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IRAN

AUTOS REPORT

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Executive Summary

The total vehicle output of automakers in Iran increased by 2.4% year-on-year (y-o-y) to 1.64mn in the Iranian year ended March 19 2012, reports inn.ir. However, **BMI** has revised down its production and sales estimates for Iran's autos industry owing to the withdrawal of many international companies from the country in the wake of global sanctions against its nuclear efforts.

Iran's domestic autos industry, which has been becoming increasingly self-sufficient in the face of international sanctions, will face its biggest test after the recent withdrawal of a number of Western carmakers. Italian carmaker **Fiat** has suspended sales to Iran, Zawya reports. The company said this was to support 'the efforts of international diplomacy to find a diplomatic solution to the issues relating to Iran.' The group added that over the last few years sales to the country 'have not been significant'. Iran and six world powers have recently closed two days of nuclear talks with little to show for it, the report says.

A particular test for Iran is the withdrawal of **PSA Peugeot Citroen**. The Peugeot arm has been a key supplier of components for leading domestic firm **Iran Khodro** (IKCO), but has suspended supplies and may have to rethink its position completely, following its tie-up with **General Motors Company** (GM).

As GM is now a 7% stakeholder in PSA Peugeot Citroen, the implications of US sanctions against Iran will extend to the French carmaker's operations. The US lobby group United Against Nuclear Iran (UANI) has called for an end to Peugeot's involvement in Iran, where IKCO builds the Peugeot 206 and 405 models. GM claims that its partner had already suspended its supplies before the agreement was signed.

UANI launched its 'Auto Campaign' in March 2012, citing a **BMI** report looking at how the enforcement of economic sanctions on Iran has resulted in the country's government prioritising the development of a strong domestic auto industry. UANI says in recent months, both **Hyundai** and **Porsche** have ended their business in Iran in response to its campaigns.

UANI has since ramped up its campaign to get foreign automakers out of Iran. It says that Fiat, **Isuzu**, **Kia Motors**, **Mazda Motor**, **Mitsubishi Motors**, **Nissan Motor**, **Peugeot**, **Renault**, **Suzuki Motor**, **Toyota Motor** and **Volvo** either export to the Islamic Republic or have manufacturing agreements with car companies controlled by the regime.

Following the release of industry data in May indicating that new car production in Iran in April dropped 27% year-on-year (y-o-y), UANI CEO and ambassador Mark D. Wallace issued a statement saying: 'The message is clear: responsible international auto companies will not continue to work in Iran. We call on all auto manufacturers – including Fiat, Mazda, Nissan, Renault, and Peugeot – to fully end their irresponsible business in Iran. We call on Congress to pass UANI's DRIVE Act, which would require

automakers to certify they are not engaged in any business in Iran to be eligible for US government contracts.'

According to a Bloomberg report, in late May Ambassador Wallace testified about Iran's automotive industry before the US House Foreign Affairs Committee. Ambassador Wallace called out Peugeot and its US partner GM, saying 'Peugeot right now is a major actor in Iran, a major manufacturer inside Iran in direct partnership with the IRGC.' He said that, while Peugeot says it suspended its business with Iran until July, Iran produced more than 15,000 Peugeot vehicles in April. At the moment, we believe the suspension is revisited on a monthly basis.

IKCO has been scaling up its domestic production operations to limit the impact of sanctions, culminating in the development of a 'national car' (the Runna) and engines to power its own vehicles, including compressed natural gas (CNG) versions to improve the fuel-efficiency of its product range. In 2011, IKCO accounted for around half of the 1.6mn units produced by the Iranian autos industry in the first 11 months of the Iranian year, ending March 2012. Rather than being deterred by the sanctions, IKCO believes it can produce 860,000 units in the new Iranian year, and export 10% of its output.

Iran's second-largest carmaker, **SAIPA**, has also been preparing to limit its dependence on foreign partners. SAIPA has already been forced to adjust after the withdrawal of Korean partner **Kia Motors** in 2010. The two had enjoyed a successful assembly agreement, which saw the Pride become one of the country's most popular models, accounting for 30-40% of all cars on the road. However, in August 2010, Kia stopped exports of completely built units (CBUs), kits for assembly and spare parts to Iran. SAIPA has since opened what it claims is the Middle East's largest production plant in Kashan to build a domestic model.

It has taken a little longer for Kia's affiliate **Hyundai Motor** to end its Iranian operations, but it has now done so, according to the New York Times. Although UANI has been pressing the carmaker to cut its ties since 2010, the group has only recently reclassified Hyundai as 'withdrawn' on its list of foreign businesses dealing with Iran. The report suggests that, in line with the US sanctions, foreign companies maintaining ties with Iran could face penalties in the US market. This would be a major incentive for Hyundai, which reported growth of 20% in US sales in 2011 and increased its market share from 4.6% to 5%.

It is not just the production side suffering from the sanctions, however. A government-imposed limit on foreign exchange, following a rush to convert rials to dollars in response to sanctions against the Central Bank, has pushed up the cost of buying foreign models, which are already in the country. Inventories are piling up and importers are no longer shipping models in as it is too expensive and clearing customs is taking too long.

Dealers say the price of imported cars has risen by around 20% in two months, with sales falling by a similar amount over the last year. As most of these imported cars are premium brands, it begs the question whether domestically-built cars would fill the void, even if they are more accessible.

We estimate 1.4mn vehicles will be produced in Iran in 2012, a drop of over 16% y-o-y. However, we estimate annual production growth will average 1.16% in 2013 to 2016.

SWOT Analysis

Iran Autos Sector SWOT	
Strengths	▪ The largest car-producing market in the Middle East. ▪ Tie-ups with foreign carmakers have expanded and updated the range of models produced by Iranian auto firms.
Weaknesses	▪ Heavily protected domestic market. ▪ Iran is subject to US trade embargoes, which have cut the country off from investment by US-based manufacturers. ▪ Local parts and components manufacturers face capacity constraints, which will mean greater reliance on foreign imports in car assembly. ▪ IKCO is suffering financial difficulties and is being bailed out by the government.
Opportunities	▪ A limited relaxation on car imports will lead to a rise in inbound shipments. ▪ As Iran's car sector grows, it will increasingly rely on outsourcing for parts and components. ▪ US$1bn scrappage plan for commercial vehicles should boost heavy vehicle sales.
Threats	▪ Iran could be subjected to an international trade embargo over its nuclear programme, affecting the importation of parts, the future of joint ventures with foreign firms and Iran's export market in the Middle East. ▪ Political instability is a key concern for the whole Iranian economy.

Iran Political SWOT	
Strengths	▪ 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	▪ 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	▪ The Majlis (parliament) is more than just a rubber stamp; the move by 150 parliamentarians (out of 290) to hold the president accountable for his handling of the economy is a positive indication that checks exist.
Threats	▪ Ongoing nuclear tensions raise the prospect of further US and UN Security Council sanctions and the – albeit very limited – possibility of a military strike by the US or Israel. ▪ Ethnic tensions are on the rise. ▪ Youth unemployment is high. ▪ The rising influence of the Revolutionary Guards within the political and economic arena may present a challenge to the status quo over the long term.

Iran Economic SWOT	
Strengths	▪ 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	▪ 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. ▪ The start of the country's subsidy reform programme has lowered its growth prospects and accelerated inflation. ▪ International sanctions discourage foreign oil companies from bringing much-needed technical knowledge and equipment to maintain oil output levels.
Opportunities	▪ 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	▪ 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. ▪ Further deterioration in Iran's relations with the international community over its nuclear programme could result in the imposition of more extensive economic measures by the UN Security Council or the US. ▪ Capital flight is likely to continue owing to high inflation and currency depreciation.

Iran Business Environment SWOT	
Strengths	▪ 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	▪ 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	▪ 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. ▪ The government has inaugurated the first phase of an oil swap project with Russia, Kazakhstan and Turkmenistan. The project will compete with the US-backed pipeline which will run to the Mediterranean from Baku in Azerbaijan through Georgia to Ceyhan in Turkey.
Threats	▪ UN, US and EU sanctions pose a significant threat to the participation of foreign firms in the oil and gas 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.

Global Overview

Global Autos Update: End Of First Quarter Brings Both Positive And Negative Revisions As Key Trends

Many of our key views for major global markets in 2012 looked to be playing out at the end of the first quarter, but the pace of growth in some instances (either positive or negative) has been greater than expected and prompted forecast revisions. This is particularly true of the US, which we expected to outperform other developed states, but its momentum has led us to raise our growth projection for the year. Similarly, while we had previously highlighted impending risks in leading emerging markets (EMs) such as Turkey and Brazil, a sluggish Q1 has confirmed our fears and our forecasts have been revised accordingly.

Table: : Passenger Car Sales (Units), Jan-March 2012

	Last Month	Monthly Sales	% chg y-o-y	YTD Sales	% chg y-o-y	BMI End-2012 Sales	BMI Full-year Growth Forecast (2012, % chg y-o-y)
Core Europe	March	1,132,296	-7.8	2,455,070	-8.7	9,724,246	-2.4
Eastern Europe	March	72,907	4.0	193,743	9.6	821,622	2.2
Japan	March	640,916	76.3	1,448,886	50.3	3,902,167	10.7
United States	March	763,306	16.0	1,843,789	19.5	7,002,834	15.0
Canada	March	73,645	6.5	161,085	14.5	702,060	1.2
Brazil	March	303,195	-1.9	706,422	-0.7	2,798,375	3.8
India*	March	229,866	19.6	2,016,115	2.2	2,804,775	9.1
China	March	1,400,000	4.5	3,770,000	-1.3	15,660,000	8.0
Turkey	March	47,270	-12.5	97,534	-20.6	619,591	2.9
Russia **	March	266,776	12.9	657,844	18.7	2,622,636	6.5

** year runs Apr-March, end-2012 refers to year ending March 2013**BMI estimates based on AEB data. Source: Individual industry associations. Please note that indicators used for monthly data purposes may not match the indicators used for annual data. Where monthly data is unavailable by the same source, we have chosen to use the closest proxy; however, it may include or may discount certain vehicle types. Please note that this will also impact growth rate comparisons between BMI's full-year forecasts and monthly and year-to-date growth rates.*

Recovery And Replacements Fuel Growth

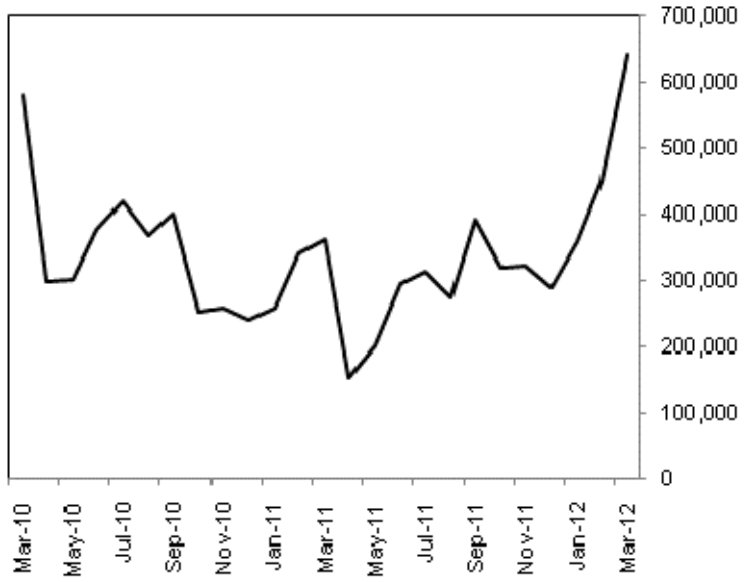
In line with **BMI**'s view that pent-up demand and more fuel efficient vehicles on offer in the US would enable the industry better to prepare for soaring fuel costs in 2012 than in 2008, passenger car sales in the US rose 16% year-on-year (y-o-y) in March and 19.5% y-o-y for Q112. **BMI** has revised its forecast for passenger car sales growth to 15%, which would take car sales to more than 7mn units for the first time

since 2007. As fuel costs soar, the key driver of sales is improved fuel efficiency, especially as the average age of US cars is at a high of 11 years.

Although the key factors driving US growth in 2012, replacing an ageing fleet and improved supplies for Japanese carmakers, are not likely to carry over beyond this year, they leave the industry in a much better position to return to its psychological benchmark of 16mn units before the end of our forecast period, in 2016. This is even with a slowdown to more stable average annual growth of 3-4% over 2013-2016.

Sustainable Growth?

Japanese Passenger Car Sales (CBUs)



Source: JAMA

Replacement sales are also continuing to fuel rapid growth in Japan, especially as the first anniversary of the earthquake and tsunami will provide a low base for sales from March onwards. Passenger car sales were up 76.3% y-o-y in March and 50.3% in Q112. For the meantime, we have retained our forecast for full-year growth of 10.7%, as a recovery in sales had started by Q311, meaning the base effect should be less prevalent in H212. However, the extension of subsidies for purchases of fuel-efficient vehicles will continue to produce upside risk to our outlook.

EM Risks Become Reality

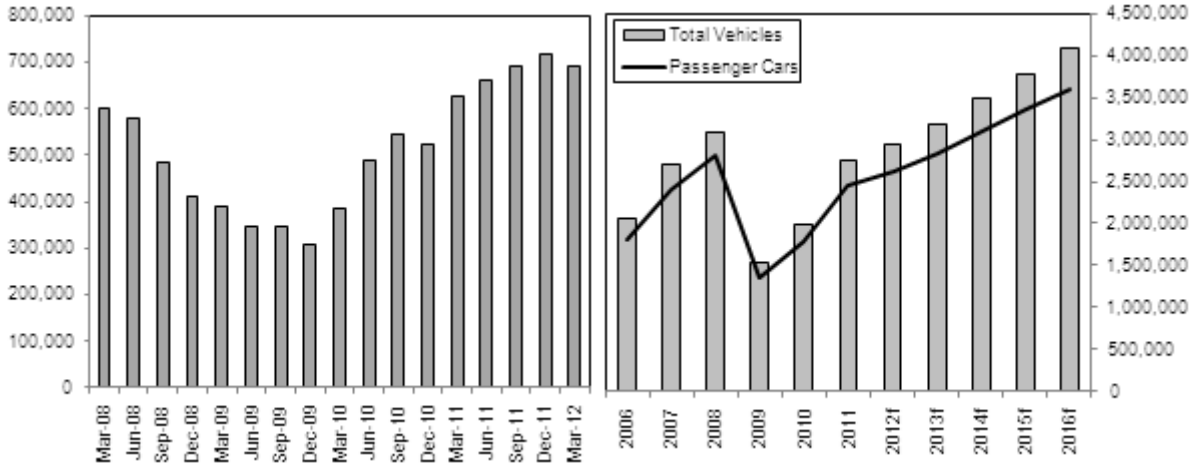
In our last update we underlined the worsening position of key EMs, such as Brazil and China. Results for March confirmed these fears, as sales in China have remained in negative territory for Q1 (-1.3% y-o-y), although growth of 4.5% y-o-y for March means the market looks slightly better than at the end of February, when two-month sales were down 4.4% y-o-y.

In Brazil the changing regulatory environment is already hampering vehicle sales, as import restrictions and the inability of domestic production to cover the shortfall combine to leave demand unfulfilled. March car sales were down 1.9% y-o-y, leaving Q1 car sales 0.7% below Q111's total. As we expect the new restrictions to be a major dampener on sales through to at least the end of 2013, we have revised down our passenger car sales growth forecast for 2012 from 5.2% to 3.5%.

While Russia continues to post much higher growth than its BRIC (Brazil, Russia, India and China) peers, a weak Q1 has also led to a revisit of our forecast for this long-time outperformer. **BMI**'s previous forecast of 10.6% y-o-y growth in 2012 was largely based on expectations of strong Q112 sales, bolstered by an increase in government spending ahead of the presidential elections in March 2012. However, Q112 sales of 614,273 units were significantly lower than Q411 sales of 715,015 units, and suggest that the impact of government spending has not been strong enough to completely offset the slump following the end of the scrappage scheme in December 2011.

Moderately Optimistic

Russia New Vehicle Sales (Units): Quarterly Sales - LHS; Yearly Sales - RHS



e/f: estimate/forecast. Source: AEB, BMI

In addition, there will be pressures from the broader economy. Our Macroeconomic team has a below-consensus forecast for Russian GDP growth forecast for 2012, projecting economic growth of 3.2%, compared with the 3.7% average Bloomberg consensus forecast. We believe consumer demand in 2012 will feel the pinch from a hike in electricity and gas tariffs later in the year, which might also add to inflationary pressures. Meanwhile, we expect demand from businesses to be cautious amid falling external demand, increasing financing constraints and policy uncertainty in Russia. We expect these forces to lead to a significant moderation in light vehicle sales growth, from 38% y-o-y in 2011 to nearly 7% y-o-y in 2012.

Europe Still Divided

Europe remains the biggest risk for carmakers, and the region is still very much split in terms of

performance, with Western European markets lagging behind. Car sales in our Core Europe group were down 7.8% y-o-y in March and 8.7% y-o-y for Q1, although this is a marginal improvement on the 9.5% contraction in the first two months of the year. Our Eastern Europe grouping, meanwhile, posted growth of 4% in March and 9.6% in Q112, which is in line with our forecast for the group to achieve positive growth. However, we believe there are some markets that are exposed to the Western slowdown more than others.

Germany is still proving to be the lynchpin of Western Europe car sales, with growth of 3.4% in March and 1.3% in Q112. While not stellar, it easily outperforms the Core Europe average and is in line with **BMI**'s forecast for 1.2% growth in 2012. The UK is also contributing positive growth to the group's average, with sales up 1.8% in March and 0.9% in Q1.

Some of the biggest problems for the region are in Italy, where new car sales fell 26% in March and 20.9% in Q112. The truckers' strike hampered the delivery of both supplies for production and finished goods to market, which came out in the final results. After a fourth consecutive year of contraction in 2011, sales are poised for a further 6% y-o-y decline in 2012, according to **BMI** forecasts.

In Eastern Europe, our view that the region's leading exporters to the EU would be left particularly exposed to the downturn was reflected in March results. Czech car sales were down by 2% y-o-y, while sales in Slovakia fell 1% y-o-y and Slovenia posted a 12% y-o-y contraction. We believe these markets will remain at risk throughout the year, and have retained our forecast of 2.2% growth for the region, despite overall Q1 growth of 9.6%.

Industry Risk/Reward Ratings

GCC States Defy Lack Of Production To Top Autos 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 – 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.

There are broadly two types of countries in the MENA region: the vibrant free-market Arab states in the Gulf region where demand for vehicles is high but where there is little or no automotive industry, and the more heavily regulated markets of North Africa which suffer high levels of negative risk. Separate to both, and in last place in our ratings table, is Iran, which has its own political and economic difficulties for automakers to deal with.

Within the Gulf states, there is little to distinguish between the states in terms of regulation of the automotive market, with the Gulf Co-operation Council (GCC) determining customs regulations. Consequently, the GCC's relative market openness and strong rates of new car sales growth have pushed these states towards the top of our rankings, largely because they do not have domestic producers to protect and they only lightly regulate their respective auto markets.

For this quarter, the Gulf Arab states – Saudi Arabia, UAE, Kuwait, and Bahrain – are in first, second, third and fifth place respectively. The key differences between these four markets relate to the size of the markets, the rates of vehicle ownership, the pace of sales growth and the degree of market risk. Saudi Arabia scores highly across the board – we feel it is a market which should show stable sales growth over our forecast period to 2016 and it is also a country that has not been as affected by political instability as its regional peers. Increased demand for new automobiles is also currently being underpinned by impressive overall economic growth on the back of continuing high oil prices. The Saudi car market has traditionally been dominated by high-end models, but as wealth increases at the lower end of the economic spectrum we anticipate a rise in demand for smaller, lower-priced family cars with more economical running costs.

The UAE is another attractive autos market, where demand for new cars has been the strongest in the region over the past few years. In light of this strong recent performance, we are now forecasting a slight easing in sales growth over the coming years. Nevertheless, we believe it is still an attractive market for auto manufacturers, especially at the high end.

In third place in our newly-updated table is Kuwait. Here, it is passenger car sales that are driving the wider market. **BMI** expects new car sales to grow by 28.4% between 2011 and 2016, with commercial vehicle sales set to grow by 12.6%. In terms of the wider economy, inflationary pressures in Kuwait will remain subdued throughout 2012, which means that financing for new cars should remain reasonably cheap.

In fourth place in our table is Israel. Last year (2011) was a strong year for new car sales, in line with **BMI**'s expectations. Moving forward, we continue to anticipate good growth levels in terms of new car sales, with annual figures set to move through the 300,000 unit mark during 2015. Israel is also embracing alternative fuel technology and, in particular, electric vehicles (EVs). We believe that there will be a sharp increase in EV sales over our forecast period to 2016.

In fifth place is Bahrain. While Bahrain's automotive market is small, it is open and highly competitive with high levels of car ownership. The main drawback, which is common throughout the Gulf, is the dominance of family-owned exclusive dealerships, which prevent competition within brands and create barriers to market entry for new dealerships. Ongoing political turmoil and the overall small size of the market represent further obstacles to the development of the auto industry moving forward.

In sixth and seventh place are the North African neighbours, Morocco and Algeria, where we expect new car sales growth of 37.3% and 27% respectively over our forecast period to 2016. Both countries are currently constrained by fairly low autos market scores, however, we would expect both countries to move up our ratings charts once planned new production facilities come onstream in the coming years, thereby expanding the size of their domestic auto industries considerably.

Egypt is in eighth place. Its autos industry remains in the doldrums, with demand for new vehicles remaining depressed by a combination of both economic and political strife. According to figures from Egypt's Automotive Marketing and Information Council (AMIC), total autos sales fell by 33% year-on-year (y-o-y) over the January-August 2011 period to just 111,108 vehicles. Overall, Egypt's auto industry size is unremarkable, although it has great potential for expansion once the political situation calms down. On the downside, Egypt is under-developed outside its main urban centres and the regulatory environment for the automotive sector is poor due to high tariff barriers. However, the government is slowly liberalising the market. Poor scores for bureaucracy, the country's legal framework and the level of market openness also drag down Egypt's country risk score.

Iran lies in last place, principally due to the closed nature of its auto market, which is dominated by the state sector, with negligible competition from imports. Therefore, in **BMI**'s global automotive Risk/Reward matrix, Iran has the dubious distinction of having the worst industry risk score, of just 10 (out of 100). The size of the local industry, which is roughly comparable with Turkey, does not provide much mitigation, with Iranian car producers dependent on trade protectionism, despite efforts to diversify

exports. With the constant threat of international sanctions and serious structural weaknesses in the economy, Iran's risk factors remain poor.

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

Country	Rewards	Industry Rewards	Country Rewards	Risks	Industry Risk	Country Risk	Autos Rating	Regional Rank
Saudi Arabia	58.9	53.3	69.1	73.1	85.0	61.2	63.1	1
UAE	55.2	41.7	80.2	78.5	85.0	72.0	62.2	2
Kuwait	53.1	35.0	86.7	73.8	85.0	62.7	59.3	3
Israel	57.6	45.0	81.1	58.8	50.0	67.5	58.0	4
Bahrain	46.1	30.0	76.0	78.2	85.0	71.4	55.7	5
Morocco	30.6	31.7	28.5	53.7	55.0	52.5	53.7	6
Algeria	43.1	36.6	46.7	57.8	65.0	50.6	47.5	7
Egypt	36.6	40.0	30.2	53.4	62.5	44.3	41.6	8
Iran	38.7	35.0	45.5	26.8	10.0	43.6	35.1	9

Scores out of 100, with 100 highest. The Business Environment Rating is the principal rating. It is comprised of two sub-ratings, 'Rewards' and 'Risks', with 70% and 30% weightings, respectively. The 'Rewards' rating is comprised of 'Industry Rewards' and 'Country Rewards', which have respective weightings of 65% and 35% and are based upon industry growth and size dynamics ('Industry') and the broader economic and socio-demographic environments ('Country'). The 'Risks' rating is comprised of 'Industry Risks' and 'Country Risk', each having a 50% weighting and based on subjective evaluation of industry regulatory and competitive issues ('Industry') and the industry's broader 'Country Risk' exposure ('Country'), which is based on BMI's proprietary 'Country Risk Ratings'. The ratings structure is aligned across the 14 industries for which BMI provides Business Environment Ratings methodology and is designed to enable clients to consider each rating individually or as a composite, the choice depending on their industry exposure in each state. For a list of data and indicators used, please consult the appendix at the back of this report. Source: BMI

Regional Overview

SUVs In Demand At Both Ends Of The Spectrum

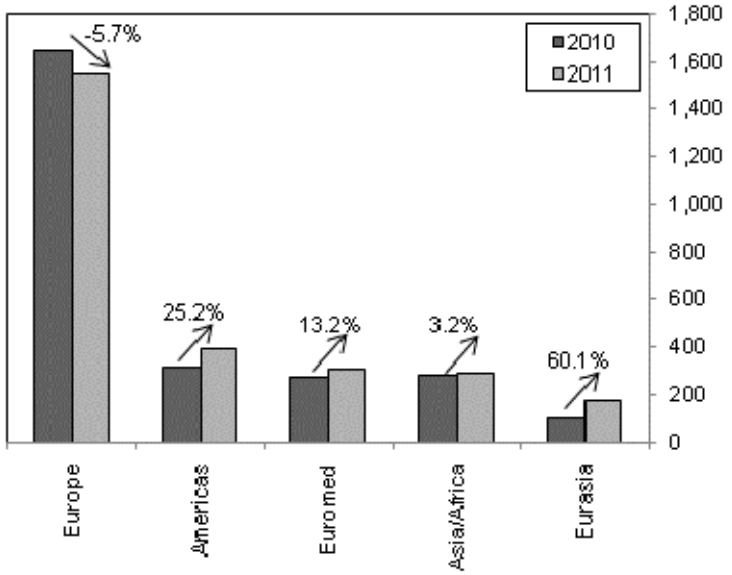
New product launches announced for the Middle East region in May support **BMI**'s view on the strength of the SUV segment, as well as our view that the volume brand segment is growing at an acceptance rate while the premium segment will maintain its position as a growth driver in the sector. Both **Audi** and **Renault** have launched compact SUVs and there is reason to believe that both will have a good chance of success.

Building on the popularity of its larger Q5 and Q7 SUVs, which accounted for 30% of the company's sales in the region in the first four months of 2012, Audi has launched its smaller Q3. According to **Audi Middle East**'s Managing Director Jeff Mannering, demand for the Q5 and Q7 still exceeds supply and the unit is negotiating with the plant responsible for a larger allocation for the region. By expanding the range to include a compact version, Audi is reaching out to a wider audience and Mannering believes the Q3 'will fare equally as well' as the Q5 and Q7.

New models are also an integral feature of Audi's growth strategy for the Middle East, which **BMI** has identified as a key region in the battle for leadership of the global premium market (*see 'Middle East Becomes Key Battleground In Audi's Global Leadership Campaign' January 10 2012 on our online service*). In 2011, Audi reported record sales of 7,865 units in its Middle East markets, up 26.8% year-on-year (y-o-y) to surpass its 25% growth target. According to the company's press release, this performance means Audi is now the fastest growing premium brand in the region. The Q7 becoming Audi's best-selling model in the region with sales of 1,588 units, while the slightly smaller Q5 led the compact SUV segment with sales of 1,218 units.

Imported Growth

Renault Vehicle Sales By Regions ('000 Units), 2010/2011



Source: Company Investor Relations

In the volume segment, Renault is looking to capture upsizing consumers in the Gulf Cooperation Council states with the new Duster SUV, developed by its Romanian subsidiary **Dacia**. It will enable consumers in the volume segment to access the practicality of an SUV, as it has been tested to cope with GCC driving conditions. However, according to a Renault press release, the model's selling point is its price. Renault GCC Managing Director Mustansir Lakdawala said the Duster takes into account: 'The needs of customers aiming to own a modern car as a badge of social progress.'

Renault's performance in the region over the last three years is evidence of the growing shift toward volume brands. The company has doubled its sales in each of the last three years, which Lakdawala said (speaking in 2011) is 'quite an improvement from Renault's record between 2005 and 2009'. Much of this growth has been attributed to frequent new launches, and the move to enter a growth segment such as SUVs promises to contribute to another year of strong growth.

Macroeconomic Forecast

Economy To Contract as Sanctions Bite

BMI View: *We project Iran's economy to contract by 1.6% and 0.3% in 2012 and 2013 respectively. Owing to international sanctions and a weaker rial, private consumption and investments will stay subdued, while exports will shrink.*

We forecast Iran's economy to contract by 1.6% and 0.3% in real terms in 2012 and 2013 respectively, down from our estimate of 0.9% growth in 2011. We expect EU and US sanctions to hinder the country's economic prospects, as hydrocarbon exports are disrupted and transaction costs for trade and investment rise. In addition, as the rial continues to weaken and consumer prices spike higher, private consumption and gross fixed capital formation are set to stay subdued. That said, government consumption is likely to grow moderately as the government seeks to maintain public support ahead of presidential elections in 2013, while imports will decrease owing in large part to the aforementioned collapse of the currency.

Private Consumption Outlook

Private consumption will be curbed by the ongoing depreciation of the rial as well as elevated inflation. While the currency was devalued by 8.0% in February, trading at IRR12,370/US$ in the official market, transactions in the black market took place at approximately IRR20,000/US$ in March, compared with IRR18,000/US$ in January. In addition, data from the Central Bank of Iran shows that headline inflation came in at 22.1% year-on-year (y-o-y) in November 2011, and we forecast it to come in at 26.0% in fiscal year 2012/13 (from 21 March 2012 to 20 March 2013). Several sources have recently reported Iranians increasingly exchanging the rial for gold or investing in the property market, indicating a widespread lack of confidence in the currency. We therefore forecast private consumption to grow 0.5% and 1.0% in 2012 and 2013 respectively.

Fixed Investment Outlook

International sanctions are expected to severely hinder gross capital formation in 2012. On March 17, the Society for Worldwide Interbank Financial Telecommunication, which manages the global communication system between financial institutions, disconnected 30 Iranian banks from its network in order to comply with EU sanctions. This will limit the ability of domestic firms to finance projects and to trade internationally. In addition, scarce domestic demand will disincentivise investment. Lower hydrocarbon revenues will limit the administration's ability to undertake large capital spending, and we think they will prioritise social spending ahead of presidential elections scheduled for June 2013. As a result, we project gross fixed capital formation to grow 0.5% and 1.0% in 2012 and 2013 respectively.

Government Spending Outlook

Sanctions will also reduce the government's fiscal coffers, as oil revenues account for half of government income. Moreover, we project lower tax revenues in 2012 owing to the subdued economic outlook. That said, the price of oil is projected at US$85/bbl in Iran's 2012 budget, while **BMI**'s Oil & Gas team sees

the OPEC oil basket averaging US$111.5/bbl, which will provide the government with some room for manoeuvre. Despite this difficult environment, the current administration will not refrain from spending on areas such as healthcare and services in order to boost its popularity ahead of the aforementioned elections. We therefore see government spending growing 3.0% and 2.0% in 2012 and 2013 respectively.

Net Exports Outlook

We forecast Iran's trade deficit to come in at IRR76,374bn and IRR51,325bn in 2012 and 2013 respectively, down from an estimated deficit of IRR121,814bn in 2011. As the rial loses value and sanctions limit the ability to pay foreign suppliers, we see imports falling by 12.0% and 6.0% in 2012 and 2013 respectively. Imports in manufactured products (which comprised 58.8% of total imports in 2010) will decrease considerably. Reports have already shown the impact this is having, with car dealers in Tehran saying that sales are down 25.0% in Q112 compared with Q111, while others have been unable to replenish stocks of US and European models for months as customers have been unable to finance their purchases. In terms of agricultural products (which comprised 14.5% of total imports in 2010) **BMI**'s Commodities team sees wheat imports trending lower in 2012 owing to a combination of increased domestic production, lower demand and the weight of international sanctions. In addition, according to **BMI**'s Pharmaceuticals & Healthcare team, sanctions are inhibiting the country's ability to pay for humanitarian goods such as medicines (see our online service, March 26, *'Financial Sanctions Create Gridlock For Pharmaceutical Import Agents*').

We forecast total exports to fall by 17.0% in 2012 and 10.0% in 2013 as sanctions curb hydrocarbon exports (which accounted for 85.0% of total exports in 2010). Tanker-tracker **PetroLogistics** sees international shipments at 1.9mn barrels a day (b/d) in March 2012, and an International Energy Agency (IEA) report estimates exports at 2.0mn b/d in February, which is 28.6% lower compared with November 2011. This is largely due to European and Asian refiners cutting back on shipments in preparation for sanctions, which the EU will implement by July 1; the IEA expects that Iranian shipments will fall by approximately 800,000-1,000,000 b/d as these take full effect, down from the average of 2.3mn b/d in 2011. Overall, **BMI**'s Oil & Gas team forecasts that Iran's oil exports will fall by 17.6% and 11.2% in 2012 and 2013 respectively.

Risks To The Outlook

We project real GDP growth to average 3.5% over the 2013-16 period, as we do not see sanctions being lifted anytime soon. Nonetheless, since Iran's political isolation has a significant influence on its economic prospects, changes to the international sanctions regime would alter our forecasts. On the other hand, the possible outbreak of a military conflict between Iran and the US and Israel represents a considerable downside risk. Although we do not expect US and/or Israeli military action in 2012, we cannot rule this possibility out entirely, and we cannot preclude air strikes beyond 2012. (see our online service March 8, *'US/Israeli Airstrikes Still Unlikely In 2012*').

Iran - Economic Activity, 2011-2016

	2011e	2012f	2013f	2014f	2015f	2016f
Nominal GDP, IRRbn [1,2]	5,310,029.4	6,270,894.4	7,519,210.8	9,005,226.5	10,639,778.0	12,325,439.3
Nominal GDP, US$bn [1,2]	498.6	583.3	645.4	818.7	967.3	1,130.8
Real GDP growth, % change y-o-y [1,2]	0.9	-1.6	-0.3	3.7	5.2	5.5
GDP per capita, US$ [1,2]	6,666	7,715	8,447	10,608	12,414	14,383
Population, mn [3]	74.8	75.6	76.4	77.2	77.9	78.6

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

Industry Forecast Scenario

Production And Sales

Table: Iran Automotive Industry Production

	2008	2009	2010	2011	2012f	2013f	2014f	2015f	2016f
Total sales (CBUs)	1,193,038	1,348,416	1,493,000	1,590,000	1,351,500	1,135,260	1,157,965	1,215,863	1,276,657
Total production (CBUs)	1,051,430	1,395,421	1,599,454	1,648,505	1,382,589	1,398,013	1,411,567	1,429,834	1,447,812
Cars production (CBUs)	940,870	1,359,520	1,367,014	1,413,276	1,201,285	1,207,998	1,213,899	1,221,850	1,229,676
Commercial Vehicles production (CBUs)	235,229	181,304	190,014	197,669	207,984	218,136	235,229	181,304	190,014

Source: Automotive News Europe, BMI estimates

The total vehicle output of automakers in Iran increased by 2.4% year-on-year (y-o-y) to 1.64mn in the Iranian year ended March 19 2012, reports inn.ir. However, **BMI** has revised down its production and sales estimates for Iran’s autos industry owing to the withdrawal of many international companies from the country in the wake of global sanctions against its nuclear efforts.

Iran's domestic autos industry, which has been becoming increasingly self-sufficient in the face of international sanctions, will face its biggest test after the recent withdrawal of a number of Western carmakers. Italian carmaker **Fiat** has suspended sales to Iran, Zawya reports. The company said this was to support 'the efforts of international diplomacy to find a diplomatic solution to the issues relating to Iran.' The group added that over the last few years sales to the country 'have not been significant'. Iran and six world powers have recently closed two days of nuclear talks with little to show for it, the report says.

A particular test for Iran is the withdrawal of **PSA Peugeot Citroen**. The Peugeot arm has been a key supplier of components for leading domestic firm **Iran Khodro** (IKCO), but has suspended supplies and may have to rethink its position completely, following its tie-up with **General Motors Company** (GM).

As GM is now a 7% stakeholder in PSA Peugeot Citroen, the implications of US sanctions against Iran will extend to the French carmaker's operations. The US lobby group United Against Nuclear Iran (UANI) has called for an end to Peugeot's involvement in Iran, where IKCO builds the Peugeot 206 and 405 models. GM claims that its partner had already suspended its supplies before the agreement was signed.

UANI launched its ‘Auto Campaign’ in March 2012, citing a **BMI** report looking at how the enforcement of economic sanctions on Iran has resulted in the country's government prioritising the development of a strong domestic auto industry. UANI says in recent months, both **Hyundai** and **Porsche** have ended their business in Iran in response to its campaigns.

UANI has since ramped up its campaign to get foreign automakers out of Iran. It says that Fiat, **Isuzu**, **Kia Motors**, **Mazda Motor**, **Mitsubishi Motors**, **Nissan Motor**, **Peugeot**, **Renault**, **Suzuki Motor**, **Toyota Motor** and **Volvo** either export to the Islamic Republic or have manufacturing agreements with car companies controlled by the regime.

Following the release of industry data in May indicating that new car production in Iran in April dropped 27% y-o-y, UANI CEO and ambassador Mark D. Wallace issued a statement saying: ‘The message is clear: responsible international auto companies will not continue to work in Iran. We call on all auto manufacturers – including Fiat, Mazda, Nissan, Renault, and Peugeot – to fully end their irresponsible business in Iran. We call on Congress to pass UANI’s DRIVE Act, which would require automakers to certify they are not engaged in any business in Iran to be eligible for US. government contracts.’

According to a Bloomberg report, in late May Ambassador Wallace testified about Iran’s automotive industry before the US House Foreign Affairs Committee. Ambassador Wallace called out Peugeot and its U.S. partner GM, saying ‘Peugeot right now is a major actor in Iran, a major manufacturer inside Iran in direct partnership with the IRGC.’ He said that, while Peugeot says it suspended its business with Iran until July, Iran produced more than 15,000 Peugeot vehicles in April. At the moment, we believe the suspension is revisited on a monthly basis.

IKCO has been scaling up its domestic production operations to limit the impact of sanctions, culminating in the development of a 'national car' (the Runna) and engines to power its own vehicles, including compressed natural gas (CNG) versions to improve the fuel-efficiency of its product range. In 2011, IKCO accounted for around half of the 1.6mn units produced by the Iranian autos industry in the first 11 months of the Iranian year, ending March 2012. Rather than being deterred by the sanctions, IKCO believes it can produce 860,000 units in the new Iranian year, and export 10% of its output.

Iran's second-largest carmaker, **SAIPA**, has also been preparing to limit its dependence on foreign partners. SAIPA has already been forced to adjust after the withdrawal of Korean partner **Kia Motors** in 2010. The two had enjoyed a successful assembly agreement, which saw the Pride become one of the country's most popular models, accounting for 30-40% of all cars on the road. However, in August 2010, Kia stopped exports of completely built units (CBUs), kits for assembly and spare parts to Iran. SAIPA has since opened what it claims is the Middle East's largest production plant in Kashan to build a domestic model.

It has taken a little longer for Kia's affiliate Hyundai Motor to end its Iranian operations, but it has now done so, according to the New York Times. Although UANI has been pressing the carmaker to cut its ties

since 2010, the group has only recently reclassified Hyundai as 'withdrawn' on its list of foreign businesses dealing with Iran. The report suggests that, in line with the US sanctions, foreign companies maintaining ties with Iran could face penalties in the US market. This would be a major incentive for Hyundai, which reported growth of 20% in US sales in 2011 and increased its market share from 4.6% to 5%.

It is not just the production side suffering from the sanctions, however. A government-imposed limit on foreign exchange, following a rush to convert rials to dollars in response to sanctions against the Central Bank, has pushed up the cost of buying foreign models, which are already in the country. Inventories are piling up and importers are no longer shipping models in as it is too expensive and clearing customs is taking too long.

Dealers say the price of imported cars has risen by around 20% in two months, with sales falling by a similar amount over the last year. As most of these imported cars are premium brands, it begs the question whether domestically-built cars would fill the void, even if they are more accessible.

Last quarter we estimated total sales of 2.4mn units in 2012, rising to 2.89mn at the end of our forecast period in 2016. We have since revised our historical data, which shows total sales of almost 1.6mn units in 2011, lower than we had originally believed. This lower base, coupled with a downward revision to take the effects of sanctions on both supplies and the economy into account, means that we now estimate total sales of 1.35mn units in 2012, a drop of 15%. By 2016 we forecast sales of just 1.27mn, as we expect the sector to struggle to return its domestic sales to positive growth before 2014. We estimate 1.4mn vehicles will be produced in Iran in 2012, a drop of over 16% y-o-y. However, we estimate annual production growth will average 1.16% in 2013 to 2016 as the leading carmakers look to exports to offset the turmoil at home.

Competitive Landscape

IKCO says it 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.

Iran exported 8,625 vehicles, worth US$44.2mn, to Iraq from March 21 2011 to October 22 2011. During the period, 934,972 vehicles were assembled at Iran's manufacturing facilities, an increase of 5.4% year-on-year (y-o-y), Zawya reports. The country also exported 40 vehicles to Benin and 116 vehicles to other countries during the eight-month period.

IKCO is keen to increase its presence in the emerging markets of Eastern Europe by boosting its exports to the region and extending its product portfolio. In particular, the company is considering shipping its Runna and Dena models to Ukraine, Zawya reports. In 2009, IKCO increased the annual production capacity of its facility in Belarus in order to cater to demand for its vehicles in Ukraine and Russia.

IKCO is aiming to triple its production capacity in Belarus, said IKCO’s deputy CEO in export and international affairs, Abdolazim Sadian, in November 2011. IKCO’s production line in Belarus capital Minsk was established under a joint venture agreement between IKCO and **Unison Co.** in 2006. IKCO aims to benefit from this site to export its cars to CIS countries.

After a visit to IKCO’s production lines, in December 2011 Cuban Vice-minister of Commerce Orlando Hernandez Guillen suggested Cuba is ready to set up an all-out bilateral cooperation with Iran, especially in the auto sector. He said interaction with IKCO would be a turning point in Cuban automotive industry. Hosting Hernandez during the visit, Abdolazim Sadian, Deputy CEO in export and international affairs, referred to the suitable existing cooperation between the two countries and hoped Iran and Cuba broaden their interaction in auto industry. Sadian believes that IKCO is able to revolutionise the auto industry in Cuba.

Exporting cars and spare parts could be a part of a bilateral cooperation between Iran and Cuba. IKCO would be able to supply the Cuban market based on its demands for gasoline, CNG and Diesel cars.

National Dual-Fuel Engine

Iran is now one of only 10 countries across the world to benefit from dual-fuel engine technology, reports Zawya. The country unveiled its national dual-fuel engine on November 28 2011, the first of its type to be developed by the country. It burns 20% petrol and 80% gas and took 18 months to develop.

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 is concentrating on boosting its automotive component production through research and development as well as design and engineering. The carmaker, which manufactures 94% of its car parts locally, says it is technically proficient and self-reliant in designing, as well as manufacturing car bodies and heavy dies. Meanwhile, IKCO will have to increase exports to strengthen its global position as the domestic market will soon be reaching saturation point. The export of automotive components has been a primary measure towards achieving global success, according to CEO Javad Najmeddin.

Political And Economic Instability

Political and economic instability in the country are risks to growth in the country. On November 30 2011 the UK government promised to take serious measures after its embassy in Tehran was attacked by hundreds of demonstrators. The Iranian parliament voted with a majority to reduce diplomatic ties with the UK, which came after the implementation of sanctions on Iranian banks by the UK Treasury on November 22.

Iran's controversial nuclear programme has raised concern among the world powers as they agree on a draft resolution on the matter to be discussed at a meeting of the International Atomic Energy Agency, the UN's nuclear watchdog. The draft resolution was formulated by Britain, China, France, Russia, the US and Germany on November 17 in Vienna. It expresses 'deep and increasing concern regarding the unresolved issues relating to the Iranian nuclear programme' (as quoted by media sources). The concerns come amid fears of 'possible military dimensions' to Iran's nuclear programme. **BMI** acknowledges that the risks of an Israeli attack on Iran are rising *(see our online service, 07 Nov 2011, 'Don't Underestimate War Risks').*

New Fuel Technologies

IKCO has confirmed plans to include micro and hybrid technology in its engine platforms, according to Zawya. The technology will allow the company to produce micro hybrid vehicles, with fuel efficient, environmentally friendly, stop-start technology.

IKCO's short-term goal was to have 75% of its fleet using fuel-efficient engines in 2011. IKCO's own plans to achieve this enhanced level of operation include employing 'the most modern technologies' to also improve the emission standards of its engines to achieve Euro IV and V levels and reduce fuel consumption to seven litres per 100km. As well as increasing production of the EF7 and TU5, other plans will see the engines using more local content by 2016.

IKCO continues with plans to improve fuel consumption across its range of vehicles. IKCO's Director for Standardisation, Kayvan Vaziri, was quoted in an April report by Iranian news agency Fars, that fuel mileage had fallen to 7.9l litres per 100km compared with an average of 8.86l/100km the previous year.

He hailed the development as evidence that Iranian produced vehicles were moving closer to international energy efficiency and conservation standards, ascribing the improvement to greater production of fuel efficient cars and the increased use of more fuel efficient engines like the TU5.

IKCO has announced that it is aiming to produce 700,000 TU5 and EF7 engines annually by 2014. Zawya reports that IKCO is set to expand its nanotechnology industry and design and produce more environmentally friendly diesel engines in the future. The planned expansion was listed in the company's 'Strategic Plan' report, which also details that the first EF7 engines will be fitted by Q211.

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 aims to begin mass production of diesel passenger cars by the end of 2011, and it is stepping up production of its alternative fuel engine, also known as the 'national engine'. About 60% of the automaker's product range will be fitted with the compressed natural gas (CNG) engine in the 2010-2011 Iranian year.

The number of CNG stations in Iran has reached 1,574 with the opening of 18 new stations in the country, according to data provided by **National Iranian Oil Products Distribution Company** (NIOPDC), reports Shana. The launch of the new stations has increased the country's CNG distribution capacity to 1.5mn cubic metres per hour.

BMI believes Iran will encounter little difficulty in becoming a dual-fuel market. CNG projects have been a key focus of the Iranian Fuel Conservation Organization (IFCO) that was established in 2000. There are also growing numbers of specifically produced CNG-fuelled vehicles on the roads, and IKCO in particular has been moving ahead with the manufacture of dual-fuel vehicles. Iran can turn to its ample natural gas reserves as a source of power for vehicles if petrol imports are sanctioned.

The University of Tehran produced the country's latest solar-powered car, the Ghazal 2, in April 2011. The mark 2 model is an upgraded version of the Ghazal 1 and is believed to be more aerodynamically advanced. It is made of carbon fibre, weighs just 150kg and is designed to reach a speed of 150km/ph.

Company News

IKCO intends to export 10,000 units of the Samand sedan to Russia by the end of 2012. 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.

We believe IKCO is likely to export 15,000 cars to Russia, Kazakhstan, Turkmenistan and Belarus by the end of the current Iranian calendar year, according to 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 will also unveil the country's first domestically made diesel car in 2012, Zawya reports. The car's diesel engine meets Euro V standard requirements and would be suitable for D-segment cars like Samand, Soren and Dena. The company intends to mass produce diesel passenger cars in less than two years.

In the supplier segment, Slovenian automotive component supplier Iskra Avtoelektrika sold its Iranian subsidiary Iskra Autoelectric Iran to a local investor in March 2012. The divestment was driven by the economic downturn, unstable business environment and weakening local currency in Iran. Furthermore, the EU sanctions on Iran have raised international pressure on the country. The financial details of the divestment were not disclosed.

Iran's local parts and components manufacturers face capacity constraints, which will mean greater reliance on foreign imports in car assembly. However, international sanctions on Iran over its nuclear programme are affecting the importation of parts, the future of joint ventures with foreign firms and Iran's export market in the Middle East.

Company Monitor

Record BMW Sales Reflect BMI Views

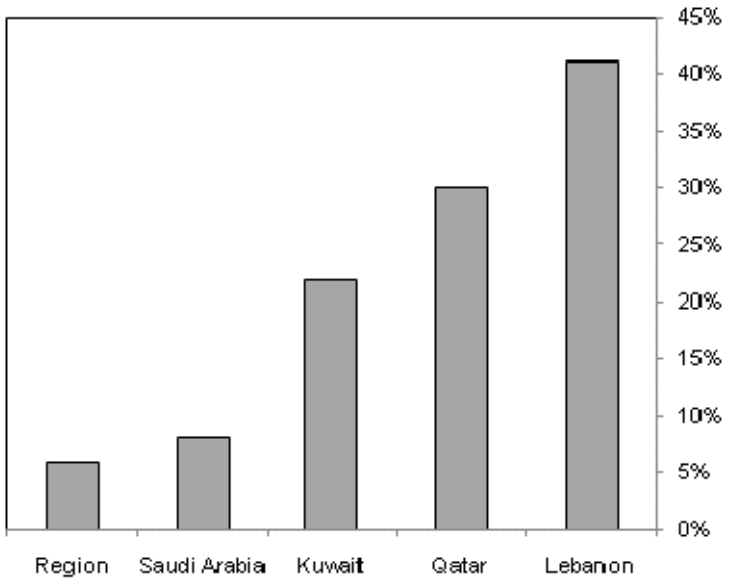
German premium carmaker **BMW** has reported record sales in the Middle East for Q112, while the breakdown of its results support a number of **BMI**'s views on the region from markets to product segments. The group's Mini brand also achieved record sales in the quarter as it continues to expand into new markets and add new models.

In line with our view that the UAE and Saudi Arabia remain favourites in terms of providing sales growth amid regional unrest, **BMW Group Middle East** reported that 51% of its sales came from the UAE, which remains its largest stand-alone market. Of the total 4,936 cars sold, the UAE accounted for 2,515, comprising 1,563 in Abu Dhabi and 952 in Dubai. In Saudi Arabia, sales rose by a steady, if not spectacular, 8% year-on-year (y-o-y). This still outperformed the group's regional growth for the quarter of 6%.

The strongest growth by market came from Lebanon where sales were up 41% y-o-y. BMW has capitalised on a good first quarter for Lebanese car sales in general, which grew 14% y-o-y. It has also outperformed the dominant Korean brands in growth terms, as market leader **Kia Motors** achieved growth of 27.1% and affiliate **Hyundai Motor** in second saw sales rise 11.3%. BMW also reported double-digit growth in Qatar (30%) and Kuwait (22%).

Lebanon Leads the Way

BMW Middle East Sales Growth By Market Q112 (% chg y-o-y)



Source: BMW

By model, BMW's best-seller was the X5 SUV, which accounted for 23% of its total group sales in the region with 1,138 units sold. This underlines our view on the sustained popularity of the segment in the Middle East. We have highlighted the segment as one of the key battle grounds for the three leading premium brands - BMW, **Mercedes-Benz** and **Audi** - as they compete both regionally and globally (*see 'SUVs Will Be Key To Sustained Mercedes Growth As Competition Hots Up' February 14 2012 on our online service*).

We also believe there is a growing acceptance of small cars in the region, however, and the Mini brand backed this up with a record first quarter. Sales rose 67% y-o-y to 351 units in nine markets in the region. The brand has sustained its momentum from 2011, when it posted the highest growth in its 11-year history in the region. If Mini continues to sell cars at the same pace as Q1, it is on course to beat that record of 1,108 units in 2012.

The main threat to the BMW group still comes from Mercedes-Benz, which intensified the SUV competition with the launch of its updated M-Class model at the end of March. The new SUV is part of the 'Year of the SUV' strategy, which will also see a new GL Class model arrive in the region in Q412.

Company Profiles

Iran Khodro Company (IKCO)

Overview

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 began production of three new Samand models for the Iranian market in April 2005. Replacing the Paykan, which ceased production at the end of March, the Samand is aimed at the mass market and for export to other Middle Eastern states.

In 2006, the company launched a new-generation Samand, the Peugeot 307 sedan, a 4x4 JV car with Suzuki Motor, and the New Paykan budget-car based on the Peugeot 206 platform.

However, controversy continues to linger over the production of the Renault Logan, codenamed L-90, which the government of President Ahmadinejad fears could undermine the success of the New Paykan, intended to be a 'national car' designed and produced in Iran.

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. In April 2009, the automaker revealed a brand new, domestically produced model, the Runna.

Strategy News

IKCO intends to export 10,000 units of the Samand sedan to Russia by the end of 2012. 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.

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IKCO will unveil the country's first domestically made diesel car in 2012, Zawya reports. The car's diesel engine meets Euro V standard requirements and would be suitable for D-segment cars like Samand, Soren and Dena. The company intends to mass produce diesel passenger cars in less than two years. Iran produced 1.6mn vehicles in 2011, about half of them made by Iran Khodro, which aims to export around 10% of its production in 2012, according to Reuters.

IKCO’s Fars branch plans to increase production to five units an hour, up from one car an hour currently, Payvand reports. In line with the government's policy to decentralise industry, IKCO has begun establishing production sites throughout the country. The Fars branch is IKCO's fifth local production site, with a total investment of almost US$60mn.

The opening of a new plant in Tabriz, north eastern Iran capable of producing 200,000 Peugeot 206 units a year is planned for 2012.

IKCO will manufacture 70,000 self-developed engines by the end of the Iranian calendar year, ending March 20 2012, the company reported in January 2012. IKCO is aiming to achieve maximum fuel economy of its vehicle range through production of the engines. The carmaker is targeting engine output of 180,000 units in 2012, with CNG-based engines accounting for 70% of the total output, according to Quality and Product Development Vice President Mir Javad Soleimani. Meanwhile, IKCO plans to equip most of its cars with the TU5 and EF7 fuel-efficient engines.

The short-term goal for IKCO was to have 75% of its fleet using fuel-efficient engines in 2011. Apart from increasing production of the EF7 and TU5 engines, other plans will see the engines using more local content by 2016. IKCO's range of domestically designed and produced vehicles and engines were intended to make the company more self-sufficient in the wake of international

sanctions. The EF4 engine will be the third in IKCO's 'national engine' range. IKCO has announced that it is aiming to produce 700,000 TU5 and EF7 engines annually by 2014.

IKCO will launch its Runna sedan in the Middle East, Russia, Turkey, Africa, South America and Iran in May 2012, it reported in January 2012. The firm is planning to manufacture 50,000 units in 2012, with annual production expected to eventually reach up to 200,000 units, according to the deputy CEO in strategy and planning at IKCO, Hamid Reza Taghavinejad. The Euro IV compliant sedan has cleared the first pre-production phase, while the second phase was planned to start in late January 2012. Mass production of IKCO's second 'national' car is scheduled to begin in May 2012.

IKCO outlined a detailed plan to be implemented over a period of seven years in July 2011, according to CEO and President Javad Najmeddin. He added that the plan involves designing and manufacturing two new platforms and 11 new cars. The carmaker also 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 confirmed the plans in May 2011, revealing that the launches would be in place by 2018. The company will dedicate 3% of sales to research and development in order to build the C and D segment vehicles. Mass production of Iran's first domestically made vehicle, the Dena sedan from ICKO, is set to commence in March 2012.

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. The company also outlined a detailed plan to boost product quality in July 2011, as well as to revamp current vehicle platforms and design new ones,

IKCO aimed to begin mass production of diesel passenger cars by the end of 2011, and it is also stepping up production its alternative fuel engine, also known as the 'National Engine'. About 60% of the automaker’s product range will be fitted with the compressed natural gas (CNG) engine in the 2010-2011 Iranian year.

IKCO got a new leader in April 2009. Iran replaced managing director Manouchehr Manteghi, who helmed the automaker for six years, with Javad Najmuddin, Reuters reported. The wire agency, citing local media, said the replacement of Manteghi was related to the decline in IKCO’s market share and an unprofitable attempt to develop a foothold outside of Iran.

Financial Results

Iranian car manufacturers produced 1.648mn cars in 2011, making the country number 13th in the world in terms of production, according to report by the International Organization of Motor Vehicle Manufacturers, as reported by the Fars news agency. About half of these vehicles were sold by IKCO.

IKCO was selected as Iran's top company in the 14th Conference of Iran's 100 Top Companies (IMI 100) in February 2012. KCO ranked first among Iran's 400 top companies for the second year in a row after selling US$11.8bn of products in 2010, US$100m more than 2009. It produced around 760,000 vehicles in 2010. IKCO's Supplying Automotive Parts Co. was ranked fourth largest, with US$7bn of sales in 2010.

In November 2011, IKCO broke previous monthly production records, Zawya reports, when it made 75,871 vehicles. It has produced a total of 449,179 units since March 21 2011. Total auto

production is likely to be further boosted by IKCO's February announcement of the production plans for its second 'national car', the Runna. The Runna forms one of the central planks in IKCO's ambitious export plans.

Key Statistics

- Year established: 1963

Saipa Diesel

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' 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. As of 2005, Saipa Diesel had an annual HCV manufacturing capacity of 15,000 units and was working at over 90% capacity.

The company exported its first trucks to South Africa in 2009. Models that were exported included the FM, FH440, and FM 6x4 trucks. The firm plans to increase truck exports to Angola in the near future. Iraq remains one of the country's main target markets with exports to Iraq totalling US$8mnn in 2008. New export markets for the company include Algeria, Ukraine, Yemen, Turkmenistan, and Azerbaijan.

Key Statistics

- Year established: 1963
- Employees: 1,727 (2008-2009)

Societe Annonyme Iranienne de Production Automobile (Saipa)

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.

Financial Results

Saipa was Iran's biggest automaker in the 2009-2010 year, according to official data cited by local press. Saipa accounted for 54% of total vehicle output in 2009. However the company was supplanted as Iran' biggest produced by Iran Khodro in 2010-2011. Saipa produced 548,119 cars in the nine months to December 2010, with just 0.4% year-on-year growth to 154,142 units in Q111.

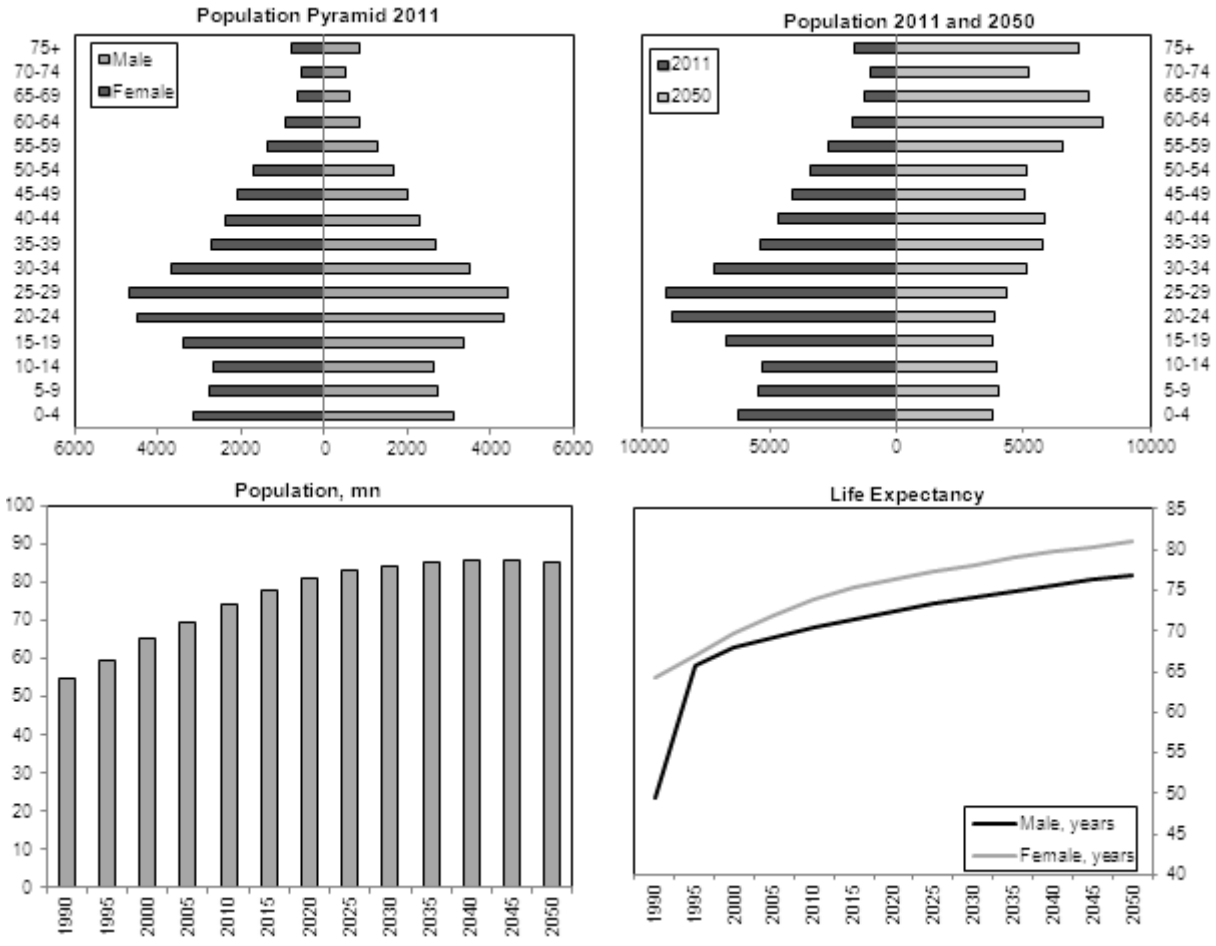
Key Statistics

- Year established: 1966

Country Snapshot: Iran Demographic Data

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 2011, the change in the structure of the population between 2011 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.



Source: World Bank, UN, BMI

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

	1990	1995	2000	2005	2010	2012f	2015f	2020f
Total	54,871	59,757	65,342	69,732	73,974	75,612	77,914	81,045
0-4 years	9,190	7,592	6,335	5,426	6,149	6,269	5,955	5,262
5-9 years	8,751	8,935	7,588	5,493	5,357	5,603	6,088	5,926
10-14 years	7,135	8,691	8,938	7,190	5,466	5,225	5,333	6,077
15-19 years	5,669	6,834	8,657	9,204	7,146	6,308	5,432	5,314
20-24 years	4,583	5,259	6,894	9,000	9,107	8,436	7,076	5,389
25-29 years	3,874	4,391	5,369	6,821	8,899	9,248	9,022	7,010
30-34 years	3,317	3,760	4,412	5,256	6,754	7,643	8,831	8,947
35-39 years	2,765	3,211	3,751	4,663	5,203	5,667	6,699	8,756
40-44 years	2,047	2,659	3,196	4,034	4,607	4,770	5,148	6,632
45-49 years	1,589	1,922	2,635	3,346	3,966	4,203	4,539	5,080
50-54 years	1,492	1,472	1,901	2,628	3,262	3,505	3,878	4,448
55-59 years	1,416	1,382	1,437	1,739	2,536	2,801	3,158	3,764
60-64 years	1,164	1,295	1,311	1,342	1,654	1,932	2,420	3,021
65-69 years	936	1,016	1,168	1,242	1,229	1,290	1,526	2,240
70-74 years	503	758	853	1,079	1,066	1,043	1,066	1,332
75+ years	439	579	898	1,269	1,574	1,669	1,744	1,846

f = BMI forecast. Source: World Bank, UN, BMI

Iran's Population By Age Group, 1990-2020 (% of total)								
	1990	**1995**	**2000**	**2005**	**2010**	**2012f**	**2015f**	**2020f**
0-4 years	16.75	12.70	9.70	7.78	8.31	8.29	7.64	6.49
5-9 years	15.95	14.95	11.61	7.88	7.24	7.41	7.81	7.31
10-14 years	13.00	14.54	13.68	10.31	7.39	6.91	6.84	7.50
15-19 years	10.33	11.44	13.25	13.20	9.66	8.34	6.97	6.56
20-24 years	8.35	8.80	10.55	12.91	12.31	11.16	9.08	6.65
25-29 years	7.06	7.35	8.22	9.78	12.03	12.23	11.58	8.65
30-34 yyears	6.05	6.29	6.75	7.54	9.13	10.11	11.33	11.04
35-39 years	5.04	5.37	5.74	6.69	7.03	7.49	8.60	10.80
40-44 years	3.73	4.45	4.89	5.78	6.23	6.31	6.61	8.18
45-49 years	2.90	3.22	4.03	4.80	5.36	5.56	5.83	6.27
50-54 years	2.72	2.46	2.91	3.77	4.41	4.64	4.98	5.49
55-59 years	2.58	2.31	2.20	2.49	3.43	3.70	4.05	4.64
60-64 years	2.12	2.17	2.01	1.92	2.24	2.55	3.11	3.73
65-69 years	1.71	1.70	1.79	1.78	1.66	1.71	1.96	2.76
70-74 years	0.92	1.27	1.31	1.55	1.44	1.38	1.37	1.64
75+ years	0.80	0.97	1.37	1.82	2.13	2.21	2.24	2.28

f = BMI forecast. Source: World Bank, UN, BMI

Iran's Key Population Ratios, 1990-2020

	1990	1995	2000	2005	2010	2012f	2015f	2020f
Dependent ratio, % of total working age [1]	96.6	85.7	65.2	45.2	39.2	38.7	38.6	38.9
Dependent population, total, '000 [2]	26,954	27,572	25,779	21,699	20,842	21,101	21,712	22,684
Active population, % of total [3]	50.9	53.9	60.5	68.9	71.8	72.1	72.1	72.0
Active population, total, '000 [4]	27,917	32,186	39,563	48,033	53,132	54,511	56,202	58,361
Youth population, % of total working age [5]	89.8	78.4	57.8	37.7	31.9	31.4	30.9	29.6
Youth population, total, '000 [6]	25,075	25,219	22,861	18,110	16,972	17,098	17,376	17,265
Pensionable population, % of total working age [7]	6.7	7.3	7.4	7.5	7.3	7.3	7.7	9.3
Pensionable population, '000 [8]	1,878	2,353	2,918	3,589	3,869	4,003	4,336	5,419

f = BMI forecast; [1] 0>15 plus 65+, as % of total working age population; [2] 0>15 plus 65+; [3] 15-64, as % of total population; [4] 15-64; [5] 0>15, % of total working age population; [6] 0>15; [7] 65+, % of total working age population; [8] 65+.
Source: World Bank, UN, BMI

Iran's Rural And Urban Population, 1990-2020

	1990	1995	2000	2005	2010	2012	2015	2020
Urban population, % of total	56.3	60.2	64.2	66.9	69.4	70.3	71.7	73.8
Rural population, % of total	43.7	39.8	35.8	33.1	30.6	29.7	28.3	26.2
Urban population, '000	30,627.2	35,490.3	41,048.6	46,219.3	51,337.7	53,170.2	55,864.0	59,811.2
Rural population, '000	23,772.8	23,463.7	22,890.0	22,867.8	22,635.9	22,441.6	22,049.5	21,233.8

Source: World Bank, UN, BMI

BMI Methodology

How We Generate Our Forecasting Model

BMI's industry forecasts are generated using the best-practice techniques of time-series 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. **BMI** mainly uses OLS estimators, and in order to avoid relying on subjective views and encourage the use of objective views, opts for a 'general-to-specific' method. **BMI** mainly uses 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 a deep industry recession, dummy variables are used to determine the level of impact.

Effective forecasting depends on appropriately selected regression models. **BMI** selects the best model according to various 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)
- Assessing all results to alleviate issues related to auto-correlation and multi-co-linearity.

BMI uses the selected best model to perform forecasting.

It must be remembered that human intervention plays a necessary and desirable role in all of **BMI**'s industry forecasting. Experience, expertise and knowledge of industry data and trends ensures that analysts spot structural breaks, anomalous data, turning points and seasonal features where a purely mechanical forecasting process would not.

Within the Automotive industry, this intervention might include, but is not exclusive to: significant company expansion plans; new product development that might influence pricing levels; dramatic changes in local production levels; product taxation; the regulatory environment and specific areas of legislation; changes in lifestyles and general societal trends; the formation of bilateral and multilateral trading agreements and negotiations; political factors, including trade; and the development of the industry in neighbouring markets that are potential competitors for foreign direct investment.

Example of Vehicle Sales Model:

$$(\text{Vehicle Sales})_t = \beta_0 + \beta_1*(\text{GDP})_t + \beta_2*(\text{Population})_t + \beta_3*(\text{Inflation})_t + \beta_4*(\text{Lending Rate})_t + \beta_5* (\text{Foreign Exchange Rate})_t + \beta_6*(\text{Government Expenditure})_t + \beta_7*(\text{Vehicle Sales})_{t-1} + \varepsilon_t$$

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.