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BMI Industry View

The main political news affecting the Iranian auto industry over the past quarter was the announcement on November 24 2014 that there has been an extension to the deadline for a 'permanent' agreement to be reached on the Islamic Republic's nuclear programme- which aims to ensure that Iran cannot use its enrichment activities to produce a nuclear weapon before the West can intervene - until June 30 2015. During this extension period to the ongoing talks between Iran and the P5+1 countries (the US, Russia, China, France, Britain and Germany), Iran will continue to receive approximately USD700mn per month from its frozen accounts, although key international sanctions on its energy and banking sector will remain in place.

BMI's Country Risk team believes that the talks will be protracted, with risks tilted slightly to the downside. Overall, we believe that a solution to the nuclear issue will not be found by June 30, as political constraints will prevent both Iranian and US negotiators from making the significant concessions necessary to bridge existing technical obstacles to a deal. That said, a complete breakdown in talks is also unlikely in June, as the costs would be immense.

Our core view therefore remains that talks will continue over the next two years through a series of partial deals and extensions. Following June 2015, we believe that a form of face-saving, partial agreement will be reached, which will allow for further talks. Sanctions will be somewhat eased, but key measures targeting Iran's oil and banking sector will remain in place. Beyond a two-year timeframe, talks will be influenced by decisions of future political leaders, and their direction is harder to decipher. Political obstacles to a final agreement will remain substantial, and we believe that risks of reaching a final agreement over the coming decade are tilted slightly to the downside.

It is clear that there is strong demand for new vehicles from the Iranian population at present. As such, the potential for improved foreign relations between Iran and the West over the short to medium term has generated considerable interest from carmakers, none more so than French brands Renault and Peugeot, which controlled around a third of the market's output before they withdrew in early 2012 in line with Western sanctions. Indeed, it appears likely that Peugeot will seek some sort of deal with previous partner **Iran Khodro,** while Renault is presently in talks with **Saipa** about buying an equity stake in its **Pars Khodro** subsidiary.

In this context, shortly after the news that the deadline for a permanent deal had been extended, AFP reported that French carmaker **PSA Peugeot Citroën** is engaged in talks to resume production in Iran, according to the company's operations director for the Middle East, Jean Christophe Quemard. Speaking in Tehran on December 1, Quemard said: 'We are in intense discussions. We have a long relationship with Iran. We have the strong will to create a joint venture covering the entire automotive chain as soon as possible'.

However, since the withdrawal of foreign carmakers in 2012, the Iranians have changed the parameters for proposed joint ventures. In November 2014, media reports cited comments from deputy industry minister Mohammed Reza Norouzzadeh, who stated that 40% of any joint venture auto production must be undertaken by domestic manufacturers, rising to 85% over five years. There are also reported that foreign cars are no longer to be imported on a completely built up (CBU) basis.

Part of the reason for these new conditions is to ensure a viable domestic auto production sector. In this context, Iranian car production in Iran totalled 455,000 units in H114, according to a report by the Trend New Agency. Domestic carmakers expect production to reach 1.2mn units by end-2014, IRIB reported on September 29, citing deputy industry minister Norouzzadeh.

Given this strong start to the current calendar year, and the short-term stability provided by the agreed extension to the nuclear talks, **BMI** has made another upward revision to its 2014/15 production forecast for Iran. We are now targeting 67.6% growth in vehicle output, to reach 1.1,mn units.

Iranian new vehicle sales have been racing ahead over 2014 year-to-date, with the Focus2Move website reporting that new vehicle sales were up by 23% over H114, at 394,463 units. For the full 2014/15 calendar year, **BMI** is targeting a strengthening of growth, to 55%. Beyond the current year, we target further growth, of 38%, which should take annual sales to the 1.76mn mark by 2018.

Looking at the most recent sales data by brand (for H114), **Saipa** remains the dominant player on the Iranian new car sales market, although second-placed **Peugeot** is closing the gap.

Over H114, Saipa sold 138,577 units for a share of 35.1%, according to information on the Focus2Move website. Peugeot sold 121,176 units for a share of 30.7%, with **Iran Khodro** in third place on 54,887 units (13.9% share). All told the Top 3 carmakers account for almost 80% of the new car sales market.

Further down the Top 10 chart, of note is the increasing market share being taken by the two Korean carmakers **Hyundai** and **Kia,** as well as the presence of three Chinese carmakers (**Chery**, **Geely** and **Lifan**). Lastly, Toyota's 10th position within Iran is a far cry from its No 1 position in many of the world's markets and **BMI** would expect the Japanese giant to continue making inroads into the Iranian market over the coming years.

SWOT

Iran Auto Industry SWOT

Strengths	▪ The largest car-producing nation in the Middle East. ▪ Domestically developed engines, as well as vehicles, reduce the country's reliance on imports. ▪ Growing middle class should provide high demand for new cars over the medium term. ▪ New car sales and production both look set for strong growth over 2014/15. ▪ BMI is forecasting steady growth in new car sales over the forecast period to 2018.
Weaknesses	▪ Local parts and components manufacturers face capacity constraints, which will mean greater reliance on foreign imports in car assembly. ▪ Iran is insisting on tough new preconditions before allowing foreign carmakers back into the country, which could deter some inward investment.
Opportunities	▪ Should a permanent deal on Iran's nuclear programme be reached and sanctions ended, then we would expect the domestic economy to grow rapidly over the medium term, which in turn would boost demand for new cars.Moreover, any permanent deal would increase Iran's attractiveness to foreign manufacturers, as it potentially offers a significant new market. ▪ As Iran's car sector grows, it will increasingly rely on outsourcing for parts and components. ▪ Agreements with Chinese manufacturers bring new business partnerships and uses for capacity. ▪ Domestic manufacturers are also looking to boost exports over the coming years.
Threats	▪ Should talks between Iran and the West collapse in 2014, then the country would remain subject to US trade sanctions, which would continue to cut the country off from international investment.

Iran Auto Industry SWOT - Continued

- Political instability remains a key concern for the whole Iranian economy.

Political

Political SWOT Analysis

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 former president Mahmoud Ahmadinejad accountable for his handling of the economy in March 2012 is a positive indication that checks exist. ▪ The victory of moderate cleric Hassan Rouhani in Presidential elections in June 2013 is leading to a significant improvement in relations with the West.
Threats	▪ Despite progress in nuclear talks, the prospect of further US and EU sanctions and the possibility of a military strike by the US or Israel cannot be dismissed. ▪ Youth unemployment is high. ▪ The strong influence of the Revolutionary Guards within the political and economic arena may present a challenge to reform over the long term.

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Economic

Economic SWOT Analysis

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. ▪ 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, provides 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. ▪ Capital flight could continue, particularly should negotiations on the nuclear programme fail.

Industry Forecast

Table: Autos Total Market - Historical Data And Forecasts (Iran 2012-2018)

	2012	2013	2014f	2015f	2016f	2017f	2018f
Vehicle production, units	993,856	643,320	1,078,492	1,277,377	1,572,430	1,729,354	1,886,749
Vehicle production, units, % y-o-y	-39.7	-35.3	67.6	18.4	23.1	10.0	9.1
Vehicle sales, units	1,030,995	711,000	1,102,050	1,278,378	1,470,134	1,602,446	1,762,691
Vehicle sales, units, % y-o-y	-35.2	-31.0	55.0	16.0	15.0	9.0	10.0
Vehicle fleet, units	11,920,000	10,507,557	10,766,031	10,970,846	11,227,117	11,583,442	12,009,252
Vehicle fleet, % y-o-y	8.4	-11.8	2.5	1.9	2.3	3.2	3.7
Vehicles per 1,000 of population	156.0	135.7	137.2	138.0	139.5	142.3	145.8

National Sources/BMI

Table: Passenger Car Market - Historical Data And Forecasts (Iran 2012-2018)

	2012	2013	2014f	2015f	2016f	2017f	2018f
Passenger car production, units	871,997	538,170	941,797	1,130,157	1,412,696	1,553,965	1,693,822
Passenger car production, units, % y-o-y	-38.3	-38.3	75.0	20.0	25.0	10.0	9.0
Passenger car sales, units	1,030,995	711,000	1,102,050	1,278,378	1,470,134	1,602,446	1,762,691
Passenger car sales, units, % y-o-y	-35.2	-31.0	55.0	16.0	15.0	9.0	10.0
Passenger car fleet, units	10,620,000	9,471,078	9,694,073	9,870,774	10,091,869	10,399,283	10,766,644
Passenger car fleet, % y-o-y	8.4	-10.8	2.4	1.8	2.2	3.0	3.5
Passenger cars per 1,000 of population	139.0	122.3	123.5	124.2	125.4	127.7	130.7

National Sources/BMI

Table: Commercial Vehicle Market - Historical Data And Forecasts (Iran 2012-2018)

	2012	2013	2014f	2015f	2016f	2017f	2018f
Commercial vehicle production, units	143,162	113,041	145,576	156,534	169,301	185,334	203,761
Commercial vehicles production, units, % y-o-y	-39.1	-21.0	28.8	7.5	8.2	9.5	9.9
Heavy truck production, units	20,172	7,441	8,557	8,973	9,193	9,534	10,365
Heavy truck production, units, % y-o-y	-40.3	-63.1	15.0	4.9	2.4	3.7	8.7
Bus and coach production, units	1,131	450	324	340	374	411	469
Bus and coach production, units, % y-o-y	-58.2	-60.2	-28.0	5.0	10.0	10.0	14.0

National Sources/BMI

Production

The main political news affecting the Iranian auto industry over the past quarter was the announcement on November 24 2014 that there has been an extension to the deadline for a 'permanent' agreement to be reached on the Islamic Republic's nuclear programme- which aims to ensure that Iran cannot use its enrichment activities to produce a nuclear weapon before the West can intervene - until June 30 2015. During this extension period to the ongoing talks between Iran and the P5+1 countries (the US, Russia, China, France, Britain and Germany), Iran will continue to receive approximately USD700mn a month from its frozen accounts, although key international sanctions on its energy and banking sector will remain in place.

BMI's Country Risk team believes that the talks will be protracted, with risks tilted slightly to the downside. Overall, we believe that a solution to the nuclear issue will not be found by June 30, as political constraints will prevent both Iranian and US negotiators from making the significant concessions necessary to bridge existing technical obstacles to a deal. In the US, Republicans won a majority in the US Senate in mid-term elections at the beginning of November. The Republican-controlled Congress will convene in January, and lawmakers are already promising an aggressive package of sanctions. As a result, room for concessions to the Iranians will be limited for US negotiators.

In Iran, hardliners have in recent months regained some of the influence they lost following moderate cleric Hassan Rouhani's victory in presidential elections in June 2013. In a sign that the current administration is increasingly under fire by the conservatives, parliament rejected Rouhani's fourth nominee for the sensitive Minister of Higher Education on November 18, with the post being held by a caretaker since August 2014. Lower oil prices in 2015 also pose a challenge to nuclear talks. Support for Rouhani, whose popularity rests on his ability to improve the economic situation, will in our view decline as low crude prices hit Iran's economy, reducing his ability to resist pressure for a more hawkish posturing vis-a-vis the West.

That said, a complete breakdown in talks is unlikely in June, as the costs would be immense. The US would have to face another major crisis in the Middle East at a time when it is grappling with the Islamic State's takeover of much of Syria and Iraq, and risks of terrorist attack on domestic soil have increased. A failure in diplomacy would also result in a significant intensification of international sanctions against Iran, leading to a dramatic worsening of the economic situation. This would prove highly risky for the ruling elite, and Iranian conservatives would prefer to see a continuation of talks rather than an abrupt end to diplomacy. In taking an incremental approach, the Iranians would still get partial sanctions relief, while preserving the long-term option of ramping up the nuclear programme.

Our core view remains that talks will continue over the next two years through a series of partial deals and extensions. Following June 2015, we believe that a form of face-saving, partial agreement will be reached, which will allow for further talks. Sanctions will be somewhat eased, but key measures targeting Iran's oil and banking sector will remain in place. Beyond a two-year timeframe, talks will be influenced by decisions of future political leaders, and their direction is harder to decipher. Political obstacles to a final agreement will remain substantial, and we believe that risks of reaching a final agreement over the coming decade are tilted slightly to the downside.

Turning away from the political backdrop, it is clear that there is strong demand for new vehicles from the Iranian population at present. As such, the potential for improved foreign relations between Iran and the West over the short to medium term has generated considerable interest from carmakers, none more so than French brands Renault and Peugeot, which controlled around a third of the market's output before they withdrew in early 2012 in line with Western sanctions. Indeed, it appears likely that Peugeot will seek some sort of deal with previous partner **Iran Khodro,** while Renault is presently in talks with **Saipa** about buying an equity stake in its **Pars Khodro** subsidiary (*see Saipa company profile for more information*).

In this context, shortly after the news that the deadline for a permanent deal has been extended, AFP reported that French carmaker **PSA Peugeot Citroën** is engaged in talks to resume production in Iran, according to the company's operations director for the Middle East, Jean Christophe Quemard. Speaking in Tehran on December 1, Quemard said: 'We are in intense discussions. We have a long relationship with Iran. We have the strong will to create a joint venture covering the entire automotive chain as soon as possible.'

However, since the withdrawal of foreign carmakers in 2012, the Iranians have changed the parameters for proposed joint ventures. In November 2014, media reports cited comments from deputy industry minister Mohammed Reza Norouzzadeh, who stated that 40% of any joint venture auto production must be undertaken by domestic manufacturers, rising to 85% over five years. There are also reported that foreign cars are no longer to be imported on a completely built up (CBU) basis.

Part of the reason for these new conditions is to ensure a viable domestic auto production sector. In this context, Iranian car production in Iran totalled 455,000 units in H114, according to a report by the Trend New Agency. Domestic carmakers expect production to reach 1.2mn units by end-2014, IRIB reported on September 29, citing deputy industry minister Norouzzadeh.

Given this strong start to the current calendar year, and the short-term stability provided by the agreed extension to the nuclear talks, **BMI** has made another upward revision to its 2014/15 production forecast for Iran. We are now targeting 67.6% growth in vehicle output, to reach 1.08mn units.

Renault's commitment to re-entering the Iranian market has been evident in its recent global restructuring, which has seen its Asia Pacific division, which previously encompassed 48 countries, divided into 'Asia Pacific' and 'Middle East and India'. One of the key areas of focus laid out for the Middle East and India division is to restart operations in Iran. Under the reported agreement between Renault and IKCO, the Iranian carmaker will produce the Clio 4 and Capture.

Similarly, IKCO will produce two new Peugeot models under its agreement with PSA, the 301 and 2008. The companies will take equal shares in the joint venture, suggesting IKCO may get some of the technology transfer it set out as a condition for co-operation back in May (*see below*), although full terms of the partnership have not been released.

Some advantage through domestic production will be useful as the market becomes increasingly open to foreign brands. In the first quarter of the Iranian calendar year, which started March 2014, the country imported around 23,000 cars, compared with 4,000 in the same period of the previous year. The government has also pledged to remove all import tariffs on cars within two years and has already dropped the tariffs on hybrid and electric vehicles as it looks to improve the competitiveness of the domestic industry. Having foreign firms producing and co-operating with national carmakers will also contribute to this goal in the longer term, although how quickly this can be achieved will depend on the progress of the nuclear negotiations.

As well as the interest from France, Austria also appears ready to invest in the Iranian auto sector. In August 2014, the Fars News Agency reported that Austria intends to establish a car manufacturing plant as well as assembly lines in the Iranian city of Tabriz, according to a statement by Austrian Ambassador in Tehran Friedrich Stift. 'We have had talks with auto parts manufacturers on launching complete production lines to manufacture cars in Tabriz,' said Stift, adding that the move is in line with the Austrian government's readiness to collaborate with Iranian enterprises in different sectors.

In May 2014, it was reported that Iranian automakers will require USD2bn in order to achieve the production target for the current Iranian calendar year, according to Mohammad Reza Najafimanesh, a member of the board of directors of the association of Iranian car part makers. Najafimanesh said: 'The Ministry of Industry, Mines and Trade has set a production target of 1.3mn cars by the end of the current year.' Official statistics have revealed that car production in the country decreased 20.2% in the previous Iranian calendar year. According to a Financial Times report published in March hundreds of auto parts manufacturers in the country became bankrupt or moved to other business areas following the imposition of sanctions on Iran's trade by the US and EU.

In May 2014, IKCO reportedly set out a number of conditions for returning to a partnership with French carmaker **Peugeot**, following a meeting between the bosses of the two companies, which **BMI** believes shows mutual needs within the industry. Peugeot and its compatriot Renault have both racked up significant losses following their withdrawal from Iran, thereby reflecting the significance of the Iranian market. However, IKCO's demands for greater investment in technology transfer and research and development (R&D) facilities show where the national industry is lacking.

IKCO managing director Hashem Yekkeh Zare said that Peugeot should end its own assembly operations and focus on joint production with the Iranian carmaker, including transferring its technology and setting up local R&D facilities. Zare said IKCO will only consider resuming its relationship if these conditions are met.

While these are significant demands, IKCO also knows how much the market means to Peugeot. After withdrawing from Iran, **PSA Peugeot Citroen** CFO Jean-Baptiste de Chatillon said the company had been losing EUR10mn (USD153mn) a month. Iran is the Middle East's biggest car market in sales volume-terms and stood at 1.6mn units in 2011 before the decline began and sanctions were stepped up. At that time, Peugeot and Renault combined accounted for one-third of total output.

Also in June 2014, ISNA reported that Japanese automaker Suzuki Motor is in discussions with Iranian carmaker **Iran Khodro** to launch a new car production line in Iran, according to Abdollah Babaee, director of marketing and sales at Iran Khodro. The discussions come after Iran, the US, France and four other countries entered an agreement in late 2013, under which the Iranian government will decrease its nuclear activities in exchange for some sanctions relief. Iran's Industry Minister Mohammad Reza Nematzadeh said: 'The foreign firms are very eager to establish ties with Iranian auto manufacturers and we intend to help further develop the country's auto industry through such interactions,' reports Trend News Agency.

In a further encouraging development, in December 2013, it was reported that more than USD1bn in foreign direct investment has been approved for Iran's automotive manufacturing industry, according to the head of the Organisation for Investment, Economic and Technical Assistance of Iran, Behrouz Alishiri. Some USD300mn has already been invested. The government wants to turn Iran into an automobile production hub by extending legal support and special privileges to overseas investors. Alishiri says the government will provide a long-term plan to the Iranian automobile sector to help find reliable foreign investors.

According to figures from OICA, Iranian auto production stood at 626,110 units in calendar year 2013, down by 38.2% year-on-year (y-o-y). IVMA figures, however, show the Iranian year, April to March.

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

New opportunities have also arisen in the form of an agreement reached in March 2014 between Saipa and Chinese automaker Chongqing Changan Automobile Co. to manufacture cars jointly, reports ISNA. Under the agreement, two models of car will be manufactured by Saipa's subsidiary Saipa Kashan. This subsidiary has the capacity to make 180,000 cars on a yearly basis. Meanwhile, 502,273 cars were produced in Iran in the first three quarters of the current Iranian calendar year, which commenced on March 21. In addition, the Iranian government intends to reduce car import tariffs to zero in two year period, according to a member of the Iranian parliamentary Industries and Mines Committee, Ali Ali-lou. The move is expected to enhance domestic production and make the auto industry competitive with its counterparts across the globe.

Further long-term upside potential comes from a new plant in the planning stages due to open in 2015. According to ISNA reports, the plant will have an annual production capacity of 5mn units and will produce the first fully national car to be sold for USD10,000-12,000. If this projected capacity is correct, **BMI** believes it will be incredibly ambitious to achieve and as such we have not factored this full total into our forecasts. We have raised our outlook for 2015 and beyond to take new capacity into account, but await confirmation of the new plant's projected capacity.

Sales

Iranian new vehicle sales have been racing ahead over 2014 year-to-date, with the Focus2Move website reporting that new vehicle sales were up by 23% over H114, at 394,463 units. For the full 2014/15 calendar year, **BMI** is targeting further growth, of 55%. Beyond the current year, we target further growth, of 38%, which should take annual sales to the 1.76mn mark by 2018.

Much will depend on how the talks between Iran and the major powers progress over H115. Should sanctions be permanently eased, then there is scope for more rapid growth in new car sales as the Iranian economy - especially its key oil sector - regains access to the world's markets. However, if the talks fail and new sanctions are imposed, then the future of the few remaining international carmakers - such as Renault - still operating in Iran would be called into question.

Turning to the macroeconomic backdrop within the country, we believe that there can be a slight increase in GDP growth over 2015, to 2.9%, although international sanctions will continue to damage the country's economic outlook over the coming quarters. Moreover, while we expect President Hassan Rouhani's administration to make significant efforts to reform to the economy, the effects will be limited by a persistently opaque business environment, domestic resistance to opening up the economy and the slow political process. We project real GDP growth to average 3.1% over the 2014-18 period, compared to 1.6% over 2009-13.

Looking at private consumption - a key indicator of demand for new vehicles - we are forecasting an increase to 4% in 2015, from 3.5% in 2014. The inflationary environment will improve, but persistently elevated price pressures will continue to hit purchasing power. We project consumer price index (CPI) inflation to average 23.0% in FY2014/15 (fiscal year running from March 21 2014 to March 20 2015) and 21.0% in FY2015/16, compared with 35.6% in FY2013/14.

One threat to new vehicle sales over the near term is posed by the mid-2014 decision by the Iranian authorities to increase domestic car prices by 30%. According to a July 2014 report by Iran Daily, three parliamentarians, Issa Emama, Mohammad Ali Madadi and Nader Qazipour, criticised the council responsible for setting domestic car prices, and urged it to reconsider its decision. Behrouz Nemati, a member of the Majlis Mines and Industries Committee highlighted mismanagement in the auto industry as the main reason for the hike.

Iranian new vehicle sales totalled 601,407 units in 2013, according to information from the Focus2Move website. This reportedly represented annual growth of 17.9%.

Trade

BMI's improved forecasts for production also mean that Iranian auto exports should also increase over the current fiscal year. In August 2014, the Fars News Agency reported that **Iran Khodro** (IKCO) plans to export 10,000 vehicles to Russia. According to CEO Hashem Yekehzare, the move is in line with the company's efforts to raise its world market share. IKCO intends to sell one-third of its cars in international markets, according to Yekehzare. He said: 'Meeting Russian standards is the first step to enter this market. But what is important is to provide suitable after-sales services to our customers in this market.'

Iran is also looking to boost its exports elsewhere in the world. In this regard, in June 2014, Ahmad Nematbakhsh, the secretary of the Association of Iranian Car Manufacturers, stated that 90% of cars produced in the country meet Euro-4 standards. Nematbakhsh added that Euro-4 standards integrated into car components cut fuel consumption and assist in environmental protection. **Peugeot** 206, L-90, Samand and Tiba are some of the vehicles conforming to the Euro-4 standards.

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

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

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

13.5% and 9.2% respectively, ISNA reported. Iran exported 2,218 sedans worth USD16mn during the period.

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

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

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

IKCO reportedly aims to export over 25,000 cars in the current Iranian year, which started on March 21. The improved scenario in Syria, which is a significant importer of IKCO products, is expected to fuel the company's exports in the reported period, according to a statement by IKCO's deputy CEO for export and international affairs, Ali Elmi.

Passenger Vehicles

Table: Passenger Car Market - Historical Data And Forecasts (Iran 2012-2018)

	2012	2013	2014f	2015f	2016f	2017f	2018f
Passenger car production, units	871,997	538,170	941,797	1,130,157	1,412,696	1,553,965	1,693,822
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Passenger car sales, units, % y-o-y	-35.2	-31.0	55.0	16.0	15.0	9.0	10.0
Passenger car fleet, units	10,620,000	9,471,078	9,694,073	9,870,774	10,091,869	10,399,283	10,766,644
Passenger car fleet, % y-o-y	8.4	-10.8	2.4	1.8	2.2	3.0	3.5
Passenger cars per 1,000 of population	139.0	122.3	123.5	124.2	125.4	127.7	130.7

National Sources/BMI

Looking at the most recent sales data (for H114), **Saipa** remains the dominant player on the Iranian new car sales market, although second-placed **Peugeot** is closing the gap.

Over H114, Saipa sold 138,577 units for a share of 35.1%, according to information on the Focus2Move website. Peugeot sold 121,176 units for a share of 30.7%, with **Iran Khodro** in third place on 54,887 units (13.9% share). All told the Top 3 carmakers account for almost 80% of the new car sales market.

Further down the Top 10 chart, of note is the increasing market share being taken by the two Korean carmakers **Hyundai** and **Kia,** as well as the presence of three Chinese carmakers (**Chery**, **Geely** and **Lifan**).

Lastly, Toyota's 10th position within Iran is a far cry from its No 1 position in many of the world's markets and **BMI** would expect the Japanese giant to continue making inroads into the Iranian market over the coming years.

US carmakers remain forbidden from entering the Iranian market, which will put them at a competitive disadvantage should Iran be welcomed back into the international fold over the coming years

Table: Iran - Top 10 Best-Selling Manufacturers, H114

Manufacturer	Sales	% Share
Saipa	138,577	35.1
Peugeot	121,176	30.7
Iran Khodro	54,887	13.9
Hyundai	20,265	5.1
Renault	19,629	5
Kia	8,946	2.3
Chery	8,162	2.1
Geely	5,764	1.5
Lifan	4,741	1.2
Toyota	4,634	1

Source: Focus2Move

Looking at the best-selling models in Iran, Saipa's Pride is currently the top seller within Iran, followed by the Peugeot Pars and the Iran Khodro Samand. Peugeot's 405 and 206 models are also reportedly popular within Iran at the present time.

In 2013, local car producer **Saipa** remained the dominant player on the Iranian new car sales market, selling 237,724 units, according to figures on the Focus2Move website. This equated to a market share of nearly 40%. Saipa manufactures Iran's most popular car, the Pride.

In second place was French carmaker **Peugeot**, on 181,051 units (30% share), followed by **Iran Khodro Company** on 102,051 (17%).

In fourth and fifth place were **Renault** (45,221; 7.5%) and Chinese automaker **Chery** (23,610; 3.9%).

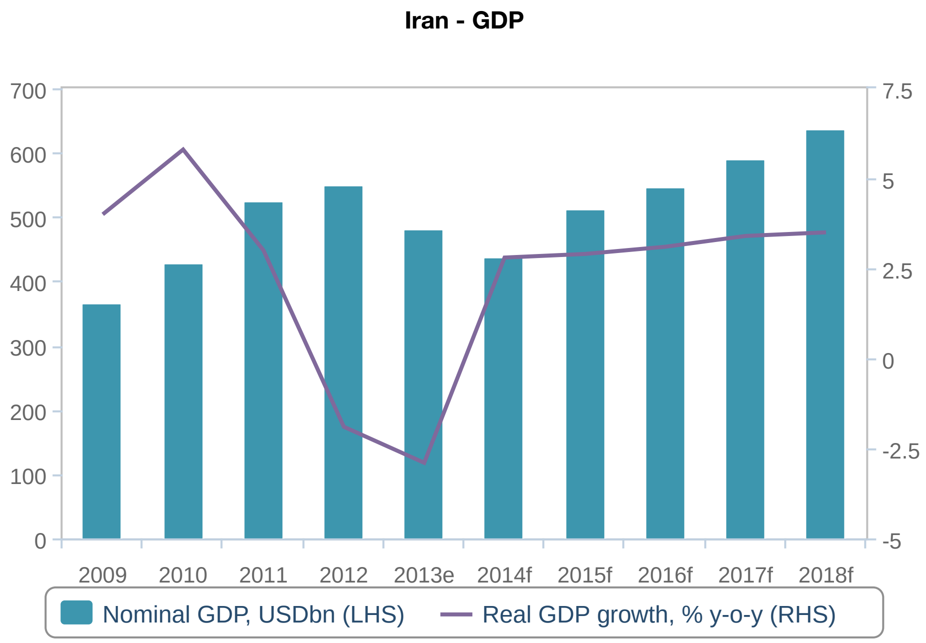
Macroeconomic Forecast

Economic Analysis

BMI View: *The Iranian economy will expand modestly over the coming years, and we project real GDP growth of 2.8% and 2.9% in 2014 and 2015, respectively. Foreign direct investment by Western companies will remain minimal next year owing to the failure to reach a breakthrough in talks on the nuclear programme.*

The Iranian economy will expand slowly in 2015 as talks on the nuclear programme continue without reaching a breakthrough, and project real GDP growth of 2.8% and 2.9% in 2014 and 2015 respectively, from our estimate of a 2.9% contraction in 2013.

Sanctions Remaining Key Constraint To Growth



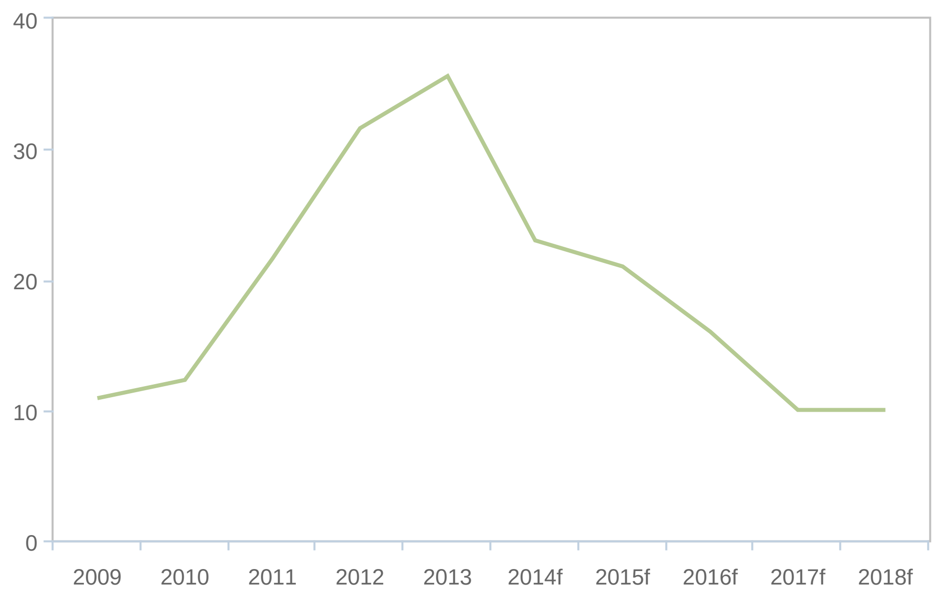
e/f = BMI estimate/forecast. Source: BMI, UN

International sanctions on the Islamic Republic's nuclear programme will continue to damage the country's economic outlook over the next quarters. We do not foresee a breakthrough in talks between the P5+1 countries (United States, Russia, China, United Kingdom, France and Germany) and Iran in 2015 following an interim agreement signed in November 2013, and oil and banking sanctions will be only marginally eased. Moreover, while we expect President Hassan Rouhani's administration to undertake significant efforts to reform to the economy, the effects will be limited by a persistently opaque business environment, domestic resistance to opening up the economy and the slow political process. We project real GDP growth to average 3.1% over the 2014-18 period, compared to 1.6% over 2009-13.

Private Consumption Outlook: Consumer spending will remain modest over the coming quarters, and we expect expansion of 3.5% and 4.0% in 2014 and 2015 respectively. The inflationary environment will improve, but persistently elevated price pressures will continue to hit purchasing power. We project consumer price index (CPI) inflation to average 23.0% in FY2014/15 (fiscal year running from March 21 2014 to March 20 2015) and 21.0% in FY2015/16, compared with 35.6% in FY2013/14. Moreover, the government will be unable to increase current spending significantly in 2015, as it seeks to improve its fragile fiscal position by cutting subsidies and limiting previously universal cash subsidies to only low-income families (*see 'Inflationary Environment Improving In 2015', September 18*). The failure to reach a breakthrough in nuclear talks will also somewhat temper confidence in the economy among domestic and international investors.

Decline Not Enough To Stimulate Consumption

Iran - Consumer Price Index Inflation, % chg, ave

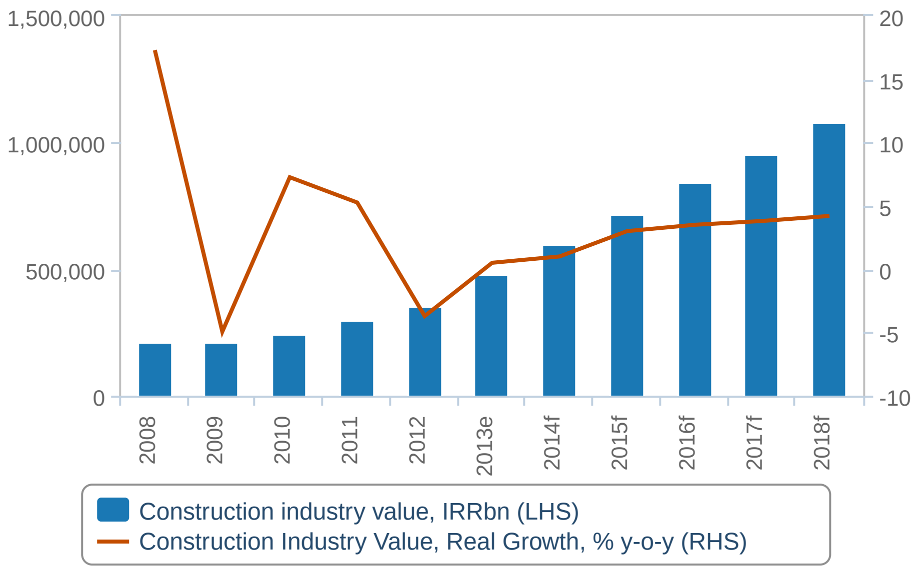


f= BMI forecast. Source: BMI, Central Bank of Iran, Bloomberg

Government Spending Outlook: Spending on the healthcare, education and services sectors will be subdued over the coming quarters owing to the executive's efforts to tighten fiscal spending. This is not to say that the government will cut on spending on public services, as it seeks to maintain popular support to its rule. As an illustration, the Iranian Ministry of Energy signed an agreement with local water and sewage utility **ABFA** at the beginning of September to develop seven water and wastewater management projects for the value of IRR9.5trn (USD310mn). We project government consumption increasing by 0.5% in 2014 and 1.5% in 2015.

High Demand Triggering Expansion

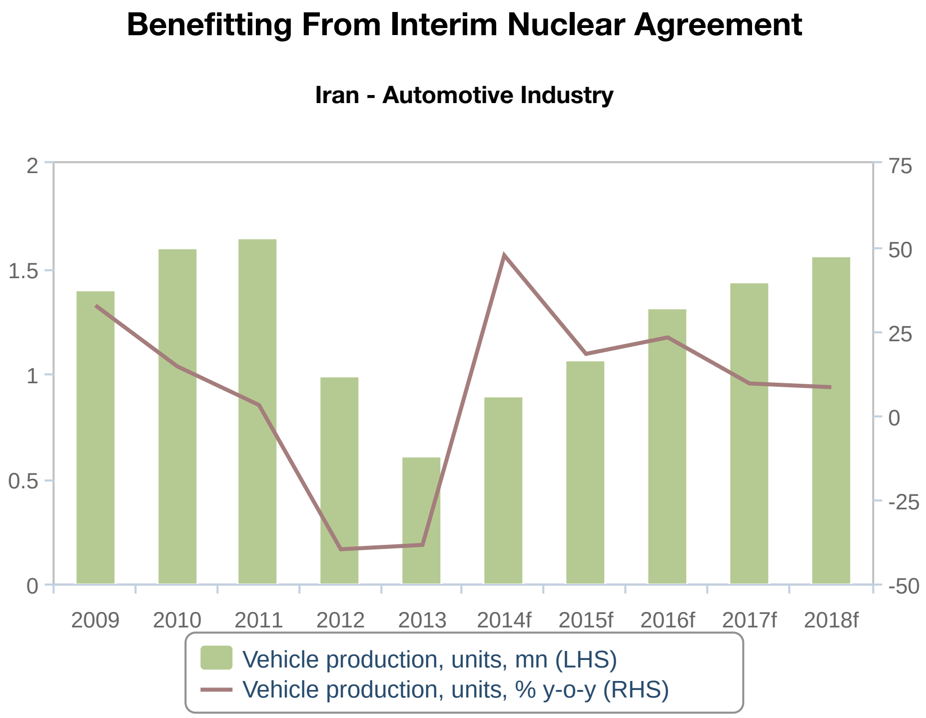
Iran - Construction Industry



e/f = BMI estmate/forecast. Source: BMI, National sources

Fixed Investment Outlook: Capital formation growth will gradually accelerate over the next quarters, which we project to expand by 3.5% in 2014 and 5.0% in 2015. **BMI**'s Infrastructure research team holds a relatively positive outlook for the construction sector, which we project to expand by an average of 4.7% over the next five years, from 0.9% growth in 2014. The gradual increase in the expansion of the segment will result from a partial easing of economic sanctions, low base effects, increasing interest from foreign players and a high demand for infrastructure projects.

The automotive sector will remain a key beneficiary of the interim agreement reached in November 2013 between Tehran and the P5+1, when sanctions for the imports of auto parts were eased. Total production by local car manufacturers reached 399,846 units during the first five months of the current calendar year, a 72% y-o-y increase, and our Autos research team expects robust expansion in the industry over the coming quarters.

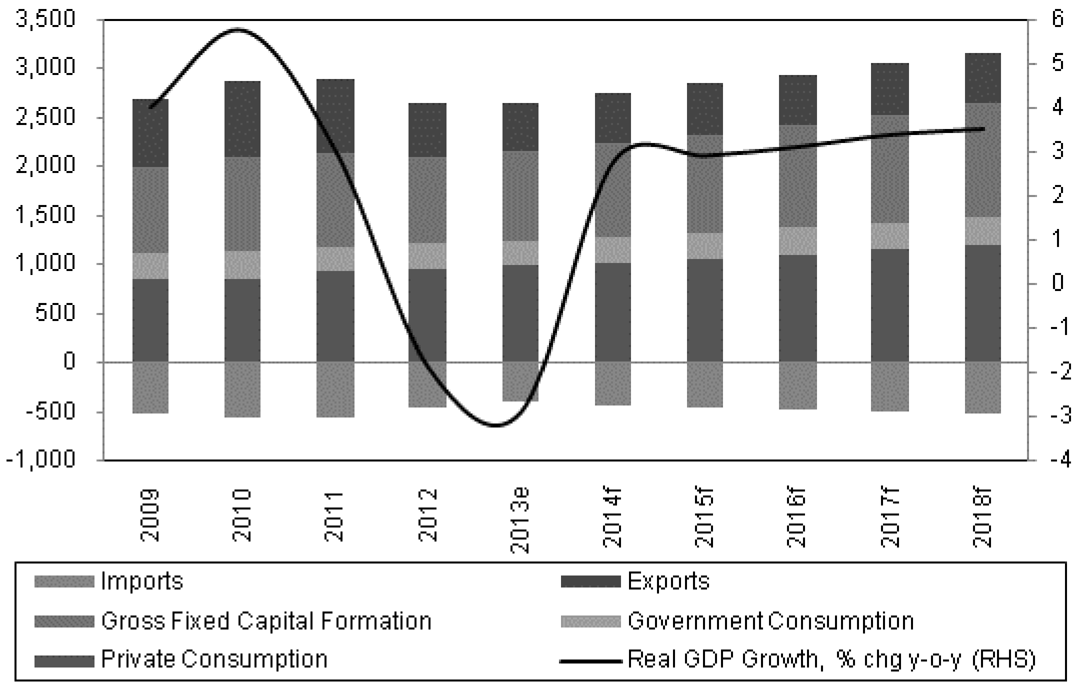


f = BMI forecast. Souce: IVMA, BMI

A host of factors will hinder a more rapid expansion of fixed investment. Foreign companies in nearly every sector have recently expressed interest in returning to the Iranian market, but we believe that Western companies will be unable to undertake major investment in the country due to the sanctions regime. Another key impediment will be Iran's difficult operational environment, with high levels of bureaucracy providing a significant barrier to trade and the utilities infrastructure struggling to meet demand. Iran scores poorly overall in the **BMI** Operational Risks Index, with 41.5 out of 100 ranking the country 13th out of 18 states in the MENA region.

Slow Growth In The Coming Five Years

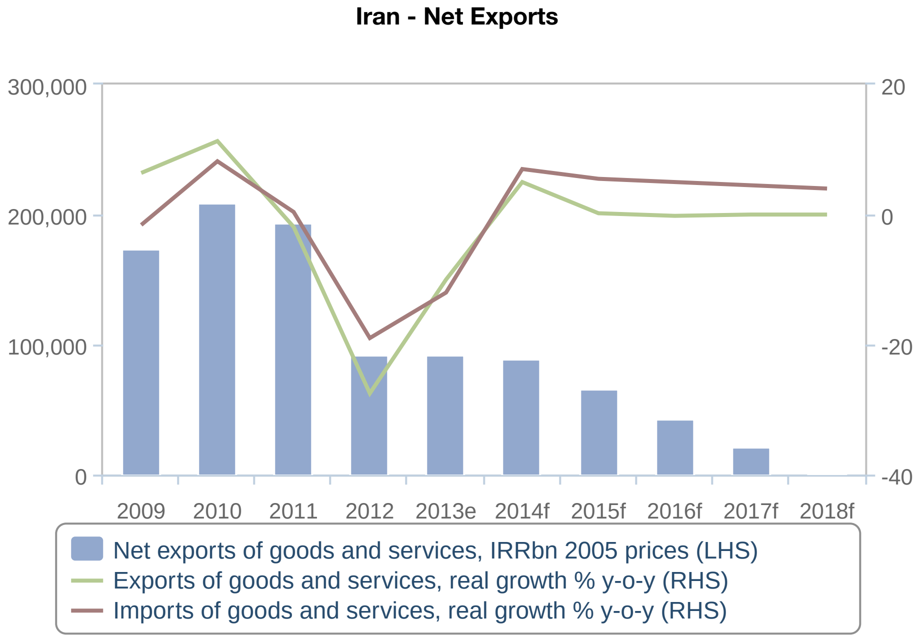
Iran - Components Of GDP (IRRtrn) & Real GDP Growth



e/f = BMI estimate/forecast. Source: United Nations, BMI

Chinese and Russian firms will remain the main contributors to foreign direct investment in 2015. In particular, Russian firms have recently expressed strong interest in the Iranian market, reflecting improving relations between Tehran and Moscow. Russia will become an increasingly important economic partner over the coming years, even as the majority of projects will not come to completion due to technical and logistical challenges. On September 9, Iran and Russia entered an agreement to collaborate in the oil sector; according to Russian Energy Minister Alexander Novak, Moscow is ready to carry out USD90.0bn worth of projects in Iran. In the same month, a memorandum was signed between unspecified Russian and Iranian firms for the construction of a pipeline stretching from Iranshahr to Chabahar in south eastern Iran, for an investment of approximately USD0.7bn.

Surplus Narrowing Steadily



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

Net Exports: We project the net exports surplus to narrow significantly over the next five years. Export growth will slow in 2015 owing to a deceleration in energy production - oil exports accounted for 70.0% of total exports in 2012 - and we project total export growth of 5.0% in 2014 and 0.2% in 2015. According to the International Energy Agency, total oil production expanded by 4.5% y-o-y in August, compared with a 10.6% decline in 2013. Low base effects and an uptick in condensates exports - which are not subject to international sanctions - will lead to an acceleration of energy export growth this year. We are pessimistic that large-scale projects which could boost oil and gas supply will come online in 2015, and the sanctions regime will continue to hinder the hydrocarbons industry.

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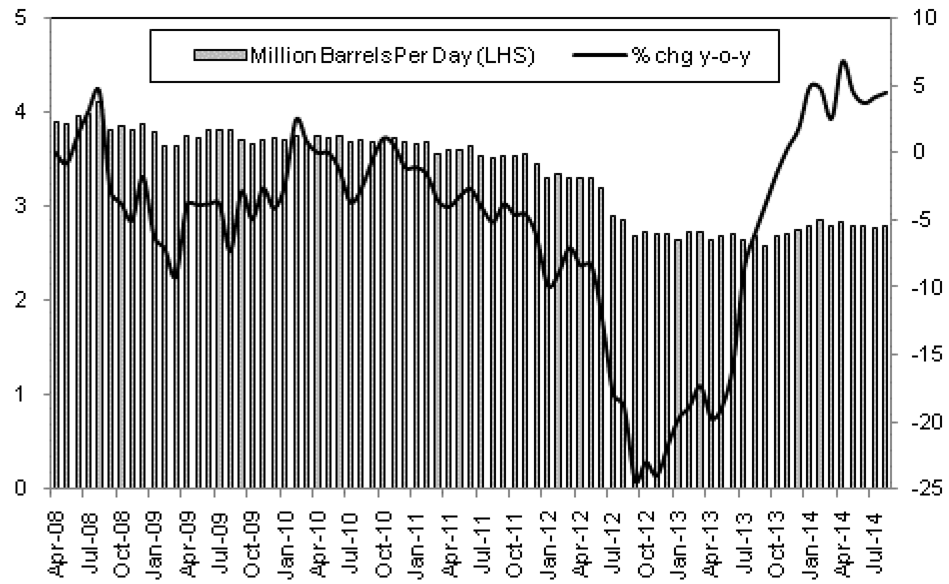
Production On The Mend...

Iran - Oil Production

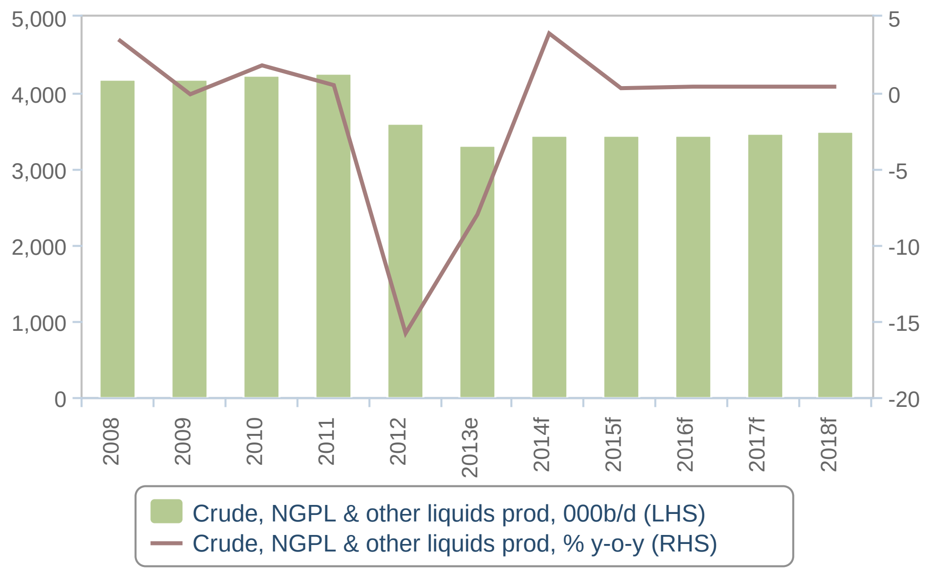


e/f = BMI estimate/forecast. Source: EIA, BMI

The medium-term outlook for exports is also uninspiring. We project total exports to remain virtually flat over the 2014-2018 period, as rapidly increasing energy consumption will result in a decline of hydrocarbons export growth.

...But Five-Year Outlook Uninspiring

Iran - Oil Production



e/f = BMI estimate/forecast. Source: EIA, BMI

A weak rial will lead to subdued import growth in 2015. Moreover, the country's dependence on imported fuels has decreased over the past few quarters owing to refining capacity expansions and fuel subsidy cuts implemented in April, and our Oil & Gas research team expects a slight decrease or stagnation in fuel demand over Q414 and early 2015 (*see 'On The Cusp Of Refined Fuels Independence' September 11*). We forecast total import growth of 7.0% and 5.5% in 2014 and 2015, respectively.

Table: Economic Activity (Iran 2009-2018)

	2009	2010	2011e	2012e	2013e	2014f	2015f	2016f	2017f	2018f
Nominal GDP, USDbn	365.7	429.4	527.3	550.6	481.6	428.7	477.4	515.7	541.0	571.0
Real GDP growth, % y-o-y	4.0	5.8	3.0	-1.9	-2.9	2.8	2.9	3.1	3.4	3.5
GDP per capita, USD	4,972	5,766	6,991	7,204	6,217	5,462	6,006	6,409	6,644	6,933
Population, mn	73.5	74.5	75.4	76.4	77.4	78.5	79.5	80.5	81.4	82.4
Unemployment, % of labour force, eop	12.0	13.5	13.3	13.1	13.0	11.0	10.0	10.0	10.0	10.0

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

Industry Risk/Reward Ratings

Middle East Risk/Reward Ratings

The aim of **BMI**'s Risk/Reward Index for the automotive industry is to show the rewards and the risks that carmakers operating in a particular region - in this case Middle East and North Africa (MENA) - may face. The unique system assesses crucial factors, such as sales and output growth, international trade, market size and location, and the level of market competition, in addition to taking into account a country's economic and political backdrop. The 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.

In the latest round-up, regional tensions are reflected in the scores, with some countries moving owing to worsening unrest making it difficult to do business. On the other hand, some countries have seen an improvement in stability and have also moved accordingly.

At the top, there is little change, however, largely owing to the more stable states of the Gulf Cooperation Council (GCC) dominating the top half of the table. Kuwait remains in first place with its score unchanged, despite its lack of large-scale domestic production operations. The relative ease of doing business and market growth on offer support its attractiveness.

Saudi Arabia has moved up one place to second, although its score is unchanged. We still believe there is potential for Saudi Arabia to reclaim the lead it once held as its developing production industry gains momentum. One of the key factors in achieving this is securing sufficient labour, however, and we still highlight the push for a nationalised workforce as an issue the government will want to make progress on (*see 'Effectiveness Of Labour Market Reforms Remains In Doubt', March 10*).

Israel slips to third with a slight drop in its autos market score, which has dragged on the overall score. The five-year forecast score has slipped, with a weak private consumption outlook threatening sales growth in the short term. However, in terms of doing business, while it is lacking large-scale production, it scores highly for its business environment and is also gaining a reputation for innovation in the industry.

Qatar stays in fourth with a slight increase in its autos market score, as already robust demand in the market looks set to remain strong over the five-year forecast period. The score for the country-based categories are also relatively high, reflecting its relatively open and well-regulated market.

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Iran has moved up one place into fifth with a considerable increase in its autos market score driving an increase in its overall score. The situation has improved markedly for Iran, with a temporary lifting of sanctions already prompting a number of carmakers to signal their interest in returning. There are still restrictions in terms of doing business but also potential for further upward moves for Iran if more long-term agreements can be reached on its nuclear programme.

As a result of this move, the UAE is now in sixth but with no change in its score. Like Qatar it enjoys transparency and stability, with the GCC determining customs regulations. Coupled with robust sales forecasts, this market openness keeps the UAE among the top GCC states.

Bahrain and Oman stay in seventh and eighth respectively with just a slightly lower country structure score for Oman lowering its overall score marginally. We have a bullish outlook for Bahrain's sales over the five-year forecast period. We still believe, however, that high levels of car ownership mean it is likely to enjoy lower levels of growth than some of the other markets that are coming from a lower base. That said, while the market is relatively small, it is open and highly competitive. Oman's autos market is also reasonably attractive. Like other GCC states, it offers strong demand and relative stability but no domestic production.

Egypt is another market to have climbed thanks to an improvement in its stability, rising one place to ninth. Its sales outlook has improved markedly as production continues unhindered by the unrest that temporarily halted output in the summer of 2013 and impacted inventories. There are also signs of investment returning to the market, which should see Egypt regaining its place as the leading North African production base.

Lebanon is in 10th following an increase in its country risk score. That said, there are still risks to the industry to be monitored closely over the next quarter. In addition to its increasing exposure to the situation in neighbouring Syria, its ongoing political crisis plays out our Country Risk team's view of a potential power vacuum. The resulting impact on the economy also poses a threat to big-ticket purchases such as vehicles.

Jordan follows in 11th, but with no change to its score. Like Lebanon, it is exposed to a certain amount of risk from neighbouring Syria, and a lacklustre economy has impacted the sales outlook. However, we see potential for low-cost brands in the market and trade talks with the Indian government could encourage new market entrants.

Tunisia has dropped one place to 12th, with a reduction in its autos market score. Although we still forecast growth over the five-year forecast period, the commercial vehicle market will take the lion's share of sales with a mixed outlook for private consumption (*see 'Commercial Vehicle Will Outperform To 2018, June 2*). The end of the country's state of emergency is a more positive sign for investors, however.

Libya is in 13th, which is a move upward thanks to a slight improvement in its five-year sales outlook. However, we still expect private consumption growth in the country to remain below potential over the forecast period, while there is also an increasing threat to the new car sales market posed by imports of older used cars.

Iraq has fallen to 14th from ninth previously, with a reduction in both the autos market and country structure categories as the security situation in the country worsens. Much will depend on what happens in Kurdistan, which is the biggest market for new vehicle sales and in the areas where vehicle production plants are based, as to whether scores fall further.

Morocco is now in 15th and Algeria 16th with similarly mixed outlooks. As production bases, they are both still burgeoning hubs with investment still flowing in from the likes of **Renault** and parts supplier **Lear Corp**. However, the sales outlook is less positive and has dragged on the autos market scores for both.

Syria remains firmly at the bottom of the rankings with a further reduction in its overall score from drops in both the market risk and country risk scores. The ongoing civil war provides no prospect of an improvement in the country's ratings in the foreseeable future.

Table: MENA Autos Risk/Reward Ratings

	Rewards			Risks				
	Autos Market	Country Structure	Industry Rewards	Market Risks	Country Risks	Industry Risks	Autos Rating	Rank
Kuwait	31.67	88.10	51.42	75.00	66.42	70.71	57.21	**1**
Saudi Arabia	40.00	69.66	50.38	75.00	69.72	72.36	56.97	**2**
Israel	30.00	86.48	49.77	75.00	68.40	71.70	56.35	**3**
Qatar	28.33	89.45	49.72	75.00	67.98	71.49	56.25	**4**
Iran	61.67	42.60	54.99	75.00	30.66	52.83	54.34	**5**
UAE	28.33	80.44	46.57	75.00	64.68	69.84	53.55	**6**
Bahrain	25.00	75.86	42.80	75.00	70.15	72.57	51.73	**7**
Oman	25.00	71.48	41.27	85.00	56.72	70.86	50.15	**8**
Egypt	46.67	34.26	42.33	75.00	49.02	62.01	48.23	**9**
Lebanon	13.33	86.48	38.93	80.00	53.91	66.96	47.34	**10**
Jordan	18.33	63.98	34.31	70.00	53.60	61.80	42.56	**11**
Tunisia	13.33	61.48	30.18	85.00	50.06	67.53	41.39	**12**
Libya	13.33	71.48	33.68	65.00	45.69	55.34	40.18	**13**
Iraq	18.33	61.48	33.43	60.00	51.55	55.77	40.13	**14**
Morocco	31.67	25.15	29.39	75.00	52.17	63.58	39.65	**15**
Algeria	18.33	36.59	24.72	65.00	50.02	57.51	34.56	**16**
Syria	25.00	53.98	35.14	10.00	37.77	23.89	31.76	**17**

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

Company Profile

Company Monitor

BMI View: *Renault's expanding domestic production in North Africa will add to its strong position in the rest of the MENA region. A permanent nuclear deal in Iran would enable the company to regain a lot of lost ground and round out its regional strategy.*

French carmaker **Renault** already has a strong footing in the Middle East and North Africa (MENA) with double-digit growth in the Gulf Co-operation Council (GCC) states, and a growing local production hub in North Africa. We see the expansion of this domestic production solidifying the company's position in the region, not only by supplying a growing domestic market, but also by providing an alternative for less competitive manufacturing elsewhere.

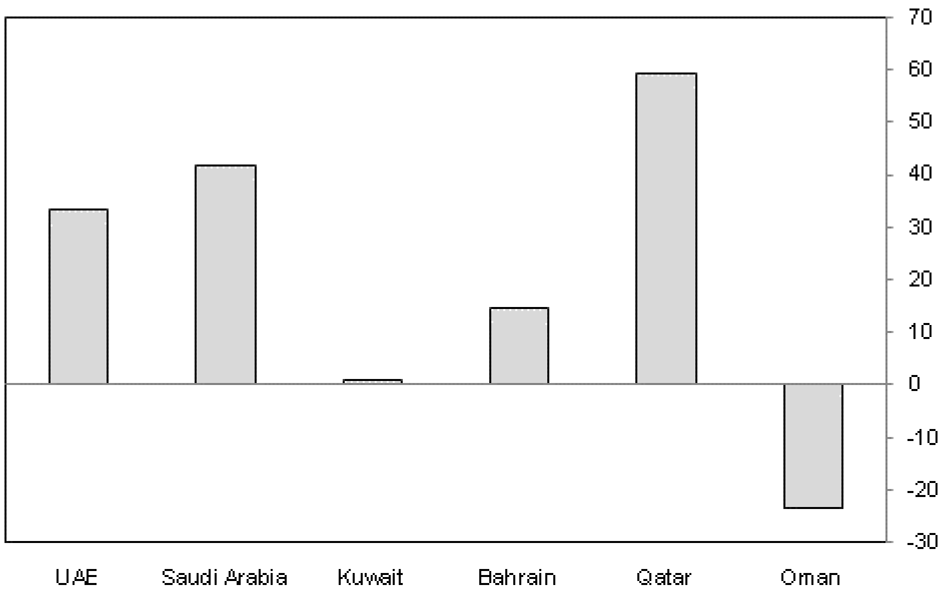
Growth In The Gulf

Renault has been achieving record results in the GCC states and ranks as the leading European brand in the largest GCC market, Saudi Arabia. The company's growth in recent years is consistent with our view on the rise of volume brands in the region, which has traditionally been a premium-oriented market (*see 'Renault Leads GCC Volume Growth', August 16 2012*).

With GCC sales for 9M14 up 32.5% year-on-year (y-o-y), Renault is on track to surpass its 19% growth of 2013. Its strongest growth is in Qatar where sales were 59.2% higher y-o-y, followed by Saudi Arabia on 41.7% y-o-y. These results suggest a strong period in Q2 and Q3, as the company's GCC sales for Q114 were up just 8% y-o-y.

Product Mix Drives Strong Sales

Renault Sales Growth By Market (% chg y-o-y)



Source: Renault

Some of the growth can be attributed to new product launches. In February, Renault launched the Twizy full electric car in the region and has cited this as one of the models driving growth for the year so far, along with the Koleos, Fluence and Duster. From its launch until September 2014, Renault sold 34 Twizys in the GCC. Indeed, choosing the right product mix for the markets has been a focal point of the company's strategy.

The Duster Cleans Up

The Duster compact SUV validates our positive view of the SUV sub-segment globally (*see 'Rising Prominence Of Subcompact SUVs' October 31*), and particularly in the MENA region. We have long held the view that SUVs will be an outperforming segment in the region, and the low-cost Duster combines this view with that of the growth of volume brands.

Globally, sales of the model were up 45.1% y-o-y in 9M14, and while a geographical breakdown was not available for the model, local dealers in the GCC report the Duster among the best-sellers. Outside of the

GCC states too, the Duster has been an outperformer. According to a release from Lebanese dealer Bassoul-Heneine in October, the Duster has been the best-selling model in Lebanon for the past three years.

Building A North African Hub

Renault is a first mover in terms of vehicle production in Morocco and Algeria and this has given the company a number of advantages, not just in its competitiveness in the local market, where the Dacia brand held a 28% share of the Moroccan in H114. We are of the view that expanding the capacity of its Tangiers plant in Morocco in late 2013 has given Renault more options when it comes to choosing the most competitive production base. Labour costs are far lower than even those of Renault's Dacia plant in Romania and it is geographically well-placed to serve the European market. Indeed, we have previously highlighted the possibility of Morocco becoming an alternative to Romania if operating conditions become difficult (*see 'Second Production Line Gives Renault Options', October 9 2013*).

The company's commitment to producing in the country was given another boost in October, when the company said it would consider an engine plant in Morocco to serve the two vehicle production lines. This is a longer term plan, however, as Renault said it would like to see a more developed supplier base in the country first.

More immediate expansion plans in North Africa lie in Algeria, where the company's new plant begins volume production in November. The plant will have an initial annual production capacity of 25,000 units of the Renault Symbol, with phase two of the project expected to triple capacity to 75,000 units. This is a much smaller venture than the Moroccan facilities, which now have combined output of 340,000 units a year. However, its significance lies in bolstering Renault's advantage in the region and again creating more options. Like Morocco, Algeria is a key market for Renault, where group sales grew 9.0% y-o-y in Q314, while the overall market contracted 6.7% y-o-y.

Opportunities In Iran

One area where Renault could make real gains heading into 2015 is Iran, although this will be dependent on a permanent nuclear deal being arranged with the P5+1 countries by the November 24 deadline. Renault has an agreement in place with major domestic producer **Iran Khodro Industrial Group** to recommence production in the country, with the Clio4 and Captur among the models to be launched.

Renault and compatriot **Peugeot** controlled around a third of Iran's output before they withdrew in early 2012 in line with Western sanctions. Renault's commitment to re-entering the market has been evident in its global restructuring earlier in 2014, which saw its Asia Pacific division, which previously encompassed 48 countries, divided into 'Asia Pacific' and 'Middle East and India'. One of the key areas of focus laid out for the Middle East and India division is to restart operations in Iran.

Iran Khodro Company (IKCO)

Strengths	▪ Iran's largest auto manufacturer ▪ Third-largest seller of cars in the domestic market over 2013 ▪ Samand and Peugeot Pars models remain popular.
Weaknesses	▪ Company needs investment in its facilities and R&D. ▪ Company is primarily focused on one country.
Opportunities	▪ Should sanctions be permanently eased, then there is scope for more rapid growth in new car sales as the Iranian economy - especially its key oil sector - regains access to the world's markets. ▪ Company is looking to increase exports. ▪ Future tie-up with Peugeot could be beneficial to both companies.
Threats	▪ If nuclear talks between Iran and the Western powers fail and new sanctions are imposed, then this would be devastating for the local auto industry. ▪ Political instability remains a key concern for the whole Iranian economy and, by extension, new car sales. ▪ Increased foreign imports could eat into IKCO's market share over time.

Company Overview

IKCO is the largest auto manufacturer in Iran and was established in 1963. The firm also has foreign production facilities, including sites in Azerbaijan, Belarus and Venezuela.

In recent years, IKCO has concentrated on expanding its own ranges, as opposed to those it produces under license to other manufacturers. These models include the Dena, Runna, Soren, Sarir, Samand and Bardo. In addition, the company still produces variants of the Peugeot 405, 206 and 207 models, according to its website.

IKCO is working intensively to expand its foreign markets, which bring in much-needed hard currency. In February 2014, IKCO exhibited a range of its models in the

Turkmenistan capital of Ashkhabad as part of a showcase of Iranian products to its northern neighbour. According to a company press release, 'Turkmenistan is considered as one of IKCO's most important target markets and consistent presence in such exhibitions can stabilise the position of the company in this market'.

Strategy

In August 2014, the Fars News Agency reported that Iran Khodro Industrial Group (IKCO) plans to export 10,000 vehicles to Russia. According to CEO Hashem Yekehzare, the move is in line with the company's efforts to raise its world market share. IKCO intends to sell one-third of its cars in international markets, according to Yekehzare. He said: 'Meeting Russian standards is the first step to enter this market. But what is important is to provide suitable after-sales services to our customers in this market.'

Over the first seven months of the Iranian calendar year, IKCO reported an annual export increase of over 100%, to 1,400 vehicles. According to IKCO's deputy head of exports and international affairs, Ali Elmi, only 600 cars were sold abroad by the company in the corresponding period of 2013. Traditional destination markets for Iranian cars are Iraq, Venezuela and Azerbaijan; however, the company expects the Russian market to be opened for Iranian cars by 2015

In October 2014, IKCO announced plans to commence production of the new PU1 pick-up truck, to be on the market by the start of the next Iranian calendar year (March 21 2015). The Tasnim news agency reports that the PU1 will be based on the Iranian-assembled Peugeot 405 platform, which features a dual-fuel 1700cc engine. Gholamreza Sadeghian, managing director of ICKO's Tabriz plant, said that production is scheduled to begin in late autumn, with a target of 5,000 units by the end of the Iranian calendar year.

In July 2014, the ISNA news agency stated that IKCO is to form a joint venture with French automaker PSA Peugeot Citroën. The move is in line with Peugeot's efforts to expand its services, products and exports, according to the report, which cited Khodro's managing director, Hashem Yekkeh Zare. Under the joint venture, the two companies are expected to manufacture Peugeot 301 and 2008 models using parts provided by IKCO. In May, IKCO set out certain conditions to Peugeot for a joint venture, including the closure of assembly units. 'We want them to transfer technology to us and establish research and development centres in Iran,' said Zare at the time.

In June 2014, ISNA reported that Japanese automaker Suzuki Motor is in discussions with Iranian carmaker IKCO to launch a new car production line in Iran, according to Abdollah Babaee, director of marketing and sales at IKCO.

In May 2014, IKCO reportedly set out a number of conditions for returning to a partnership with French carmaker Peugeot, following a meeting between the bosses of the two companies, which BMI believes shows mutual needs within the industry. Peugeot and its compatriot Renault have both racked up significant losses following their withdrawal from Iran, thereby reflecting the significance of the Iranian market.

However, IKCO's demands for greater investment in technology transfer and research and development (R&D) facilities show where the national industry is lacking.

IKCO managing director Hashem Yekkeh Zare said that Peugeot should end its own assembly operations and focus on joint production with the Iranian carmaker, including transferring its technology and setting up local R&D facilities. Zare said IKCO will only consider resuming its relationship if these conditions are met.

In November 2013, IKCO said that it had registered a 53% increase in production during September 23-November 21. The company's average daily output reached 1,530 cars in the reported period, compared with the average output of 1,000 vehicles a day in the first half of the current Iranian year started March 21, according to a report on the Islamic Republic News Agency. From October 23 to November 21, IKCO's production jumped 25% year-on-year (y-o-y) to 35,000 vehicles. Growth in production is expected to continue and is likely to touch an average of 1,800 cars daily. The increase in production was attributed to the government's ongoing efforts to revive the auto industry.

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

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

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

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

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

Societe Annonyme Iranienne de Production Automobile (Saipa)

Strengths

- Second-largest car manufacturer in Iran
- No1 seller on the domestic market
- Company's Pride model is the most popular in Iran

Weaknesses

- Company needs investment in its facilities and R&D
- Company is primarily focused on one country

Opportunities

- Should sanctions be permanently eased, then there is scope for more rapid growth in new car sales as the Iranian economy - especially its key oil sector - regains access to the world's markets.
- Company is looking to increase exports.
- Future tie-up with Renault could be beneficial to both companies.

Threats

- If nuclear talks between Iran and the Western powers fail and new sanctions are imposed, then this would be devastating for the local auto industry.
- Political instability remains a key concern for the whole Iranian economy and, by extension, new car sales.
- Increased foreign imports could eat into Saipa's dominant market share over time.

Company Overview

Saipa is the second-largest auto manufacturer in Iran. The company produces a wide range of passenger and commercial vehicles, some of which are based on models previously developed by Kia (Pride) and Renault (Logan). The company is also looking to develop its own models, such as the Tiba.

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.

In November 2014, The Tehran Times reported that French carmaker Renault was in talks with Saipa about buying a stake in its Pars Khodro subsidiary, according to comments from Majid Souri, Saipa's investment management director. However, there has yet to be any definitive agreement between the two companies, according to Souri, with much depending on the final outcome of the ongoing nuclear talks between Tehran and the P5+1 group of nations.

In June 2014, Renault's Chief Performance Officer Jerome Stoll said that his company is looking for a financial partner to resume full operations in Iran, where it had enjoyed a strong market position before the imposition of international sanctions against Iran in 2011.

Production of SAIPA's Nasim and Saiba Pride models reached 75,863 units between March 21 and August 22, according to a report by the IRNA.

In March 2014, Saipa signed a deal with Chinese automaker **C**hongqing Changan Automobile Co. to manufacture cars jointly, according to a report by ISNA. Under the agreement, two models of car will be manufactured by Saipa's subsidiary Saipa Kashan. This subsidiary has the capacity to make 180,000 cars on a yearly basis.

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

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.

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

Regional Overview

Middle East Overview

In **BMI**'s regular round-up of production investments, we track the latest projects from the production side of the industry and analyse trends that we see developing on a regional basis. In doing so, we hope to build a picture of any potential hubs that may be developing, as well as company strategy in terms of production bases and export programmes. As production is less widespread in the Middle East and North Africa (MENA) region, this latest update covers June to October 2014.

Table: MENA Autos Production Investments

Date Announced	Country	City/State/ Region	Company	Brief Description	Date Onstream
Jun-14	Saudi Arabia	n/a	BYD Auto	Joint venture to locally produce BYD cars	In feasibility study phase
Aug-14	Iran	Tabriz	Austrian government	Plans to establish a full production line served by local suppliers	n/a
Oct-14	Iraq	Iskandariya	IKCO	Increasing daily output of passenger cars to 50, with plans to double to 100	2014
Oct-14	Iran	Tabriz	IKCO	Production of new pick-up truck	2015

n/a = not available. Source: BMI

It is most notable in this latest round-up of autos investment in the Middle East and North Africa region that the number of confirmed projects does not reflect the amount of interest shown in the region by the autos sector. In some cases, companies are waiting for the sector to become more developed, or in the case of Iran especially, foreign carmakers are awaiting a finalised nuclear deal with the P5+1 countries.

For that reason, the confirmed investment in Iran so far comes from domestic giant **Iran Khodro Industrial Group** (IKCO), which is adding new products to its production line. Its latest addition is the PU1 pick-up truck, which will enter production in autumn 2015, but it also has more long-term plans to introduce new or revamped models every six months, plus a new engine every three years starting from October 2105. It has also been expanding its operations in Iraq, which has traditionally been one of its biggest export markets, but is now a growing production base.

The bigger boost to its operations will come, however, if a permanent nuclear deal is signed. The company has reached an agreement with French carmakers **PSA Peugeot Citroen** and **Renault** to establish joint ventures for domestic production. At least two new Peugeot models, the 301 and 2008, would be produced under the deals, as well as the Renault Clio4 and Captur. **Suzuki Motor** has also met with the company regarding a production deal. The deadline for a permanent nuclear deal is November 24, which would give the green light for many of these projects to go ahead.

Other areas of potential not covered in the table include Egypt, where the country's domestic producer **Nasr Automotive** is in talks with Russia's **AvtoVAZ** regarding a production joint venture. We see this as a win-win for both sides if it goes ahead, as Nasr has been looking to ramp up volume production since being given a reprieve from liquidation by the government in 2013, and AvtoVAZ needs new markets to focus on outside of Russia (*see 'AvtoVAZ-Nasr Deal Is A Boost For Both Sides', October 2*).

In another positive sign for North Africa, Renault is considering an engine plant in Morocco to support its vehicle production plants in Tangier and Casablanca, which have a combined annual capacity of 400,000 units. However, Renault's Chief Competitive Officer, Thierry Bollore, said the company would need a better supply chain on the ground in Morocco before embarking on such a project. It would align with our long-held view of Morocco as a developing autos production and export hub, particularly for Renault (*see 'Second Production Line Gives Renault Options', October 9 2013*).

Global Industry Overview

***BMI View**: Rising demand for in-car connectivity will spur more collaboration between automakers and internet companies. While challenges still exist, we believe connected cars would become the norm within the next decade.*

While the 'connected car' has remained a buzzword for the industry over the past few years, this concept appears to be gaining traction, with connectivity functions becoming more of a factor that can sway consumers' car purchase decisions. According to Spanish broadband and telecommunications provider **Telefonica**, the number of vehicles with built-in connectivity as a percentage of total vehicles is expected rise from 10% in 2013 to 90% in 2020. This, coupled with **BMI**'s bullish outlook on global auto sales over the next 10 years, highlights immense potential in this area. Although we foresee various challenges to the development of the 'internet car', we believe the value connected cars can offer in terms of safety will eventually push them to the mainstream within the next decade.

Challenges Amidst Greater Collaboration

We believe the rising demands by consumers for in-car technology will continue to fuel collaboration between internet companies and automakers, which has become more of a trend over the past two years. In July 2014, Chinese automaker **SAIC Motor** and e-commerce giant **Alibaba** announced their partnership in providing navigation and music services as well as cloud computing ability in cars. Due to automakers' lack of expertise in connectivity systems and infotainment development, this will result in more automakers partnering with companies who are specialists in this field.

Table: The Internet Of Cars

Company	Auto Partner	Service/Product
Alibaba	SAIC	'Yun' operating system
China Unicom	Tesla	Internet connectivity
Apple	Mercedes-Benz, Ferrari, BMW, Hyundai	CarPlay
Microlise	Tata Motors	Telematics solutions
Baidu	-	Carnet
Tencent	-	Lubao Box
Google	-	Andriod Auto

Source: BMI

However, as automakers gradually go through a paradigm shift in their business and increasingly work with other industries, we foresee that they will face various challenges. One key problem lies in the mismatch in speed between development of automobiles and in-car technology. Given that it takes four to five years to develop a vehicle, automakers will face difficulties in adapting to rapidly changing internet and mobile technology that sees new developments every one to two years. SAIC's Roewe 350, for example, equipped with the 'inkaNet Intelligent Driving System', has not been well received due to its outdated software and difficulty in usage, and dealers have seen customers request for older models that do not offer the intelligent driving system.

Moreover, with cars having a useful life of around 10 to 15 years, the short innovation lifecycle of operating platforms and internet application would leave vehicle owners with an outdated connectivity system if it cannot be upgraded. **As such, the ability to replace and update connectivity systems over the lifespan of cars will be crucial for drivers.** Even having resolved that, compatibility issues will also arise, owing to different operating systems being installed on different cars, bringing with it a different set of concerns regarding ownership of data and privacy.

Connected Cars Only A Matter Of Time

Having said that, we believe the industry has the technology to overcome these challenges, and connected cars can become the norm within the next decade. **Audi**, for example, has a 'Modular Infotainment Units' system that enables the driver to easily upgrade the car's system. By using a modular central computer to drive its Multimedia eXtention Board, the system can easily be updated by replacing the central computer - akin to replacing spare parts of a car.

Moreover, consumers are increasingly looking for connectivity features that enhance safety, navigation and enable vehicle diagnostics. Even regulators are catching on to the potential of connected cars, and in August, we discussed how regulatory change by the US's National Highway Traffic Safety Administration will require vehicle-to-vehicle (V2V) safety technology to be installed in new cars and trucks, presenting opportunities for suppliers (*see 'Regulations Create V2V Opportunities For Suppliers', August 19*). With the push for safer and more connected vehicles, automakers would be left with no choice but to work with other industries in making connectivity a staple feature of cars.

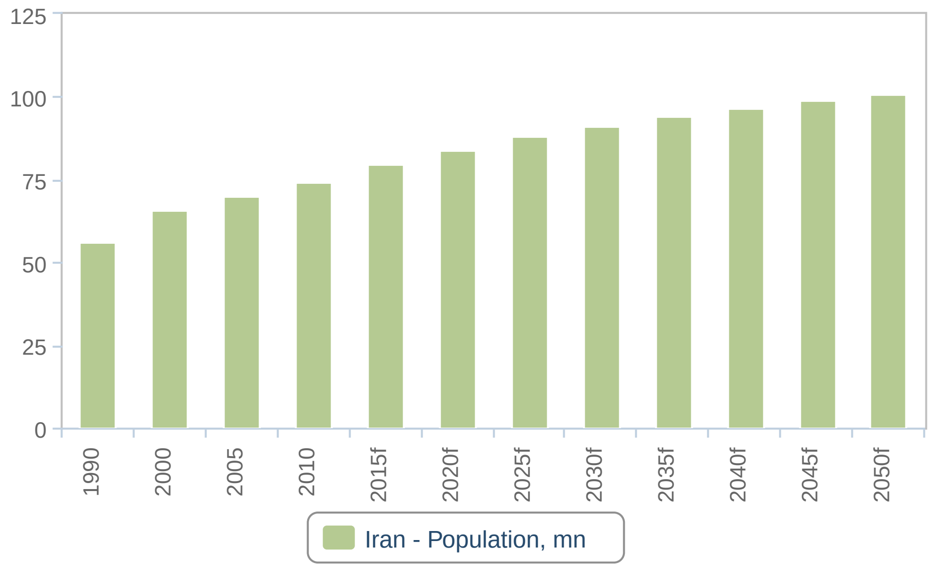
Demographic Forecast

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 essential to understanding issues ranging from future population trends to productivity growth and government spending requirements.

The accompanying charts detail the population pyramid for 2015, the change in the structure of the population between 2015 and 2050 and the total population between 1990 and 2050. The tables show indicators from all of these charts, in addition to key metrics such as population ratios, the urban/rural split and life expectancy.

Population

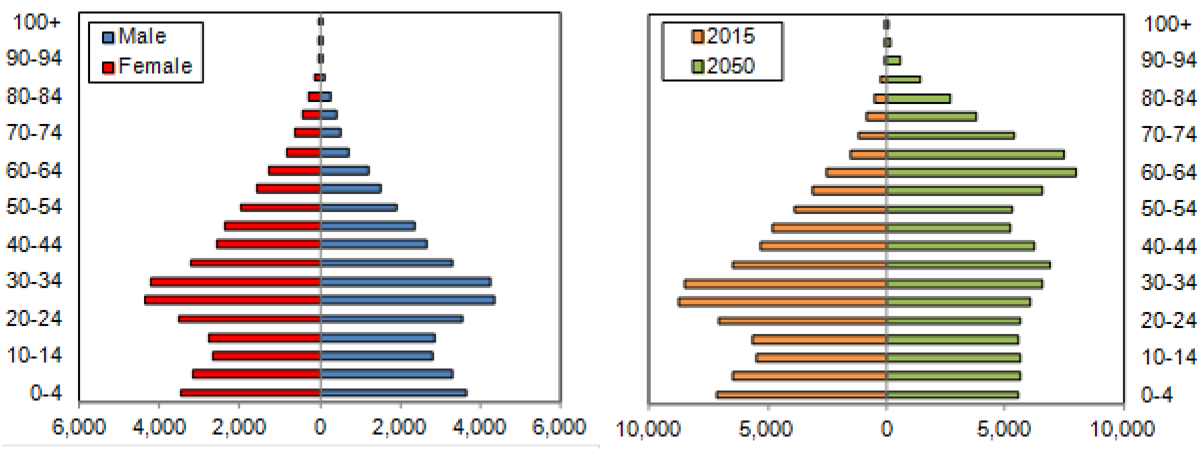
(1990-2050)



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

Iran Population Pyramid

2015 (LHS) & 2015 Versus 2050 (RHS)



Source: World Bank, UN, BMI

Table: Population Headline Indicators (Iran 1990-2025)							
	1990	**2000**	**2005**	**2010**	**2015f**	**2020f**	**2025f**
Population, total, '000	56,361	65,911	70,152	74,462	79,476	84,148	88,064
Population, % change y-o-y	na	1.6	1.2	1.3	1.3	1.1	0.8
Population, total, male, '000	28,807	33,504	35,917	37,656	39,915	42,307	44,213
Population, total, female, '000	27,554	32,406	34,235	36,805	39,560	41,840	43,850
Population ratio, male/female	1.05	1.03	1.05	1.02	1.01	1.01	1.01

na = not available; f = BMI forecast. Source: World Bank, UN, BMI

Table: Key Population Ratios (Iran 1990-2025)							
	1990	**2000**	**2005**	**2010**	**2015f**	**2020f**	**2025f**
Active population, total, '000	28,945	40,290	48,583	53,034	55,945	58,184	60,945
Active population, % of total population	51.4	61.1	69.3	71.2	70.4	69.1	69.2
Dependent population, total, '000	27,415	25,620	21,569	21,427	23,530	25,964	27,118
Dependent ratio, % of total working age	94.7	63.6	44.4	40.4	42.1	44.6	44.5

Key Population Ratios (Iran 1990-2025) - Continued

	1990	2000	2005	2010	2015f	2020f	2025f
Youth population, total, '000	25,543	22,850	18,115	17,585	19,140	20,362	19,984
Youth population, % of total working age	88.2	56.7	37.3	33.2	34.2	35.0	32.8
Pensionable population, '000	1,872	2,770	3,453	3,841	4,389	5,601	7,134
Pensionable population, % of total working age	6.5	6.9	7.1	7.2	7.8	9.6	11.7

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

Table: Urban/Rural Population And Life Expectancy (Iran 1990-2025)

	1990	2000	2005	2010e	2015f	2020f	2025f
Urban population, '000	31,748.6	42,210.8	47,393.5	51,332.8	55,362.4	59,374.4	63,078.7
Urban population, % of total	56.3	64.0	67.6	68.9	69.7	70.6	71.6
Rural population, '000	24,613.2	23,700.3	22,758.8	23,129.5	24,113.9	24,774.2	24,985.6
Rural population, % of total	43.7	36.0	32.4	31.1	30.3	29.4	28.4
Life expectancy at birth, male, years	61.2	68.7	70.0	71.3	72.8	74.2	75.5
Life expectancy at birth, female, years	65.8	70.6	73.1	75.1	76.6	78.0	79.2
Life expectancy at birth, average, years	63.4	69.6	71.5	73.1	74.6	76.0	77.3

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

Table: Population By Age Group (Iran 1990-2025)

	1990	2000	2005	2010	2015f	2020f	2025f
Population, 0-4 yrs, total, '000	9,312	6,316	5,483	6,555	7,146	6,751	6,148
Population, 5-9 yrs, total, '000	8,905	7,552	5,476	5,416	6,507	7,116	6,729
Population, 10-14 yrs, total, '000	7,324	8,981	7,154	5,613	5,487	6,494	7,105
Population, 15-19 yrs, total, '000	5,822	8,800	9,247	7,215	5,643	5,466	6,474
Population, 20-24 yrs, total, '000	4,697	6,932	9,143	8,993	7,067	5,595	5,424
Population, 25-29 yrs, total, '000	4,054	5,315	6,859	8,704	8,726	6,997	5,541
Population, 30-34 yrs, total, '000	3,535	4,442	5,202	6,521	8,484	8,649	6,937
Population, 35-39 yrs, total, '000	3,030	3,886	4,693	5,210	6,497	8,410	8,579
Population, 40-44 yrs, total, '000	2,123	3,372	4,112	4,833	5,262	6,431	8,333
Population, 45-49 yrs, total, '000	1,620	2,857	3,421	4,032	4,757	5,193	6,353

Population By Age Group (Iran 1990-2025) - Continued	1990	2000	2005	2010	2015f	2020f	2025f
Population, 50-54 yrs, total, '000	1,526	1,929	2,800	3,244	3,895	4,665	5,101
Population, 55-59 yrs, total, '000	1,393	1,431	1,766	2,637	3,109	3,788	4,548
Population, 60-64 yrs, total, '000	1,140	1,322	1,336	1,639	2,500	2,985	3,652
Population, 65-69 yrs, total, '000	898	1,145	1,257	1,279	1,550	2,340	2,813
Population, 70-74 yrs, total, '000	507	825	1,055	1,129	1,143	1,369	2,090
Population, 75-79 yrs, total, '000	269	508	654	802	876	902	1,105
Population, 80-84 yrs, total, '000	135	203	347	413	528	598	637
Population, 85-89 yrs, total, '000	48	66	112	172	216	290	343
Population, 90-94 yrs, total, '000	10	17	21	38	63	84	119
Population, 95-99 yrs, total, '000	1	2	3	4	8	15	22
Population, 100+ yrs, total, '000	0	0	0	0	0	1	2

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

Table: Population By Age Group % (Iran 1990-2025)	1990	2000	2005	2010	2015f	2020f	2025f
Population, 0-4 yrs, % total	16.52	9.58	7.82	8.80	8.99	8.02	6.98
Population, 5-9 yrs, % total	15.80	11.46	7.81	7.27	8.19	8.46	7.64
Population, 10-14 yrs, % total	13.00	13.63	10.20	7.54	6.90	7.72	8.07
Population, 15-19 yrs, % total	10.33	13.35	13.18	9.69	7.10	6.50	7.35
Population, 20-24 yrs, % total	8.34	10.52	13.03	12.08	8.89	6.65	6.16
Population, 25-29 yrs, % total	7.19	8.06	9.78	11.69	10.98	8.32	6.29
Population, 30-34 yrs, % total	6.27	6.74	7.42	8.76	10.68	10.28	7.88
Population, 35-39 yrs, % total	5.38	5.90	6.69	7.00	8.18	9.99	9.74
Population, 40-44 yrs, % total	3.77	5.12	5.86	6.49	6.62	7.64	9.46
Population, 45-49 yrs, % total	2.88	4.33	4.88	5.42	5.99	6.17	7.22
Population, 50-54 yrs, % total	2.71	2.93	3.99	4.36	4.90	5.54	5.79
Population, 55-59 yrs, % total	2.47	2.17	2.52	3.54	3.91	4.50	5.17
Population, 60-64 yrs, % total	2.02	2.01	1.90	2.20	3.15	3.55	4.15
Population, 65-69 yrs, % total	1.59	1.74	1.79	1.72	1.95	2.78	3.19
Population, 70-74 yrs, % total	0.90	1.25	1.50	1.52	1.44	1.63	2.37
Population, 75-79 yrs, % total	0.48	0.77	0.93	1.08	1.10	1.07	1.26
Population, 80-84 yrs, % total	0.24	0.31	0.50	0.55	0.66	0.71	0.72

Population By Age Group % (Iran 1990-2025) - Continued							
	1990	2000	2005	2010	2015f	2020f	2025f
Population, 85-89 yrs, % total	0.09	0.10	0.16	0.23	0.27	0.34	0.39
Population, 90-94 yrs, % total	0.02	0.03	0.03	0.05	0.08	0.10	0.14
Population, 95-99 yrs, % total	0.00	0.00	0.00	0.01	0.01	0.02	0.03
Population, 100+ yrs, % total	0.00	0.00	0.00	0.00	0.00	0.00	0.00

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

Methodology

Industry Forecasts

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

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

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

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

BMI mainly uses OLS estimators and in order to avoid relying on subjective views and encourage the use of objective views, **BMI** uses a 'general-to-specific' method. **BMI** mainly 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 poor weather conditions impeding agricultural output, 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 different criteria and tests, including but not exclusive to:

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

BMI uses the selected best model to perform forecasting.

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

Sector-Specific Methodology

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

- **Production And Sales**

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

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

- **Auto Imports And Exports**

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

Sources

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

Risk/Reward Index Methodology

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

Rewards

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

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

Risks

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

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

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

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

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

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

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

Source: BMI

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