

## THIS MONTH

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The Tehran Stock Exchange (TSE) saw a continuation in July of its outstanding performance in June, although growth stagnated towards the end of the month. The IPO of the Telecommunications Company of Iran was authorized in July by the exchange regulators. This section provides an analysis of the market and some of the main sectors.

### Turquoise Iran Equity Fund **4**

The Turquoise Fund performed well in July, with its NAV gaining 8.5% in value. This section provides various information and charts on the Fund's performance.

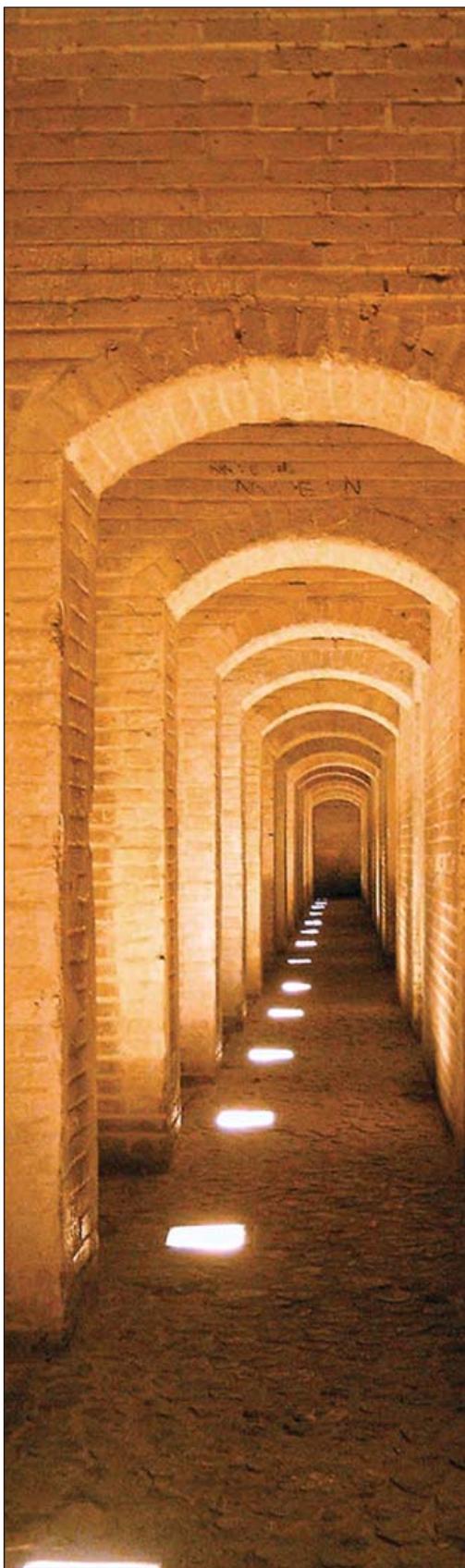
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This section covers the government's economic reform plan, which was announced by President Ahmadinejad in July.

### Economy **7**

The annual monetary policy of the Central Bank of Iran, the TSE's status as the most profitable exchange in the world this year, Gazprom in Iran and Iran's non-oil exports are the topics of discussion in this section.

Internal Structure of Khajoo Bridge, City of Isfahan, Central Iran



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The Tehran Stock Exchange (TSE) began the month of July with a continuation of the rapid growth that had characterised June's performance. Following the announcement of the liberalisation of the cement price and the closure of cement stocks for an earnings adjustment in June, most of these companies re-opened this month with gains ranging from 25% to 100%. This was the key driver behind the market rallies in the first half of July. However, towards the end of the month, growth began to stagnate and trading volumes fell significantly. Profit takings following two months of strong growth, the closure of a number of large stocks for their Annual General Meetings, the unclear outcome of the international talks over Iran's nuclear programme, and uncertainties surrounding domestic fiscal policies were some of the reasons for the slow down.

In the third week of July, the Tehran Stock Exchange Corporation announced that it had authorised the IPO of the Telecommunication Company of Iran (TCI), which would take place in early August. It is worth noting that analysts' initial valuations show that TCI may become the largest listed company on the TSE by market capitalisation, with an expected size of between \$8 billion and \$12 billion. While this news caused excitement in the market, it also put pressure on a number of other stocks, because investors began to sell their positions to obtain cash for the IPO.

On the 20<sup>th</sup> of July, the subscription process for the shares of the newly incorporated Iran Over-The-Counter (OTC) market began. This offering attracted huge interest and was completed within 48 hours for a total value of \$21 million. Experts see this development as a major milestone for the Iranian capital market, believing that it will stimulate innovation in financial products. Iran OTC is expected to begin its operations towards the end of 2008.

Some of the key sectors are analysed in more detail below:

### **Steel Manufacturers**

This sector, as predicted by many analysts at the start of the year, has been the best performing sector since the beginning of the Iranian calendar year (which started 21<sup>st</sup> March). The liberalisation of the steel price as it commenced trading on the commodity exchange at the start of the year, the sharp rises in the global steel price over the past year or so, and the fact that most steel manufacturers in Iran receive their energy and raw materials at a discount, mean that these companies have seen their profits soar. However, most steel makers have not been as successful as expected in converting these windfall profits into expansion plans. It is therefore clear that this rate of growth in their profitability is not sustainable, particularly if the global steel price enters a correction cycle. The market also reacted to this in July, as trade volumes in the sector quickly fell and the price rallies that most steel manufacturers experienced in June disappeared.

### **Iron Ore**

Despite the prescribed price by the government for the sale of iron ore domestically, companies of this sector have generally performed well this year. Chador Malou, the largest company in this sector, released a very strong first quarter earnings statement as it has been able to increase its production capacity beyond analysts' expectations. Iron ore companies are permitted to export their production in excess of domestic consumption and at global prices. With the increased production volume and higher average selling price, analysts predict that Chador Malou's earnings this year could be around 80% higher than what was originally forecasted and the company is expected to release a positive adjustment to its earnings forecast shortly. Gol Gohar, the second largest company in this sector, has been hit by a fall in its export volumes and delays in its expansion plans. The price of the latter stock experienced some modest falls in value, following two months of strong performance.

### **Petrochemicals**

Companies in this sector can be divided into two groups, based on the type of their feedstock. Following the removal of the government discount on crude oil, those companies that use crude oil as their feedstock have seen their profit margins fall significantly. In this group, Arak petrochemical had a downward revision of around 50% to its earnings forecast compared with last year. The situation is expected to remain the same for these companies in the short term.

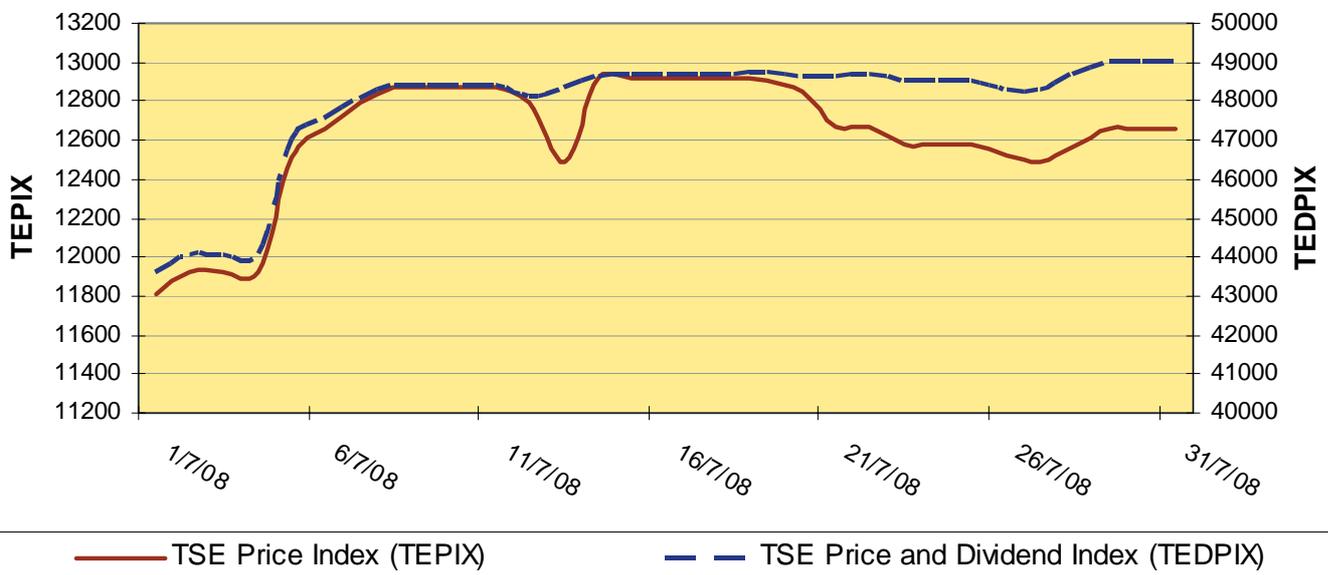
The group of petrochemical companies that are gas-based did not witness significant change in the pricing of their feedstock. With the increase in the price of most petrochemical products, particularly methanol, over the past year, these companies have enjoyed bigger profits than analysts predicted. In addition, a number of expansion plans are expected to be completed this year. These will position Iran as a leading methanol producer in the world in the next 2-3 years. Shares of Fanavaran Co. and Kharg Co. have experienced a solid performance since the beginning of the year.

**Pharmaceuticals**

The sale prices of most generic products in the pharmaceutical sector are set by the government. With the ever increasing price of raw materials, the profit margins of most companies in this sector are diminishing, and the government has yet to authorise a price increase this year. For this reason, shares of companies in this sector have underperformed in comparison with the market index. For the past two years, the Ministry of Health and Medical Education has approved a sale price increase in the second half of the Iranian calendar year. Most analysts are hopeful that the same will happen this year.

Overall, the Tehran Stock Exchange experienced another outstanding performance, with the Dividend and Price Index (TEDPIX) gaining 13.1% in value. Trade volumes, however, fell by around 10%, from \$1.67 billion in June to \$1.5 billion in July.

**Performance of TSE Indices (July 2008)**

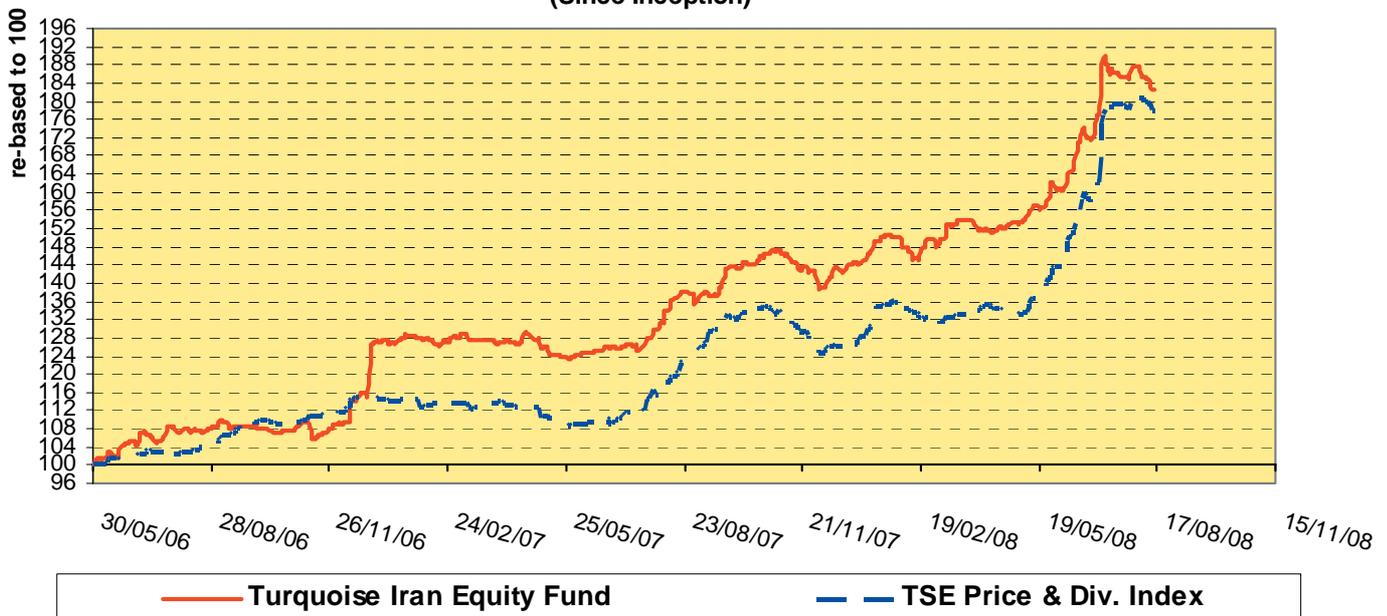


**Investment Objective** – The Turquoise Equity Fund seeks superior long-term capital growth by investing in the consumer and commodity potential of Iran, one of the most under-valued emerging markets in the world. Turquoise combines international experience with local expertise in investing in equities listed on the Tehran Stock Exchange (TSE) and other Iranian-based securities, thereby seeking to provide superior returns with greater diversification and lower volatility. The base currency of the Fund is Iranian Rial.

**Monthly Report** – The Net Asset Value (NAV) of the Turquoise Fund grew sharply in July, increasing by approximately 8.5% to stand at 187.7 by the end of the month. Most market indices also experienced large gains over the month, with the TSE Price and Dividend Index (TEDPIX) gaining 13.1% in value and the TSE Price Index (TEPIX) 7.7%.

The charts below provide an update up until the middle of August, on the following: the performance of the Fund against both the TEDPIX in local currency and also the Emerging Market index in USD, as well as the overall performance of the Fund in USD, Euro and GBP. The performance table also displays the historical performance of the Fund.

**Turquoise Portfolio vs. TSE Price & Div Index (TEDPIX)  
(Since Inception)**



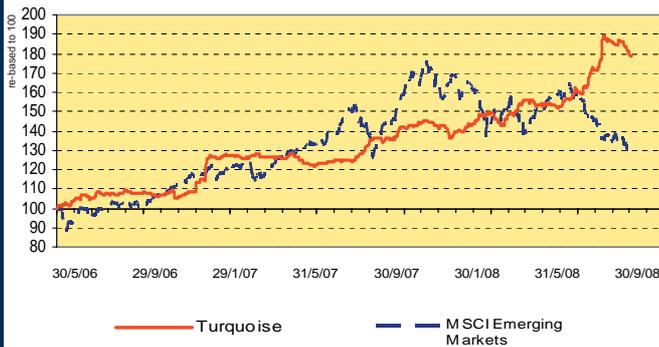
	May 08	Jun 08	Jul 08
<b>Turquoise Fund</b>	↑ 5.1%	↑ 7.3%	↑ 8.5 %
<b>TEDPIX</b>	↑ 7.2%	↑ 11.1%	↑ 13.1 %

## Performance

As of 15 August 2008

Period	Fund Return
Last Month	↓ 2.0 %
Last 3 Months	↑ 16.4 %
Last 6 Months	↑ 25.6 %
Last 12 Months	↑ 33.5 %
Since Inception (30 May 06)	↑ 82.6 %

### Turquoise Performance vs. MSCI Emerging Markets



### Turquoise Performance in US Dollar (US\$)



### Turquoise Performance in Euro (€)



### Turquoise Performance in British Pound Sterling (£)



This edition of Country Overview focuses on the government's economic reform plan.

At the end of June, President Ahmadinejad announced the details of the government's so-called "economic reform plan". According to Mr. Ahmadinejad, the government has conducted a survey of the economy's status and has identified three main risks confronting the achievement of sustainable long-term economic growth. Firstly, the growth rate over the past decades has experienced significant fluctuations, and this makes the economy vulnerable to any shocks. Secondly, the unemployment rate has been in double digits for approximately 20 years. Thirdly, the economy has suffered from a high rate of inflation for a number of years. He stressed that huge efforts and funds have been allocated to removing these obstacles, but there are a number of structural problems that need to be addressed first. Consequently, a number of reforms have been introduced, some of which are summarised below:

One of the key reforms is in the tax system. According to the government, the existing tax system cannot appropriately identify tax payers, and consequently the proportion of payments received is not balanced. Mr. Ahmadinejad explained that the government has devised a new information and tax collection system which can correctly identify tax collection opportunities. For example, all real estate transactions will be recorded in a data bank from which capital gains taxes can be identified and collected. He also referred to the status quo of the custom system, highlighting the need for this organisation to be appropriately resourced and for nationwide links between information systems in local offices to be put in place.

One of the more controversial reforms that the government plans to introduce is a major restructuring of the subsidy system. Currently, the government is spending nearly \$100 billion annually on subsidies, most of which are spent on fuel, energy and consumable products, such as sugar, rice and cleaning products. Mr. Ahmadinejad explained that subsidies are an economic tool that can be used to support low income groups, to reduce the social gap, and to boost the more vulnerable industries. However, for this tool to work effectively, funds need to be targeted towards specific industry sectors and needy social groups, rather than the current system which just targets all sectors. The government has proposed the removal of subsidies from the price of all commodities and services, and instead intend to pay out cash to the targeted families and industries. The details of this proposal are yet to be announced by the government.

The long-term economic policy of Iran is to move from a state-dominated economy to one dominated by the private sector. The need for the removal of subsidies to achieve this policy has been widely recognised for many years. However, Ahmadinejad's government is the first to take a real step towards implementing it. Nevertheless, this proposed plan also has its critics. This group argue that the plan will not only send the already high rate of inflation rocketing, but will also widen the social gap in the country. What is clear is that any changes in the existing subsidy system will have a major impact on the economy and will therefore need to be carefully planned and implemented.

### **Annual Monetary Policy of the Central Bank of Iran**

In July, the Central Bank of Iran released its annual monetary policy report. The Central Bank has been implementing a contractionary policy for the past two years to control economic growth and inflation. This year, the Bank introduced a series of stronger measures to further reduce excess liquidity in the economy, in order to dampen the growing rate of inflation. One of the notable measures is the ban on mortgage lending by all financial institutions, except for Bank Maskan, which is a state-owned mortgage lending specialist. Many experts believe that the excessive mortgage lending over the past few years is one of the main reasons for the high inflation in house prices. The Bank is aiming to direct bank resources previously used for mortgage lending towards various industry sectors where funds are needed to stimulate an even growth in the economy. Also, despite the government's attempts to reduce lending interest rates, the Bank kept the base lending rate unchanged at 12%, reasoning that lowering interest rates would further increase the inflation rate.

One of the important features of this report was a series of improvements to existing banking regulations. The Bank is placing significant emphasis on risk management, liquidity and capital adequacy, and has introduced new enforcement measures for non-compliance. Furthermore, the Bank has obliged all banks and credit institutions to commence their preparations for the implementation of the Basel II standards. There was also encouragement for the introduction of innovative financial products.

### **The Most Profitable Exchange in the World**

According to the most recent statistics published by the World Federation of Exchanges, from the beginning of 2008 until the end of July, the Tehran Stock Exchange (TSE) has been the best performing exchange in the world. The overall index of the TSE has gained more than 55% year-to-date. The market capitalisation of the TSE has also grown by 106% since the beginning of the year to stand at \$67 billion, the highest growth in the world in this period. Total trade volumes also grew by 99.2% year-to-date compared with the same period last year, placing the TSE in 2<sup>nd</sup> place in the world rankings.

At a time when developed capital markets around the world are going through turmoil, the Tehran Stock Exchange has become the most profitable exchange in the world to invest in. There are a number of reasons for this outstanding performance, but analysts believe that the ongoing privatisation programme has been and will continue to be the key driver behind growth in the Iranian capital market.

### **Gazprom in Iran**

In mid-July, a Memorandum of Understanding (MoU) was signed between Seifollah Jashnsaz, the National Iranian Oil Company (NIOC) Managing Director, and Alexei Miller, Chief Executive of Gazprom, the largest extractor of natural gas in the world. This MoU is for the development and expansion of a number of oil and gas projects in Iran. According to the agreement, Gazprom will participate in the development of the South Pars gas field in the Persian Gulf, which holds nearly half of Iran's gas reserves. In addition, the two parties agreed to establish a joint venture for the development of a number of other oil and gas fields in the Persian Gulf and the Caspian Sea, a pipeline for the transfer of crude oil from the Caspian Sea to the Gulf of Oman, and the establishment of a new oil refinery in the north of Iran.

This major energy deal comes just after Total of France withdrew from a development project in the South Pars gas field. Analysts are of the opinion that the withdrawal had a political dimension to it, and was fuelled

by the pressure from the US on Total. At the time, the Iranian officials said that Iran would continue the development plan, with or without Total.

### **Iran's Non-Oil Exports**

In the first three months of the Iranian calendar year 1387 (ends 21st March 2009), Iran's total non-oil exports amounted to \$4.3 billion, showing a 37% growth compared with the same period last year. In the same period, the value of total imports stood at \$13 billion. Liquefied propane at \$283 million and methanol at \$249 million were ranked at the top of the list of Iran's non-oil exports, comprising 6.6% and 5.8% of the amount of total exports respectively. The UAE, China, India and Japan are the main destinations for Iran's non-oil exports.

## About Turquoise

Turquoise is a boutique investment bank based in Iran with offices in Tehran and London. Turquoise creates financial products and offers financial services to select clients and investors who are interested in the Iranian market. Having a qualified and diverse management team based both in Europe and in Iran enables Turquoise to benefit from coupling local knowledge and presence with global expertise.

Turquoise publishes this electronic newsletter, *Iran Investment Monthly*, with the aim of keeping its recipients updated on the latest macroeconomic developments in Iran, providing an in-depth analysis of the Tehran Stock Exchange as well as introducing new financial products and private equity opportunities to potential investors.

*Iran Investment Monthly* is distributed exclusively amongst Iran analysts and potential investors who have worked closely or have been in contact with Turquoise Partners. Subscription to this newsletter is by referral only or through an online request sent to: [ramin.rabii@turquoisepartners.com](mailto:ramin.rabii@turquoisepartners.com)

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