent auto industries, and in order to encourage automakers to produce domestically, they usually impose high tariffs on auto imports. While both auto parts and vehicle imports are taxed, parts are usually taxed at a lower rate. We believe this may be because governments realise that the lack of localisation in their domestic auto industries requires local manufacturers to import components from overseas. A case in point is Vietnam, where the import tariff on completely built unit (CBU) imports from ASEAN will be 50% in 2014, but for car parts only 15-25%.

The upshot of this, in our opinion, is that suppliers will find it easier to export their parts to early emerging/frontier markets than automakers, whose exports may be priced out due to exorbitant tariffs.

Can Suppliers Continue Outperforming?

While there may definitely be other reasons for suppliers' share prices outperforming manufacturers in the past few years, the important question is whether this trend will endure. We believe it is hard to tell at this point. However, we highlight two future developments that may cause a reversal in fortunes.

▪ Pick Up In The European Vehicle Market

Although **BMI** maintains a bearish outlook on the European vehicle market, we expect the region to recover in coming years. As sales in individual car markets begin to slow their rate of contraction and eventually return to growth on the back of pent-up demand, European carmakers' could begin to outperform suppliers.

▪ Upcoming 2015 AEC Could Tilt The Scales In OEMs' Favour

The formation of the AEC in 2015 will bring down trade tariffs in South East Asia and by 2018 most, if not all, countries in South East Asia will cut their import tariffs to zero. This development may end up being a game changer for automakers as they concentrate their production in one or two hubs in the region and export their CBUs tariff-free to the rest of the AEC.

Demographic Forecast

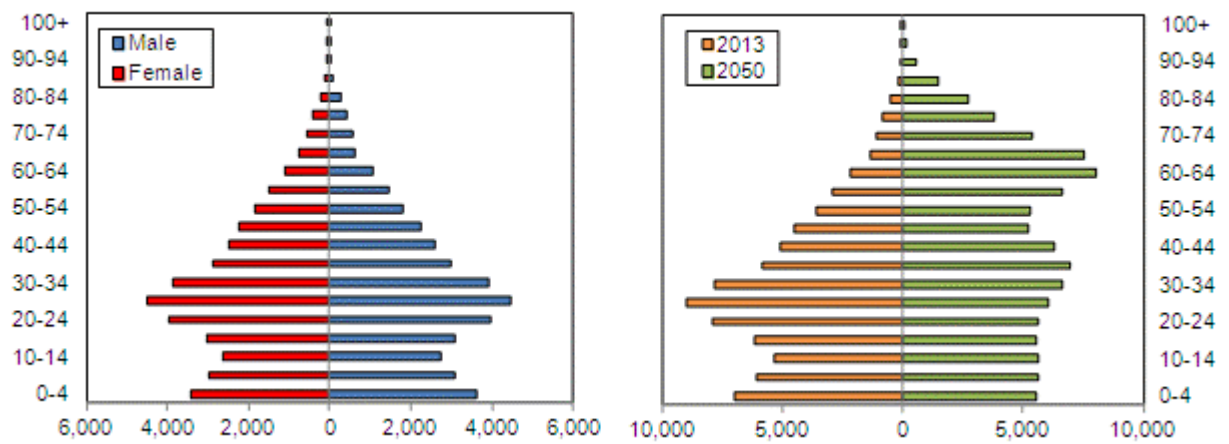
Demographic Outlook

Demographic analysis is a key pillar of **BMI**'s macroeconomic and industry forecasting model. Not only is the total population of a country a key variable in consumer demand, but an understanding of the demographic profile is key to understanding issues ranging from future population trends to productivity growth and government spending requirements.

The accompanying charts detail Iran's population pyramid for 2013, the change in the structure of the population between 2013 and 2050 and the total population between 1990 and 2050, as well as life expectancy. The tables show key datapoints from all of these charts, in addition to important metrics including the dependency ratio and the urban/rural split.

Population Pyramid

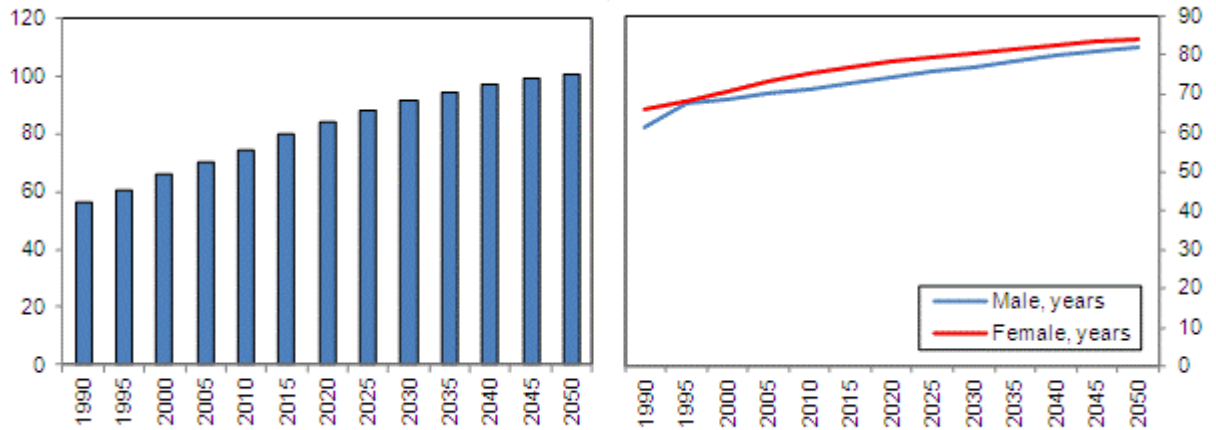
2013 (LHS) And 2013 Versus 2050 (RHS)



Source: World Bank, UN, BMI

Population Indicators

Population (mn, LHS) And Life Expectancy (years, RHS), 1990-2050



Source: World Bank, UN, BMI

Table: Iran's Population By Age Group, 1990-2020 ('000)

	1990	1995	2000	2005	2010	2013e	2015f	2020f
Total	56,362	60,468	65,911	70,152	74,462	77,447	79,476	84,149
0-4 years	9,313	7,568	6,317	5,484	6,556	7,034	7,146	6,751
5-9 years	8,906	8,983	7,552	5,477	5,416	6,046	6,507	7,117
10-14 years	7,325	8,837	8,981	7,155	5,613	5,357	5,488	6,494
15-19 years	5,823	6,885	8,801	9,248	7,216	6,124	5,644	5,467
20-24 years	4,698	5,222	6,932	9,143	8,994	7,904	7,068	5,596
25-29 years	4,054	4,429	5,316	6,859	8,705	8,978	8,727	6,998
30-34 years	3,536	3,901	4,443	5,202	6,521	7,789	8,485	8,650
35-39 years	3,031	3,393	3,886	4,693	5,210	5,858	6,497	8,410
40-44 years	2,123	2,888	3,372	4,113	4,833	5,057	5,263	6,431
45-49 years	1,621	1,956	2,857	3,421	4,033	4,495	4,758	5,193
50-54 years	1,527	1,469	1,930	2,801	3,245	3,605	3,896	4,665
55-59 years	1,393	1,396	1,431	1,767	2,638	2,933	3,110	3,788
60-64 years	1,140	1,265	1,322	1,336	1,640	2,159	2,500	2,986
65-69 years	899	995	1,146	1,258	1,279	1,379	1,551	2,340
70-74 years	507	717	826	1,056	1,130	1,129	1,143	1,369

Iran's Population By Age Group, 1990-2020 ('000) - Continued

	1990	1995	2000	2005	2010	2013e	2015f	2020f
75-79 years	269	344	509	654	803	858	877	902
80-84 years	136	147	203	347	413	482	528	598
85-89 years	49	56	66	113	173	198	217	290
90-94 years	11	14	17	22	39	54	64	85
95-99 years	2	2	3	3	5	7	9	16
100+ years	0	0	0	0	0	1	1	1

e/f = BMI estimate/forecast. Source: World Bank, UN, BMI

Table: Iran's Population By Age Group, 1990-2020 (% of total)

	1990	1995	2000	2005	2010	2013e	2015f	2020f
0-4 years	16.52	12.52	9.58	7.82	8.80	9.08	8.99	8.02
5-9 years	15.80	14.86	11.46	7.81	7.27	7.81	8.19	8.46
10-14 years	13.00	14.61	13.63	10.20	7.54	6.92	6.90	7.72
15-19 years	10.33	11.39	13.35	13.18	9.69	7.91	7.10	6.50
20-24 years	8.34	8.64	10.52	13.03	12.08	10.21	8.89	6.65
25-29 years	7.19	7.32	8.06	9.78	11.69	11.59	10.98	8.32
30-34 years	6.27	6.45	6.74	7.42	8.76	10.06	10.68	10.28
35-39 years	5.38	5.61	5.90	6.69	7.00	7.56	8.18	9.99
40-44 years	3.77	4.78	5.12	5.86	6.49	6.53	6.62	7.64
45-49 years	2.88	3.23	4.33	4.88	5.42	5.80	5.99	6.17
50-54 years	2.71	2.43	2.93	3.99	4.36	4.65	4.90	5.54
55-59 years	2.47	2.31	2.17	2.52	3.54	3.79	3.91	4.50
60-64 years	2.02	2.09	2.01	1.90	2.20	2.79	3.15	3.55
65-69 years	1.59	1.65	1.74	1.79	1.72	1.78	1.95	2.78
70-74 years	0.90	1.19	1.25	1.50	1.52	1.46	1.44	1.63
75-79 years	0.48	0.57	0.77	0.93	1.08	1.11	1.10	1.07
80-84 years	0.24	0.24	0.31	0.50	0.55	0.62	0.66	0.71
85-89 years	0.09	0.09	0.10	0.16	0.23	0.26	0.27	0.34
90-94 years	0.02	0.02	0.03	0.03	0.05	0.07	0.08	0.10
95-99 years	0.00	0.00	0.00	0.00	0.01	0.01	0.01	0.02

Iran's Population By Age Group, 1990-2020 (% of total) - Continued

	1990	1995	2000	2005	2010	2013e	2015f	2020f
100+ years	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

e/f = BMI estimate/forecast. Source: World Bank, UN, BMI

Table: Iran's Key Population Ratios, 1990-2020

	1990	1995	2000	2005	2010	2013e	2015f	2020f
Dependent ratio, % of total working age	94.7	84.3	63.6	44.4	40.4	41.1	42.1	44.6
Dependent population, total, '000	27,416	27,664	25,621	21,569	21,427	22,544	23,530	25,965
Active population, % of total	51.4	54.3	61.1	69.3	71.2	70.9	70.4	69.1
Active population, total, '000	28,946	32,805	40,290	48,583	53,035	54,903	55,946	58,184
Youth population, % of total working age	88.2	77.4	56.7	37.3	33.2	33.6	34.2	35.0
Youth population, total, '000	25,543	25,388	22,850	18,116	17,586	18,436	19,141	20,363
Pensionable population, % of total working age	6.5	6.9	6.9	7.1	7.2	7.5	7.8	9.6
Pensionable population, total, '000	1,872	2,276	2,770	3,454	3,842	4,108	4,390	5,602

e/f = BMI estimate/forecast. Source: World Bank, UN, BMI

Table: Iran's Rural And Urban Population, 1990-2020

	1990	1995	2000	2005	2010	2013e	2015f	2020f
Urban population, % of total	56.3	60.2	64.0	67.6	68.9	69.4	69.7	70.6
Rural population, % of total	43.7	39.8	36.0	32.4	31.1	30.6	30.3	29.4
Urban population, total, '000	31,749	36,424	42,211	47,394	51,333	53,726	55,362	59,374
Rural population, total, '000	24,613	24,045	23,700	22,759	23,129	23,722	24,114	24,774

e/f = BMI estimate/forecast. Source: World Bank, UN, BMI

Methodology

Industry Forecasts

BMI industry forecasts are generated using the best-practice techniques of time-series modelling and causal/econometric modelling. The precise form of model we use varies from industry to industry, in each case being determined, as per standard practice, by the prevailing features of the industry data being examined.

Common to our analysis of every industry is the use of vector autoregressions. Vector autoregressions allow us to forecast a variable using more than the variable's own history as explanatory information. For example, when forecasting oil prices, we can include information about oil consumption, supply and capacity.

When forecasting for some of our industry sub-component variables, however, using a variable's own history is often the most desirable method of analysis. Such single-variable analysis is called univariate modelling. We use the most common and versatile form of univariate models: the autoregressive moving average model (ARMA).

In some cases ARMA techniques are inappropriate because there is insufficient historic data or data quality is poor. In such cases we use either traditional decomposition methods or smoothing methods as a basis for analysis and forecasting.

BMI mainly uses OLS estimators and in order to avoid relying on subjective views and encourage the use of objective views, **BMI** uses a 'general-to-specific' method. We mainly use a linear model, but simple non-linear models, such as the log-linear model, are used when necessary. During periods of 'industry shock', for example when poor weather conditions impede agricultural output, dummy variables are used to determine the level of impact.

Effective forecasting depends on appropriately selected regression models. We select the best model according to various different criteria and tests, including but not exclusive to:

- R^2 tests explanatory power; adjusted R^2 takes degree of freedom into account.
- Testing the directional movement and magnitude of coefficients.
- Hypothesis testing to ensure coefficients are significant (normally t-test and/or P-value).
- All results are assessed to alleviate issues related to auto-correlation and multi-collinearity.

BMI uses the selected best model to perform forecasting.

Human intervention plays a necessary and desirable role in all of our industry forecasting. Experience, expertise and knowledge of industry data and trends ensure that analysts spot structural breaks, anomalous data, turning points and seasonal features where a purely mechanical forecasting process would not.

Sector-Specific Methodology

A number of principal criteria drive our extrapolations and forecasts for each autos variable.

■ Production And Sales

At a general level, we approach our forecasting from both a micro and a macro perspective, assessing the expansion plans of relevant multinationals/indigenous firms, while also taking account of the prevailing economic outlook. In this latter respect, our projections for macro variables such as industrial output, private consumption, government investment, monetary policy and GDP growth play a key role.

Figures for production are derived from a generic source (thereby ensuring maximum comparability between country data-sets), and include all vehicles with four wheels or more. For sales, we rely on data from government agencies and national automobile associations. Unless otherwise stated, sales numbers include domestically produced and imported vehicles, but not exports. The sector's contribution to GDP is projected by taking the US dollar production value as a proportion of nominal GDP, using our own macroeconomic and demographic forecasts.

■ Auto Imports And Exports

These variables are mainly calculated at the micro level, using individual company reports. Changes in government policy, particularly with regard to tariffs and quotas, also have a significant bearing.

Sources

Aside from government departments and official company reports, we rely on the International Organization of Motor Vehicle Manufacturers (OICA), other established think tanks, institutes, and international and national news agencies.

Risk/Reward Ratings Methodology

BMI's Risk/Reward Ratings (RRR) provide a comparative regional ranking system evaluating the ease of doing business and the industry-specific opportunities and limitations for potential investors in a given market. The RRR system divides into two distinct areas.

Rewards

Evaluation of sector's size and growth potential in each state, and also broader industry/state characteristics that may inhibit its development. This is further broken down into two sub categories:

- Industry Rewards (this is an industry-specific category taking into account current industry size and growth forecasts, the openness of market to new entrants and foreign investors, to provide an overall score for potential returns for investors).
- Country Rewards (this is a country-specific category, and the score factors in favourable political and economic conditions for the industry).

Risks

Evaluation of industry-specific dangers and those emanating from a state's political/economic profile that call into question the likelihood of anticipated returns being realised over the assessed time period. This is further broken down into two sub categories:

- Industry Risks (this is an industry-specific category whose score covers potential operational risks to investors, regulatory issues inhibiting the industry, and the relative maturity of a market).
- Country Risks (this is a country -pecific category in which political and economic instability, unfavourable legislation and a poor overall business environment are evaluated to provide an overall score).

We take a weighted average, combining industry and country risks, or industry and country rewards. These two results provide an overall Risk/Reward Rating, which is used to create our regional ranking system for the risks and rewards of involvement in the autos industry in a particular country.

For each category and sub-category, each state is scored out of 100 (100 being the best), with the overall Risk/Reward Rating a weighted average of the total score. As most of the countries and territories evaluated are considered by **BMI** to be 'emerging markets', our rating is revised on a quarterly basis. This ensures that the rating draws on the latest information and data across our broad range of sources, and the expertise of our analysts.

In constructing these ratings, the indicators in the table below have been used. Almost all indicators are objectively based. Given the number of indicators/datasets used, it would be inappropriate to give all sub-components equal weight. The weighting given is described in the table.

Table: Automotive Risk/Reward Ratings Indicators And Weighting Of Indicators

Indicator	Weighting, %
Rewards	70, of which
Industry Rewards	65, of which
Vehicle ownership, % of population	10
Total vehicle stock, mn	10
Total production	10
Production growth, five-year forecast average	10
Total vehicle sales	10
Sales growth, five-year forecast average	10
Country Rewards	35, of which
Urban/rural split	10
Rigidity of employment	10
Labour costs	10
GDP per capita, US\$	10
Risks	30, of which
Industry Risks	50, of which
Regulatory environment	10
Competitive landscape	10
Country Risks	50, of which
Corruption	10
Bureaucracy	10
Market orientation - openness	10
Legal framework	10
Long-term monetary risks	10
Long-term external risks	10
Long-term financial risks	10
Long-term policy continuity	10

Source: BMI

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.