GriffonCapital

Asset Management and Private Equity

Monthly Newsletter

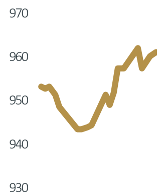
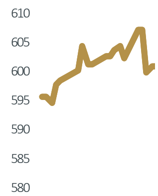
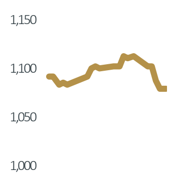
September 2017

In this issue:

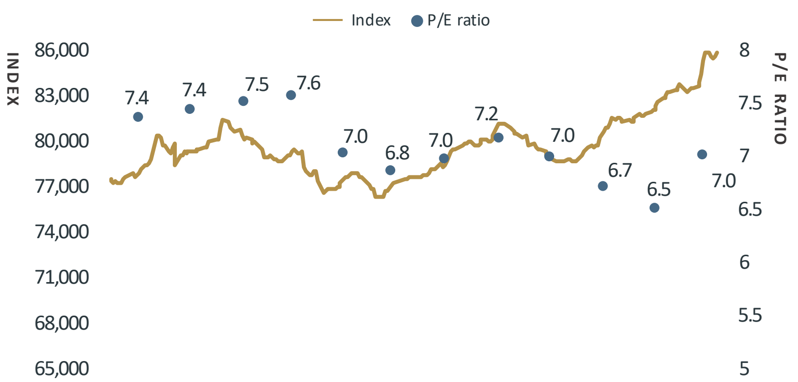
Please see the important Sanctions Disclaimer on pages 7 and 8 of this document.

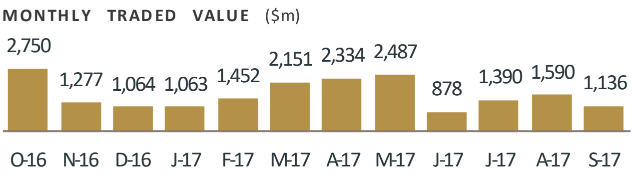
IRAN EQUITY MARKETS

INDICES

Past month	TSE (TEDPIX)	Farabourse (IFX)	Frontier Market (MSCI FM)	Emerging Market (MSCI EM)
Monthly Performance	3.1% ⬆ 	0.8% ⬆ 	0.8% ⬆ 	-0.7% ⬇ 
Last close	85,819	961	601	1,080
Past 12M	11.0%	17.6%	21.4%	18.4%
YTD	8.8%	12.7%	20.3%	25.3%
P/E (fwd.)	7.0x	8.3x	15.1x(hist.)	12.6x
Div. yield	10.1%	11.3%	3.3%	2.3%

TEDPIX INDEX & P/E (fwd.) RATIO





MARKET CAPITALISATION

Market Cap ($m)		Value traded ($m)	
TSE	Farabourse	TSE	Farabourse
87,839	14,624	907	229

MARKETS AT A GLANCE

Iranian equities maintained their upward trend in September, with the TEDPIX and IFX closing 3.1% and 0.8% higher, respectively. This is the third consecutive positive month for the TEDPIX, which has gained 9.0% since July. Its all-time high of 89,500 – set on 5 January 2014 and 4.1% above current levels – is within sight.

September's average daily trade value (ADTV) dropped to $60.7m versus August's ADTV of $75.7m. Institutional activity stood at 59.3% versus 40.6% for retailers. The most actively traded sectors were base metals (14.2%), autos (9.3%), chemicals (9.0%), ETFs (8.5%), pharma (8.2%) and metal ores (6.8%), which together made up 56.0% of total trades. The pickup in volume in the ETFs (the underlying instruments are predominantly fixed income) is attributable to the recent and more assertive directive from the CBI to lower bank deposit rates.

As well as four IPOs this month, five new Government Islamic Treasury Bills – 'Sakhabs' – started trading on the IFB, with average YTMs of 18.5%. This is a notable drop from the 20-25% YTMs of the previous Islamic Treasury Bills witnessed in Q1 and Q2 2017.

In September the rial fell 0.9% versus the dollar and gained 0.5% versus the euro. The CBI official rate's weakness was greater: 1.7% versus the dollar. It appears incremental steps are being taken towards FX unification this year.

$1 : 39,000 IRR is the monthly average free-market exchange rate used for this report.
All market data represents the period September 1-27, 2017.
Sources: Tehran Stock Exchange, Bloomberg, MSCI, Royal Exchange, Griffon Asset Management, Bourseview.

IRAN EQUITY MARKETS

SECTOR PERFORMANCE[a]

BEST PERFORMING SECTORS

Refineries	↑	13.6%
Telecommunications	↑	8.6%
Utilities	↑	7.1%
Paper & paper products	↑	6.8%
Chemicals	↑	5.2%

WORST PERFORMING SECTORS

Ceramics & tiles	↓	-3.7%
Construction & real estate	↓	-3.5%
Base metals	↓	-3.1%
Leasing	↓	-2.1%
Motor vehicles	↓	-2.0%

TOP GAINERS AND LOSERS

GAINERS

Chodan[b]	*Metallic products*	↑	64.9%
Iran Aluminium	*Base metals*	↑	62.5%
HiWeb[b]	*Telecom services*	↑	54.9%
Mobin One Kish[b]	*Telecoms*	↑	51.1%
Indamin Saipa	*Motor vehicles*	↑	45.2%

LOSERS

Ilam Cement	*Cement*	↓	-22.5%
Piazar Agriculture	*Food stuff excl. sugar*	↓	-22.3%
Loghman Pharm. & Hygiene	*Pharmaceuticals*	↓	-21.3%
Behpak Co.	*Food stuff excl. sugar*	↓	-21.1%
Lent Tormoz Iran	*Motor vehicles*	↓	-18.0%

SECTOR NEWS

Banking and foreign financing
Iran's banking system is making tangible progress in attracting foreign financing. Since the €8bn credit line granted by South Korea's Eximbank, China's CITIC Investment Group has agreed a $10bn credit line to finance water, energy and transport projects. The CBI has also announced that China Export-Import Bank has committed $10bn and China Development Bank has signed preliminary deals worth $15bn in funding for infrastructure and manufacturing projects. European banks have also made smaller financing arrangements; for example, Oberbank (Austria's 7th largest bank) agreed a €1bn credit line for 14 Iranian banks, and Danish Danske bank signed a €500m finance agreement with 10 Iranian banks for domestic projects.

Auto
Local auto production grew 21.8% during the first five months of the current fiscal 1396 (21 March 2017 to 20 March 2018). 545,936 cars were produced during this period by Iranian manufacturers – mostly by Iran Khodro, which built 273,441 cars (+16.8% y/y) and has a 50% market share. Saipa, Iran's second largest automaker, produced 223,392 cars (+24.1% y/y) and has a 41% market share. According to the Customs report, 26,376 units were imported in the first five months of 1396 (+42.6% y/y).

$1 : 39,000 IRR is the monthly average free-market exchange rate used for this report.
(a) Main sectors are included, whereas smaller sectors (comprising less than three companies) are excluded.
(b) Mobin One Kish, Chodan and Hiweb were recent IPOs (see page 4).
All market data represents the period September 1-27, 2017.
Sources: SEO, Bourse Press, Financial Tribune, Codal.ir, Griffon Asset Management.

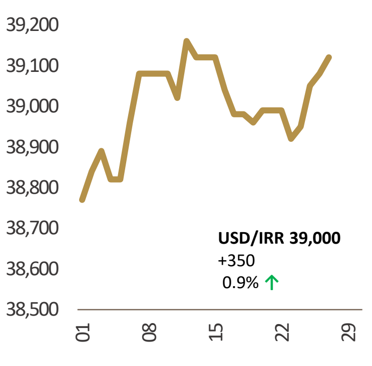
IRAN EQUITY MARKETS

TOP 10 COMPANIES BY MARKET CAPITALISATION

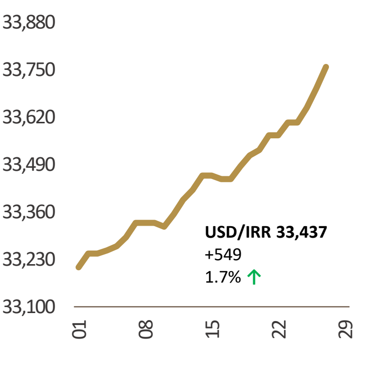
Price values in IRR	Market cap ($m)	Last price		1M	YTD	52 w/h	52 w/l
Khalij Fars Petrochemical *Chemicals*	6,318 *5.72%*	4,847	↑	5.4%	7.2%	5,049	4,120
MCI *Telecommunication*	3,958 *3.58%*	16,291	↑	10.1%	38.1%	16,291	11,630
Mobarakeh Steel *Base metals*	3,798 *3.44%*	1,998	↑	6.7%	56.8%	2,035	1,111
TCI *Telecommunication*	3,169 *2.87%*	2,034	↑	5.4%	11.0%	2,070	1,796
Maroon Petrochemical *Chemicals*	3,104 *2.81%*	30,000	↑	6.1%	3.4%	30,352	24,614
NICICO *Base metals*	2,581 *2.34%*	2,020	↓	-4.9%	31.3%	2,316	1,349
Golgohar Mining & Industrial *Metallic ore*	2,147 *1.94%*	2,798	↑	7.6%	35.4%	2,899	1,472
Ghadir Investment *Conglomerates*	2,027 *1.84%*	1,094	↑	4.2%	-9.8%	1,240	1,032
Jam Petrochemical *Chemicals*	2,022 *1.83%*	8,220	↑	5.4%	2.1%	8,300	6,841
Parsian Oil & Gas *Chemicals*	2,008 *1.82%*	1,931	↑	3.8%	2.1%	2,000	1,655

USD/IRR EXCHANGE RATE, SEPTEMBER 2017

FREE MARKET RATE



CBI OFFICIAL RATE



SECTOR NEWS (CONT'D)

Steel

Although the European Steel Association (Eurofer) lodged a complaint in May 2016, European Union members have thus far rejected an outright import tariff on Iranian steel. According to the latest decisions, Iranian steel producers must adhere to a minimum import price measure. However, a fixed-price duty mechanism (per tonne) may replace this in due course.

IPOs

This month there were four IPOs. First, Isfahan Kowsar Hotel, a hotel chain in Isfahan – an international tourist hotspot – with a market cap of $42.7m, debuted on the IFB on 3 Sept., closing 32.5% higher as of 27 Sept. Second, HiWeb ($431.4m market cap) – an ISP that focuses on ADSL internet (B2C and B2B) and fixed-wireless access (B2C) – traded on the TSE on 13 Sept. and closed 54.9% higher as of 27 Sept. Third, steel-products manufacturer Chodan ($62.9m mkt. cap.) debuted on the IFB on 12 Sept. and closed 64.9% higher as of 27 Sept. And finally, in the pharma sector, Rishmac Production & Export Co. ($19.8m market cap), a manufacturer and exporter of iodine powder, listed on the IFB on 23 Sept. and closed 21.5% higher as of 27 Sept.

All market data represents the period September 1-27, 2017.
Sources: SEO, CBI, IFB, Donya-e-Egthesad, Codal.ir, Tehran Stock Exchange, Royal Exchange, and Griffon Asset Management.

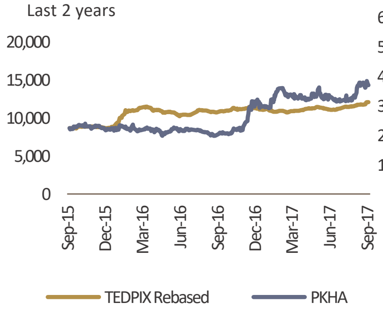
IRAN EQUITY MARKETS

KHARG PETROCHEMICAL CO.

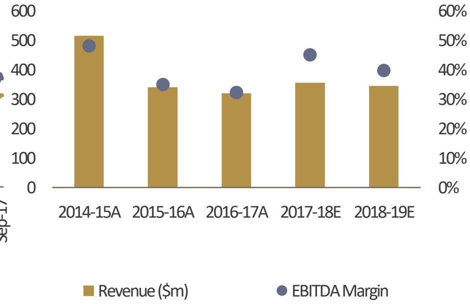
Symbol: PKHA	Market cap.: $775.4m	P/E (17-18E)[b]: 4.9x	12-month return: ↑79.9%
Exchange: TSE	Enterprise value[a]: $738.8m	5-yr (avg.) dividend payout ratio: 97%	EV/revenue (17-18E)[b]: 2.1x
Listed since: 1999	% of market (TSE): 0.8%	Dividend yield (17-18E)[b]: 18.5%	EV/EBITDA (17-18E)[b]: 4.6x
Last close: IRR 14,500	Free float: 12%	Avg. daily trade value: $143.6K	ROCE (hist.): 52.8%
90-day change: ↓-1.1%	Shares outstanding: 2bn	52-wk high/low (IRR): 14,989/7,873	ROE (hist.): 48.8%

PKHA AND TEDPIX

Last 2 years

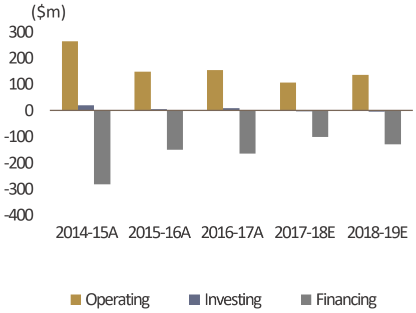


REVENUE & EBITDA MARGIN



CASH FLOW

($m)



FINANCIAL STATEMENTS ($M)

	14-15A	15-16A	16-17A	17-18E[b]	18-19E[b]
Methanol Price ($/MT)	324.9	251.8	268.5	310.0	315.0
Revenue	515.3	341.5	320.7	353.8	350.0
Growth %	-33.8%	-33.7%	-6.1%	10.3%	-1.1%
EBITDA	247.7	119.3	103.3	159.3	137.0[c]
Growth %	-41.6%	-51.8%	-13.4%	54.2%	-13.9%
EBITDA margin	48.1%	34.9%	32.2%	45.0%	39.1%
Net Income	276.8	141.9	109.1	159.2	133.1
Growth %	-43.9%	-48.7%	-23.1%	45.9%	-16.4%
Net Profit Margin	53.7%	41.5%	34.0%	45.0%	38.0%
Net Debt	(107.5)	(38.5)	(36.6)	(32.2)	(19.9)
Capex	19.7	18.2	24.9	14.0	13.9
Dividend	271.8	138.8	101.6	143.3	119.8

COMPANY OVERVIEW

Although headquartered in Tehran, Kharg Petrochemical Company has its production complex on Kharg Island, located in the Persian Gulf 25 km off Iran's coast. The company was founded in 1967 and listed on the Tehran Stock Exchange in 1999. It produces primarily methanol (~60% of revenue) as well as liquefied petroleum gases (LPGs – propane, butane and pentane). Sulphur (~4% of revenue) is also a by-product of the manufacturing process, created by turning sour natural gas (feedstock) into sweet natural-gas. All the company's production are exported – mainly to India, China, Taiwan and Europe.

The strengthening methanol price (up 54.2% from August to December 2016), was the major cause of the 49.2% move in the company share price over the same period. Despite the higher methanol prices, the increase in the cost of feedstock has meant net profit margins have fallen sharply since 2011, when they were as high as 77%. The company's sole feedstock is sour natural gas, which is priced in USD using the CBI official FX rate. Hence two key risks for the company (and the sector) are the long-term future price of this feedstock and the expected unification of the dual FX rate structure. Despite the recent introduction of a formulaic pricing mechanism by the Ministry of Oil and Gas to address this, the method still lacks full transparency. In the past feedstock prices have been volatile, rising from $0.03 per cubic metre in 2011 to as high as $0.13 in 2014. Historically the feedstock price paid by Kharg has been even higher – for example, $0.09 and $0.16 in 2010 and 2014, respectively, when peers paid $0.03 and $0.14. In the last few years the discrepancies in Kharg's pricing issues have been reconciled.

Kharg is planning to significantly expand its methanol production capacity, currently 640,000 metric tonnes per year, by 1.4m metric tonnes per year; the effort is projected to cost ~$457 million and is 38% completed. Iran's methanol producers hold around 3% of global capacity, with 4.4m tonnes produced in 2016. This year two huge methanol complexes (Marjan and Kaveh) are scheduled to become operational, almost doubling Iran's capacity and global market share.

This is not a stock recommendation. The above is an introductory information overview.
The reference currency rates are based on the yearly average of the free market exchange rates.
a) The enterprise value calculation is based on net debt from 2016-17 audited annual reports.
b) 2018 and 2019 numbers are based on Griffon Asset Management's expectations.
c) For 2018-19, it has been assumed the CBI and free market exchange rate will be unified resulting in higher feedstock cost.
d) Sources: TSE, Annual company accounts (Codal.ir), company website, Griffon Asset Management.

ABOUT GRIFFON CAPITAL

Griffon Capital is an Iran-focused asset management and private equity group established to unlock value from the country's public and private equity markets. Among Griffon's primary objectives is to allow local and international institutional investors the ability to seamlessly access and maximise opportunities in Iran through purpose-built vehicles and investment products spanning traditional and alternative assets.

The Group's strength is rooted in a robust operating platform developed by leading international advisors and are supported by internationally recognised administrators and auditors. Our platform consists of a high-calibre team with deep local market expertise and an international financial pedigree blended at the board, management and execution levels. This includes a management team steeped in investment banking, wealth and asset management and corporate finance experience. Griffon is also distinguished by on-the-ground local research and primary thinking and a governance culture defined by global best practices in risk management, compliance and reporting.

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On July 14, 2015, the P5+1, the European Union, and Iran reached a Joint Comprehensive Plan of Action ("JCPOA"). Subsequently, following confirmation that relevant JCPOA commitments had been delivered, certain of the international sanctions and restrictive measures relating to Iran were eased or lifted on 'Implementation Day', 16 January 2016, including the majority of previous EU and UN sanctions on Iran. While this represented a significant relaxation of the sanctions in place against Iran, a number of important restrictions remain in force (including certain sanctions which may affect financial and investment activity).

In particular, notwithstanding the relaxation of sanctions on 'Implementation Day', certain categories of persons may be prohibited from investing in the Fund. The Fund and Investment Manager's policy is to comply with all applicable sanctions, and not to engage in activity that would be sanctionable under the sanctions applicable to non-US persons. Before making or managing any investments in Iranian securities, the Fund and the Investment Manager will put in place a robust compliance framework based on professional advice with a view to ensuring that its activities and investments are compliant with EU and applicable US sanctions and restrictive measures in force from time to time regarding Iran.

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