Iran Market Watch:
Power Sector
Our “Iran Market Watch” aims to examine the broad potential of Iran’s generally uncovered markets to provide an unrivaled informational edge to investors and commercial operators through deep tissue due diligence and analysis. In this issue, our on-the-ground market intelligence has uncovered some valuable insights on opportunities into Iran’s power sector, about which we provide a teaser in this report. We would be happy to provide you with a deeper look if the highlighted issues are of interest to you.

Iran: privatization of the Power sector

Iran has one of the largest power industries in Southwestern Asia, accounting for around 17% of MENA power generation, and the 19th biggest in the world, according to the EIA. Nonetheless, ample room for investment remains, as the sector has suffered heavily under sanctions. Further, the sector has maintained strong domestic technical competence despite the lack of technology from outside. Paired with cheap local feedstock in the form of natural gas, the country thus has a substantial competitive advantage among its neighbors, positioning it as a growing exporter. Further, the domestic sector has more than 28 million users connected to Iran’s national electricity grid. Consequently there has been something of a ‘gold rush’ among international investors, particularly from China, Germany, Japan, and South Korea, looking to upgrade the domestic infrastructure of more than 400 power plants and almost 40 electricity distribution companies, with 73 GigaWatts (GW) of capacity and a total value of USD 5.8 bn.

Thus, with the government planning to add more than 5 GW of generation capacity annually to reach a cumulative output of 122 GW by 2022, we see significant potential for growth in the sector, particularly if a nuclear deal with P5+1 countries is reached.
Iran's power sector is potentially an attractive investment as the country seeks to become a major regional exporter of electricity, attracting significant investments for the construction of new power plants. The concerted push has resulted in major investments domestically and by international actors. In March 2014, a number of plants were converted to combined-cycle technology, raising the average efficiency of power plants from 37.5% to 50%. In 2015, Iran and Russia signed an agreement for the construction of eight thermal power plants in country, to raise the total installed capacity by 2,800 MW, for an investment of USD 3.57 million per MW (or a total of USD 10 billion). Also this year Iran launched talks with three global electricity giants from Germany, Japan and South Korea, who intend to establish renewable energy plants in country. Furthermore, our sources indicate that Chinese investors are also a large presence in the Iranian power sector, negotiating with Iran to finance about USD 20bn of the country's electricity and water projects.

All of this investment is focused on taking advantage of Iran’s potential to develop cheap local feedstock (natural gas), as well as technical self-sufficiency in the design and construction of power infrastructure in a region that is severely under-developed from a power standpoint. Iran actively exports its power expertise to over 40 countries worldwide. Since 2007, Iran’s net electricity trade surplus has increased more than six times, a trend that apparently is continuing. In March 2015, it signed an agreement with Pakistan to export 1,000MW of electricity. Because the current US sanctions regime precludes Pakistan from paying in dollars, the two countries signed a barter deal through which the former will give wheat to Iran in exchange for electricity valued at over USD 100mn. However, this payment issue could potentially fall with sanctions relief. The country currently exports more than 7bn Kilowatt hours (KWh) of electricity to its neighboring countries, including, besides Pakistan, Afghanistan, Armenia, Azerbaijan, Iraq, Turkey, and Turkmenistan. The traffic is also two-way however, making Iran something of a hub and arbitrager with imports of more than 3bn KWh of electricity mainly from Armenia, Azerbaijan and Turkmenistan.

However, although the country continues to integrate with regional neighbors, certain challenges remain. For one, the government’s faces some difficulty in meeting domestic electricity demand that is expected to increase annually 5-6% based on EIA data. Further, local electricity trade unions report that the industry suffers from financing issues, mismanagement, inefficiency, and corruption. Another significant problem is that most of Iran’s plants are aging and in need of repair or replacement – both a financial and technology problem. However, many of these issues may be mitigated with the opening of the economy under sanctions relief. Further, the government’s response to high electricity consumption has been to phase out electricity subsidies as part of a subsidy reduction program, which began under Ahmadinejad. With a return to market pricing, the power sector is expected to continue to increase in efficiency...
over the next 3-5 years. Thus, increasing efficiencies as well as growing domestic and regional end markets provide for a solid investment thesis.

Finally, the increasing move to privatize end-user market pricing is mirrored by increasing traction in efforts to privatize the sector in recent years. Various governments have undertaken start-and-stop efforts to modernize the country’s power sector through privatization over the past 20 years, but momentum really began to pick up with the third economic, social, and cultural development plan (2000–2004), which called for a larger role for the private sector, specifically in the electricity sector. This effort spawned the transfer of some of the state’s electricity assets to the Tehran Stock Exchange (TSE) in 2004. From that period through 2013, four firms were privatized at a cumulative value of IRR 140 trillion. In May 2014, Iran announced a plan under which 183 government-owned companies, including power companies, would be listed on the TSE by early 2015 (with 130 having been listed thus far). We note that at least 80% of electricity distribution companies must be privatized according to the Principle 44 of the Iranian Constitution, and the market is increasingly seeing shares of distribution companies being transferred from the government to the private sector. We believe the privatization of the power sector should help Iran achieve its goal of sustaining domestic consumption and maintaining net export capacity. Electricity supplied by private power plants is sold to Tavanir, which is responsible for domestic distribution. Consequently, despite the amount of additional supply coming on the TSE, we expect there will be a rush to invest in select quality Iranian power companies over the coming years to take advantage of the burgeoning sector.

We list below the major companies who currently dominate the Iranian power sector:

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<th>Mega power companies - Valued above IRR 10,000bn</th>
<th>Major companies valued between IRR 1,000-10,000bn</th>
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Iran's electricity net generation and consumption (bn Kilowatthours)

Source: U.S. Energy Information Administration - latest available data
About Whispering Bell

Whispering Bell is a leading security risk management consultancy advising clients in high-risk environments throughout the Middle East and North Africa. We establish an in-depth understanding of the political and security environments in which our clients operate. Whispering Bell works with clients throughout the region to provide the following services:

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