



Shazand Oil Refinery, City of Arak, Central Iran

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*Iran Investment Monthly is produced by Turquoise Partners. Distributed electronically by exclusive subscription.*

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In July, the Tehran Stock Exchange (TSE) had its strongest monthly performance of 2010. The Iranian equity market has yet to experience a negative month this year. In the past month, the AGM's for some of the largest listed companies took place. The anticipation of high dividend payouts created a degree of excitement among investors and accelerated the positive momentum of the market.

Year-to-date performance of the TSE main index is now 41%. However, many analysts argue that macro-economic indicators and the fundamentals of most companies do not justify this level of performance. In their opinion, the bull run of the past few months has substantially increased the downside risks of the market and a trend reversal could result in a slump in prices. In addition, the subsidies removal plan, which is expected to commence before the end of 2010, remains a risk for the market as a whole. This is because there are still many uncertainties and unknowns surrounding the plan. On the other hand, a lack of investment opportunities in parallel markets, such as real estate, has led to the deployment of a significant amount of capital into the equity market. With the latest reduction in bank deposit interest rates, this process has gained further speed. As a result, strong support levels for stock prices seem to have been created, which, in turn, would block any sharp falls in prices.

Some of the key events and sectors of the market will be analysed below:

### **Launch of Financial Futures Market**

On 26<sup>th</sup> July, the financial Futures market commenced its operations. During the first few days, Futures contracts for the stocks of Karafarin and Parsian banks were traded. Stock Futures are the first type of financial derivative contract to be introduced onto the Iranian market. This comes as part of an initiative by the exchange corporation and the regulator to develop and expand financial instruments within the Iranian capital markets. In 2008, commodity Futures came onto the Iranian Mercantile Exchange (IME) and Option contracts are expected next year.

The high leverage of stock Futures and restrictive trading regulations make this product a complex and a relatively high risk one. Therefore, it will be some time before the market is fully developed.

### **Automotive Manufacturing**

The sale by the government of 18% blocks of shares in Iran Khodro and Saipa, Iran's two largest automotive manufacturers, has been a controversial issue within the privatisation programme for quite a while. After several months of speculation and contradictory news, the Iranian Privatisation Organisation finally auctioned the two blocks in June. In that month, Iran Khodro's block was bought for \$420 million.

The bidding war for Saipa's block continued into July. At the beginning of July, the government announced that quasi-governmental institutions, to which the government owed a debt, were also permitted to compete for and acquire the block in exchange for their debt. This brought several new competitors, such as the Social Security Organisation, into the equation. This heated up the bidding war and significantly reduced sensitivity to the price. Not surprisingly, the government's move was widely criticised by market players, who argued that the decision went against the spirit of the privatisation programme. Nevertheless, on 21<sup>st</sup> July, the block was bought for a staggering value of \$1.56 billion by a consortium created by the staff and the existing management of Saipa. During the bidding process, Bahman Group, which currently holds 14% of shares in Saipa, went from competing for the government's 18% block to becoming a seller of its own block after the bidding price broke the \$1 billion level. If the winning consortium is able to acquire Bahman Group's block, the existing management would retain control of Saipa.

### **Metals and Mining**

These two sectors were among the best performers in July. Stability in the global prices of metals and minerals, and strong first quarter earnings results by companies in these sectors were the main reasons for this performance. The base metals sector index and the mining sector index gained 13.5% and 18.7% respectively in value over the course of July.

Stocks of steel and iron ore producers were the top performers among metals and mining companies. Strong domestic demand for steel products and government imposed limitations on the imports of crude steel has led to IME prices of steel rising to levels considerably above the global average. The buoyant domestic steel market has also had a positive effect on the iron ore sector. Shares of Mobarakeh Steel, Iran's largest steel manufacturer, gained 16% in value. Also, Chador Malou, the largest listed producer of iron ore, had a 15% rise in its share price in July.

The first quarter earnings update from the National Iranian Copper Industries Co. (NICIC) was above what was budgeted, due to a higher-than-expected average copper price. Shares of NICIC gained 8% in value in July.

### Cement

The cement sector was one of the best performing sectors over the course of July. The sector index gained 20% in value. The recent statistics on housing and construction shows increased activity and indicates a possible rebound in the real estate construction market. This is despite the fact that there has not been much of an increase in the average property price. The strong earnings results from most cement companies further confirm the possible rebound. There are, however, disagreements as to whether the increased activity is mainly due to the nationwide Mehr Housing scheme, or whether there is genuinely a recovery in the real estate sector as a whole.

Over the past two years, the cement sector has been one of the main under-performers of the Iranian equity market. Analysts believe that despite the recent rebound, the subsidies plan remains a major risk for the cement sector.

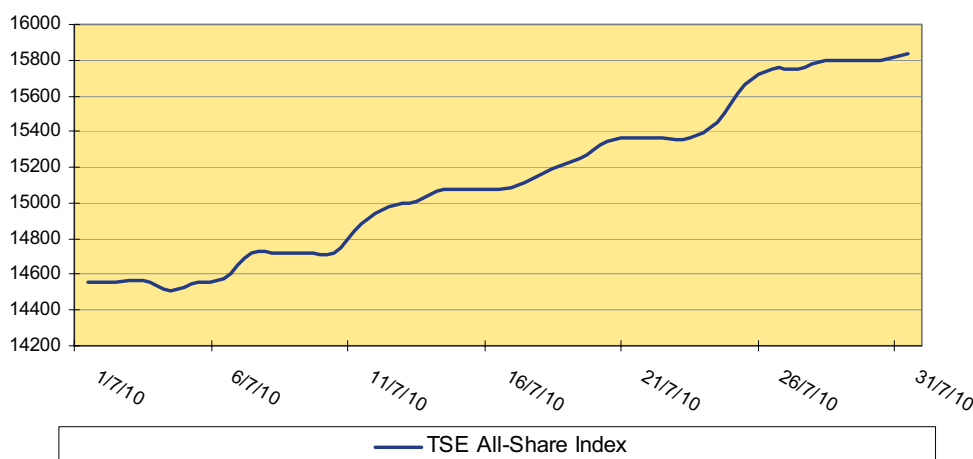
### Fixed Income Market

The Iranian fixed income market continues to both attract significant capital and also compete with the equity market. After the reduction of bank deposit interest rates earlier this year, participation papers (an Islamic form of bond), the vast majority of which pay coupon rates of 2-3% above bank rates, have become extremely popular with investors. New issues in July included \$300 million of papers by the Tehran Municipality and \$100 million of participation papers by the Ministry of Energy.

Also in July, Iran & Shargh Leasing Co. listed \$8 million worth of participation papers on the Iranian OTC market. These papers have a tenure of 4 years and pay an annual coupon rate of 17%. According to the OTC corporation data, the entire issuance was sold within seconds. Iran & Shargh Leasing is the first non-bank entity to list a fixed income product on the OTC market.

Overall, the TSE had an outstanding performance in July, with the TSE All-Share Index gaining 8.9% in value in Rial terms. The Euro exchange rate gained 5.8% against the Rial, which is pegged to the US Dollar. Trade volumes stood at \$1.1 billion.

**Performance of TSE All-Share Index (July 2010)**



### **Turquoise Partners Launches Domestic Fund**

In August, Turquoise Partners launched its first domestic equity fund. Firouzeh Mutual Investment Fund (FMIF) is licensed and regulated by the Securities & Exchange Organisation (SEO) of Iran. The fund is an open-ended unit trust and is marketed through selected branches of a prestigious private bank. FMIF is the first domestic product launched by Turquoise, and comes as part of Turquoise's long term strategy of becoming a leading asset management firm in Iran.

The subscription period commenced on 1<sup>st</sup> August and continued for 10 days. During this period Turquoise raised over \$2.8 million of funds. This set a new record of money raised during subscription periods for this type of fund. Approximately 90% of the funds raised came from individual investors and the remaining 10% came from legal entities. Turquoise has set a target of \$5 million of assets under management by the end of the first year from the inception of the fund.

The fund management industry in Iran is still a nascent industry. Regulations and operational procedures for structuring and managing a fund were put in place in early 2008. Since then, 41 funds have been established, 4 of which are fixed income funds and the remainder of which are equity funds. By the end of the subscription period, FMIF ranked 11<sup>th</sup> among equity funds in terms of assets under management. Total assets under management within the Iranian fund management industry amount to approximately \$230 million. Given the vast unutilised liquidity in the Iranian economy, the fund management business has tremendous growth potential.

Iran and Russia's 30 year energy agreement and its implications within the context of long-term relations between the two countries will be the topic of discussion in this edition of Country Overview.

In July, Iran and Russia signed an agreement to increase their cooperation in developing their energy sectors. A 30 year agreement was signed between the two countries in order to join forces in facilitating exploration, extraction, refinery and production of oil, gas and petrochemical products.

Iran and Russia have a long history of economic and socio-political interaction. However, relations between the two countries have followed a turbulent path over the years. After World War II and prior to Iran's Islamic Revolution, the US used its influence over Iran's Pahlavi regime to position Iran as an anti-communist state. This led to a significant dampening of relations between Iran and the Soviet Union. Relations further soured after the 1979 revolution in Iran and particularly during the Iran-Iraq war, when the USSR was selling weapons to Saddam Hussein. However, after the collapse of the Soviet Union and the formation of the Russian Federation, there was a sudden change in the political and economic interaction between the two countries. Relations strengthened further when Iran awarded the construction of the Bushehr nuclear power plant to Russia.

With the increasing tensions between Iran and the US and the pressure on Iran from the West, Iran has gradually shifted its trade to countries such as Russia and China. Russia has now become a strategic trade partner for Iran. In 2009, total trade between the two countries stood at \$1.2 billion. In recent years, prominent Russian companies such as Gazprom and Lukoil have become increasingly involved in the development of Iranian oil and gas projects. Also, since President Ahmadinejad took office in 2005, he has made significant efforts to expand political and economic ties between the two countries. However, over the past 6 months or so, a number of controversial issues have placed the two countries at loggerheads. In the view of many experts, relations between the two have deteriorated to a certain extent. The potential sale by Russia of the S300 missile system to Iran has been strongly opposed by the West. After considerable delays by Russia in delivering the system, Russia has indicated that it may cancel the \$12 billion deal with Iran. In addition, Russia voted in favour of the latest round of sanctions imposed on Iran by the UN Security Council in June. Russia's action was heavily criticised by Iranian officials.

The recent energy contract comes at a crucial time when, in the view of experts, Iran may be on the verge of losing one of its allies. The contract may prove an important step in restoring relations between the two countries. Furthermore, the agreement will have major benefits for both countries. Iran and Russia collectively hold 18% of the world's crude oil and 40% of the world's natural gas reserves. The agreement provides a platform for the two countries to draw upon each other's expertise and resources for the development of their energy sectors. Also, Russia has indicated that it may be prepared to commence exporting gasoline into Iran. Currently, Iran imports around 40% of its domestic gasoline consumption and there are concerns about a potential embargo on fuel by the West. Other features of the agreement include the establishment of a joint oil exchange, which with a combined production of up to 15 million barrels of oil per day has the potential to become a leading market globally. Also, there is an agreement in place regarding the modernisation of the Iranian oil industry.

The details of the agreement and the underlying contracts are to be structured during a meeting of the oil ministers, which is scheduled for late 2010. There may be doubts over the long-term commitment of the two countries to the agreement. However, it is evident that for the time being, the contract could provide grounds for an improvement of relations between the two countries.

### Iran's Zinc & Lead Industry

Modern zinc and lead industry in Iran dates back to 1961, when the first excavation and refinery unit was built in Iran. For the next 32 years, all extracted zinc and lead was exported in the form of concentrate. However, from 1993, Iran began the production of zinc and lead ingots.

Zinc and lead are typically excavated from the same mine, although concentration of zinc in the ore tends to be considerably higher than that of lead. Iran has over 220 million tonnes of zinc and lead ore reserves. With approximately 11 million tonnes of zinc metal constituent and 5 million tonnes of lead metal constituent, Iran has just below 5% of the world's metal constituent reserves. Two important mines in Iran are Mahdi-Abad, which has 75 million tonnes of ore with a zinc concentration of 6% and a lead concentration of 2.7%; and the Angouran mine, which has 16 million tonnes of ore with a zinc concentration of 26% and a lead concentration of 6%.

In 2009, with approximately 165,000 tonnes of production, Iran ranked first in the Middle East and 15<sup>th</sup> in the world in terms of zinc and lead production. Production figures stood at 120,000 tonnes in 2008 and 150,000 tonnes in 2007. The reason for the fall in production in 2008 was the global financial crisis, which sent zinc and lead prices to levels (\$1,100 - \$1,200) where production was no longer profitable for most producers. In 2009, Iran exported 77,000 tonnes of zinc and lead concentrate and ingot.

Despite the vast reserves, Iran's zinc and lead industry is significantly under-developed. It is believed that there are vast reserves in the North West of Iran; however, little exploration has been done to date. Mahdi-Abad mine, Iran's largest mine by ore reserves, is currently non-operational, due to technological challenges. To make matters worse in 2006 Angouran mine, Iran's largest operational mine at the time, suffered partial structural collapse. This was a disaster for the industry, as four major producers are dependent on this mine. It is predicted that Angouran will become fully operational in 2011, at the earliest. Therefore, the vast majority of production over the past 3 years has come from smaller mines. Iran Zinc Mines Development Group is the largest producer of zinc and lead in Iran. At its peak, it accounted for 80% of Iran's production. However, with the collapse of Angouran, its production and profitability fell significantly. Bama Mining & Industrial Co. and Bafgh Mines Co. are, perhaps, the most profitable companies in this sector, as they both own their own mines. There are currently 6 zinc and lead producers listed on the Tehran Stock Exchange, including the three companies mentioned above.

Given the long term concerns about the supply of zinc and lead globally, and in turn, the positive outlook on the price of zinc and lead, it is evident that Iran's zinc and lead industry has a tremendous potential for expansion and development. However, financing and technology will prove to be the key challenges along the way.

### Inflation and Unemployment

The latest statistics published by the Central Bank of Iran reveals that annual inflation rate as at end of July stood at 9.4%. Also, the Consumer Price Index (CPI) grew by 1.1% in July, in comparison to the previous month. Annual inflation rate as at end of Iranian calendar year 1388 (which ended 20<sup>th</sup> March) stood at 10.4%.

According to the Statistical Centre of Iran, unemployment in the first quarter of Iranian calendar year 1389 increased to 14.6%. Unemployment rate in the same period last year was 11.1% and as at end of 1388 was 14.1%. Unemployment is at its highest level for the past 13 years.

### New Petrochemical Plants

In July, two new petrochemical plants were inaugurated. Morvarid and Pardis 2 are situated in the Assalouyeh special economic zone, on the shore of the Persian Gulf.

Morvarid is an Olefin plant, with an annual capacity of 500,000 tonnes of ethylene (a mid-stream petrochemical product). Construction of the plant has cost approximately \$460 million, and it is estimated that it could generate an annual profit of over \$200 million, once it reaches its production capacity. Pardis 2 is the second production unit of the Pardis Complex. It has a capacity of 1.75 million tonnes of urea and 680,000 tonnes of ammonia per annum. The project has cost \$450 million. M.W. Kellogg of the UK and Stamicarbon of the Netherlands were the technical advisors of the project. The two plants are expected to create 1,000 jobs collectively.

### **Iran – Turkey Real Estate Agreement**

In July, housing ministers of Iran and Turkey signed a Memorandum of Understanding (MOU) for the mass production of low cost housing in Iran. Under the agreement between the two sides, Turkish firms are to build 20,000 residential units in the new city of Parand. The deal comes as part of the nationwide Mehr Housing project in Iran, which aims to provide affordable housing to low income families and first time buyers. Mehr Housing project is expected to provide 600,000 residential units in its first phase. Turkey has a strong track record in mass producing affordable houses. A similar project was successfully implemented in Turkey recently. Previously, companies from Malaysia and South Korea have won development contracts under the Mehr Housing project.

## 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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