

Iran - An Unlikely Area of Opportunity

A year ago it would be barely conceivable that equity investors might be looking towards Iran as the new investment destination. However since Hassan Rouhani's election win in the summer of 2013 (and the most dire predictions of the Western press) the outlook for the country has brightened significantly. Despite being a cleric himself, the president has presented himself in a far more conciliatory light than his predecessor Mahmoud Ahmadinejad. Ayotollah Khamenei, Iran's Supreme Leader, perhaps aware of the effect that sanctions are having on the regime's support has so far not objected. An interim deal was struck at the beginning of this year in Geneva between Iran and the P5+1 over Iran's nuclear weapon program in exchange for a lifting of some sanctions. The deal is temporary and will expire in July. There is hope that President Obama will push for something more permanent. His foreign policy is seen as weak after little or no response to Syria and now Russia's recent crimes. Finding or at least putting the building blocks in place for a solution to Iran's isolation would be one way of securing a positive legacy to Obama's presidency.

Regional Obstacles

Israel and Saudi Arabia represent the biggest opponents to any rapprochement between the West and Iran. Hawks in Israel understandably wish to maintain their country's monopoly as a nuclear power in the region. Handily, existential threats do also make high military spending easier to justify. They have encouraged the discussion of pre-emptive raids on Iran's facilities and allegedly



Since Hassan Rouhani's election win in the summer of 2013 the outlook for the country has brightened significantly.

sponsored an assassination program of its nuclear scientists. Several 'point of no return' deadlines have been identified and subsequently passed. If they are to be believed, Iran is alleged to have reached a point where its nuclear resources are so well protected or dispersed that a raid to stop them from manufacturing a bomb is no longer feasible. Despite encouragement from the Israelis, the US hasn't seemed particularly enthusiastic about unilaterally bombing Iran. Israel has stated they will go it alone if needs be, but the threat seems increasingly unconvincing as time passes and the probability of successful raid decreases.

Saudi Arabia is perhaps the bigger obstacle for a possible deal. Iran has the largest Shia Muslim population in the world and is the most populous country in the Gulf. It also has plentiful natural resources, most notably hydrocarbons. The Salafi religious establishment, who endorse and legitimise Saudi Royal family rule, dislike Shia Muslims more than Westerners. Saudi Princes can't be

seen to be too friendly towards Iran. On a strategic level the Royal Family do not wish their country to play second fiddle in the region nor do they want to lose their status as the most important player in OPEC. A resurgent Iran and a (Shia led Iraq), unfettered by sanctions could easily usurp them on both counts. Iran is not a liberal democracy but it is less alien and less extreme than Saudi Arabia is for foreign investors and politicians. Iraq provided a convenient buffer between the two countries when it was led by a secular, albeit Sunni, dictator. Since power has shifted towards the Shia majority in the country, the Saudis have become uncomfortable. Sharing a long border with a rich, populous and ambitious Iran is not desirable.

Whilst speculating on the politics of the situation is interesting, we think it is more important to begin to understand the opportunity that Iran represents. 2012 PPP GDP is close to 1trn US\$, which puts it in the top 20 largest economies in the world. Only Turkey has a larger economy in the immediate region. Demographics

are favourable: the country has a population of approximately 77mn, slightly more than Turkey but behind Egypt's 80mn. Over 60% of Iranians are under the age of 35. Moreover they are well educated (98% literacy rate in 15-24 age cohort) and 70% urbanised. Unlike in other parts of the Arab world, women are more freely able to participate in society. The distribution of males and females at university for example is evenly spread. Talking to a number of Iranians it becomes clear that the depth of support for religious extremism is pretty thin and that most young people just want to enjoy a better standard of life for themselves.

The country has extensive mineral wealth. It has the second largest proven gas reserves after Russia and the fourth largest proven oil reserves after Saudi Arabia, Venezuela and Canada. In common with the region, the existing basins are large and allow cheap extraction. To paint the country as a gulf petrostate would be unfair however as oil and gas accounts for only 14% of GDP versus 50% in Saudi Arabia. Aside from hydrocarbons, Iran has the ninth largest reserves of copper, eleventh of iron ore and has significant zinc, lead and chromite production.

The Tehran stock exchange is surprisingly large with over 300 listings and a market value of US\$170bn. The average price to earnings multiple is in single digits and the average dividend is over 10%. Since 2007 the government has committed itself to a surprisingly comprehensive privatisation process covering all sectors except some

security and upstream oil and gas. Foreign investors are allowed to invest in whatever opportunities domestic private investors can. There is an upcoming pipeline over the next few years, worth billions of dollars, covering various power plants, refineries, steel mills and the state airline. Compared with the strict foreign ownership caps in the Gulf States and myriad investment restrictions in India, Mullah run Iran does seem quite welcoming towards investors.

Unfortunately, at present, getting money into the country is practically impossible for the institutional investor. The SEC has made it clear it will pursue, fine and imprison any executives in companies filing in the US who may have connections with the Iranian oil industry. Furthermore any banks operating in the US risk having their license revoked if they deal with Iran. In January of this year the SEC announced that they are considering censuring PetroChina. Unsurprisingly the list of banks willing to telegraph funds into the country has become very short.

There are reasons to believe that this state of affairs could change profoundly before the summer. Bank Mellat is suing the UK Treasury for US\$4bn in damages for the unlawful application of sanctions on it. This move follows on from last year when the UK Supreme Court and the European high court called into question the legality of the sanctions. This could open up the possibility of funding from Europe which has traditionally had closer ties the country. Secondly and more

We believe that Iran is an exciting market which could be on the cusp of opening up to investors. We will carefully monitor the situation and begin to build our knowledge on listed companies in the country.

importantly, the Obama administration looks to be pushing for a deal before the November mid-terms in the US whilst it still has some legislative power. Even Saudi Arabia is approaching an understanding with Tehran. Prince Bandar bin Sultan was relieved of his position as head of the secret service in February. A security hawk, he played a big role in funding some of the harder Sunni elements in Syria to prevent Iran from gaining influence in a new regime there. It is also suspected that Saudi support was a contributing factor behind the recent increase in attacks on Shia Iraqis and oil infrastructure from Sunni groups. His demotion is seen as punishment for the chaos in Syria and a sign of a shift in the Kingdom's regional strategy. Low key negotiations between the Saudi Arabia and Iran are thought to have begun in Oman. We believe that Iran is an exciting market which could be on the cusp of opening up to investors. We will carefully monitor the situation and begin to build our knowledge on listed companies in the country.