



THIS MONTH

Market Overview **2**

The strong performance of the Tehran Stock Exchange over the past few months gained further momentum in August. The TSE main index had its strongest monthly performance for the past 6 years. However, analysts believe that stocks in a number of sectors are now trading above their fair value and price corrections are expected.

Turquoise Iran Equity Investments **4**

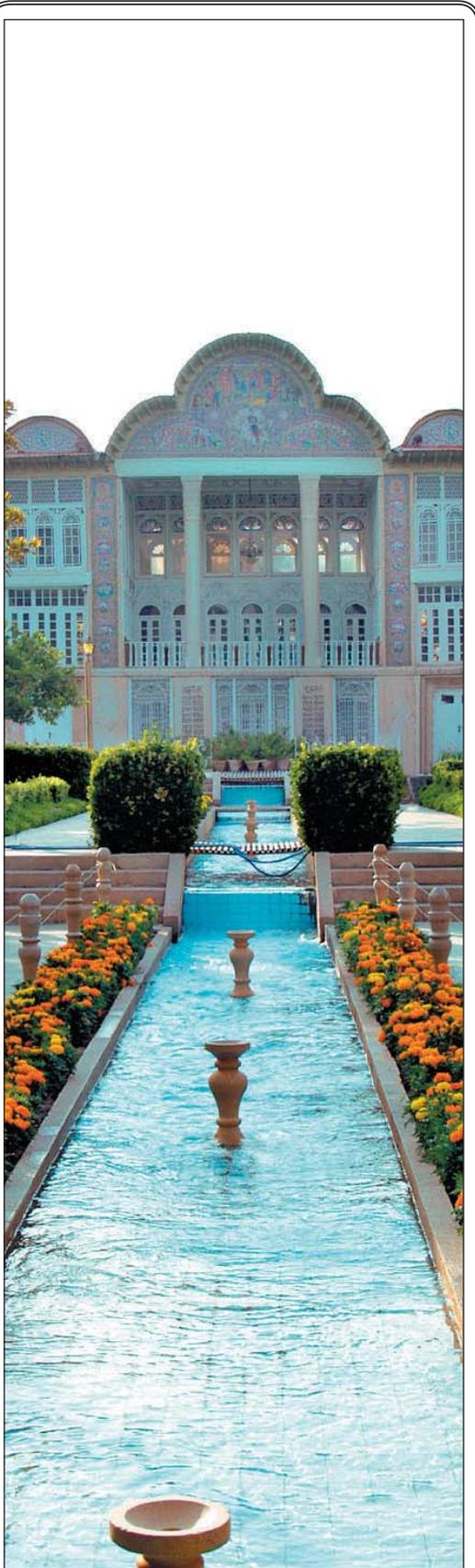
This section provides data and charts on the performance of Turquoise Iran Equity Investments Class A for the month of August.

Country Overview **5**

Inauguration of the Bushehr nuclear power plant and Mashaei's controversial speech during the congress of Iranian expatriates will be discussed in this section.

Economy **7**

Iran – Iraq trade, the petrochemical agreement between Iran and Venezuela, the development of financial markets in Iran, and foreign investment in Iran's power generation sector will be covered in this section.



In August, the strong positive performance of the Tehran Stock Exchange (TSE) since the beginning of the year gained further momentum. The TSE main index had its best monthly performance over the past 6 years. A further strengthening of global commodity prices and also the constantly increasing inflow of new funds into the equity market were assessed as some of the reasons for this strong performance. While these factors have contributed towards the positive performance of the market, none of them can justify the double digit gains in the market index. There are concerns among market players as to whether the recent rallies have pushed the prices above their fair values and that a downturn in the market may occur at some point in the near future. Also, there are signs that many investors are now pursuing more defensive strategies in the market.

As at the end of August, the weighted average price/earnings (P/E) ratio of the TSE was 6.8, up from 5.8 at the beginning of the current Iranian year (which started on 21st March). Despite the sharp increase, the P/E ratio is still significantly below its high of 11.5 in 2003. However, share prices in a number of companies are considerably overvalued. In particular, stocks in the automotive and engineering services sectors have increased dramatically in value and the earnings prospects do not justify the existing P/E ratios.

The general consensus is that a price correction is likely to happen in a number of sectors in the near future. The removal of subsidies, which is expected to start this autumn, may trigger this. However, the relatively low P/E ratios in some other sectors mean that there are still many long term investment opportunities in the market.

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

Initial Public Offering of Dana Insurance

On 16th August, a 5% stake in Dana Insurance was sold on the market as part of the ongoing privatisation programme. The positive sentiment in the market, the high risk appetite of market speculators and a bidding war for the shares resulted in an IPO price of \$2.61 per share. This put the lagging P/E ratio at 183 and the market capitalisation of the company at \$275 million. Dana was the third and the smallest state-owned insurance company to undergo privatisation, but had the highest market capitalisation at IPO.

In the view of most analysts, Dana was significantly overvalued at these prices. As a result, the share price tumbled for the remainder of the month and ended the month 14% below the IPO price. Dana has a share capital of \$10.5 million. Its net profit for the existing year in its budget is \$21 million. Of this amount, \$8 million is expected to come from operations and the remaining \$13 million from the sale of real estate assets. Most analysts are sceptical about Dana's ability to reach this target. Last year, Dana's net profit stood at \$1.5 million.

The excitement over Dana's IPO spilled into other listed insurance companies, causing strong price rallies. The insurance sector, with a 28% gain, was the best performing sector of the month. However, the sector now appears considerably overvalued and price declines are expected in the coming weeks.

Steel

The latest data reveals that imports of steel and its by-products have fallen over the past 3 months. Restrictions on imports that were imposed by the government along with the latest round of sanctions were assessed as the main reasons for the decline in imports. Meanwhile, domestic demand remains robust, and Iran is a net importer of steel. As a result, the domestic price of raw steel and its by-products has risen sharply. For example, rebar was traded at around \$900 per tonne in August, some 25% above the regional average.

Unsurprisingly, shares of listed steel manufacturers enjoyed strong rallies over the course of the month. The best performing companies in the steel sector were Khouzestan Steel with a 74% gain, Khorasan Steel with a 52% gain and Mobarakeh Steel with an 18% gain.

Automotive Manufacturing

It appears that the controversy over the sale by the government of 18% blocks of shares in Iran Khodro and Saipa, Iran's two largest automotive manufacturers, is going to continue for some time. The two blocks were auctioned in June and successfully sold off. However, in August, both deals were cancelled by the Iranian Privatisation Organisation. No clear reason was given for the cancellation of the deals, but analysts believe that discontent over the prices at which the blocks were traded is the most likely reason. Iran Khodro's block was sold for \$420 million and Saipa's block was sold for a staggering value of \$1.56 billion.

Unexpectedly, rumours about a possible re-auctioning of the blocks at higher prices drove the share price of both companies higher, such that the automotive sector index was up 26% over the course of August. The average P/E of the sector, which was below 3 at one point, is now close to 5. The profitability prospects of the companies in the sector do not justify the existing price levels and this sector, in the view of many analysts, is one of the most overvalued sectors of the market.

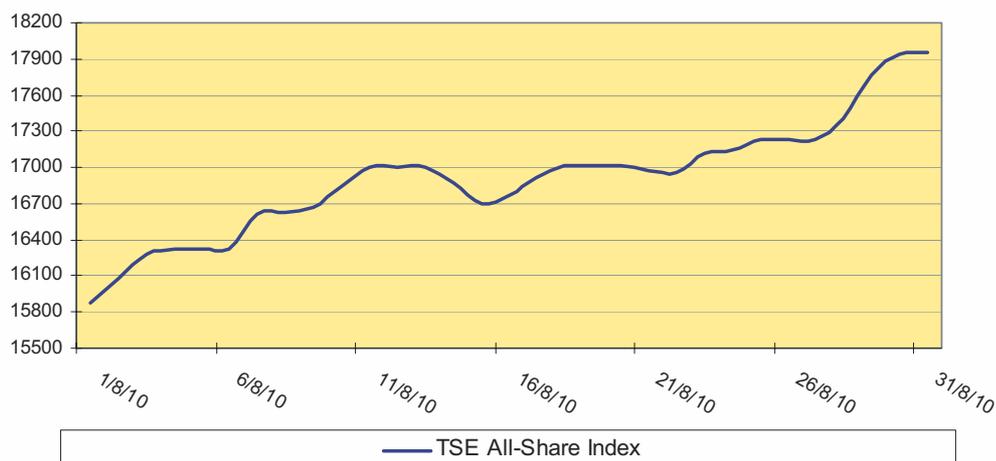
Fixed Income Market

The Iranian calendar year 1389 (which began on 21st March), has been an astonishing year for the fixed income market. The reduction by the Central Bank of the bank deposit interest rates this year has created huge demand for high yield fixed income products such as participation papers (an Islamic form of a bond).

In August, \$500 million worth of participation papers for the development of the South Pars oil and gas field was offered by Pars Oil & Gas Company (POGC) and on behalf of the Oil Ministry. This was the first tranche of a \$3 billion issuance planned for this year. The first tranche attracted significant interest and was completely sold on the offering day. Consequently, POGC offered and successfully sold another \$1 billion the following week. The papers have a 3 year tenure and pay a coupon of 16% per annum.

Overall, the TSE had a very strong performance in August, with the TSE All-Share Index gaining 13.4% in value. Trade volumes stood at \$2.1 billion, 90% higher than the previous month.

Performance of TSE All-Share Index (August 2010)



Investment Objective – The Turquoise Equity Investments seeks superior long-term capital growth by investing in the consumer and commodity potential of Iran, one of the most undervalued 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. The goal is to provide superior returns, with greater diversification and lower volatility.

Class A

NAV = 147.5

Vehicle Domicile
British Virgin Islands

Management Fee
2.0% p.a

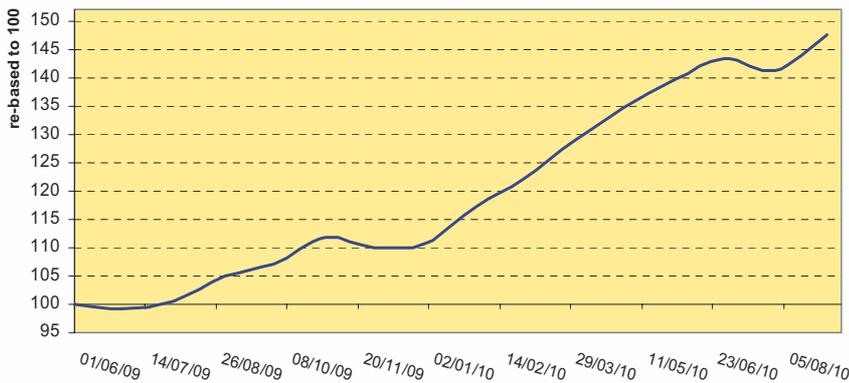
Currency
Euro (€)

Launch Date
01 June 2009

Carried Interest
20% (High Water Mark Applies)

Minimum Investment
€100,000

Class A Performance (Euro) - As at 31st August 2010



| Period | Portfolio Return |
|------------------------------|------------------|
| Last Month | 4.4 % |
| Last 3 Months | 5.7 % |
| Last 6 Months | 21.0 % |
| Last 12 Months | 40.3 % |
| Since Inception (01 June 09) | 47.5 % |

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The inauguration of the Bushehr nuclear power plant, and Mashaei's controversial speech during the congress of Iranian expatriates will be the topics of discussion in this edition of Country Overview.

In August, Iran's first nuclear power plant, Bushehr, was officially inaugurated. The fuelling process began on 2nd August and production of electricity is expected to commence within the next few months.

The construction of the Bushehr power plant commenced in 1975, after Iran awarded a \$4 billion contract to Germany to build a pressurised water reactor nuclear plant. However, Germany withdrew from the contract in 1979 after the Islamic Revolution. During the Iran – Iraq war in the 1980's, the plant suffered significant structural damage. After the war, Iran began looking for a partner to resume the construction. Finally, in 1995, Iran signed a contract with Russia for the reconstruction of the plant.

The Bushehr power plant has faced many challenges throughout its construction. The project was delayed a number of times due to financing problems as well as political pressure from the West. Russia itself was facing financial difficulties after the dissolution of the Soviet Union. Also due to a shortage of engineers and expert technicians, Russia had to decrease the number of workers. In 2007, the project nearly collapsed due to funding shortfalls and increased costs. The contract was eventually renegotiated and Iran agreed to provide compensation for the increased costs resulting from inflation. The plant has the capacity to generate 1,000 mega watts of electricity. Russia began delivering 82 tonnes of low enriched uranium fuel to the reactor on 21st August. As per the terms of the latest agreement, Russia is to provide the Bushehr plant with fuel for 10 years. However, Iranian officials are sceptical about Russia's commitment to deliver the fuel, due to previous delays in the construction of the plant. They have used this as an argument for pursuing uranium enrichment.

The West has expressed their sentiments that, despite the highly sensitive nature of this plant, it is an example of peaceful power production. The International Atomic Energy Agency (IAEA) also issued a statement in favor of the Bushehr plant and stated that it would be carrying out its routine inspections of Iran's nuclear programme. In the latest round of sanctions, the US and Russia came to an understanding that Bushehr would be exempt from measures taken against Iran's nuclear programme, as Iran has agreed to send its spent fuel back to Russia.

Given the difficulties and the delays in the construction, the inauguration of the Bushehr power plant is viewed as a significant achievement by Iran. Nevertheless, disputes over Iran's enrichment programme remain an unresolved issue.

The second congress of Iranian expatriates was held on 2nd August. This two day seminar was hosted by the High Council of Iranian Expatriates in Tehran and was reportedly attended by 1,200 Iranian expatriates, who are all prominent leaders in various fields including medicine, art, sciences and business. The aim of this event was both to introduce the expatriates to Iran's potential and investment opportunities and also to mobilise Iranian expatriates in order to create development opportunities for Iran. Participants were given the opportunity to visit a city of their choice and get acquainted with their heritage.

A speech given by Mashaei, head of the Presidential office, during the event caused a great deal of controversy. He stated that Iran's ideology as a state should be the principal focus rather than its religion of Shia Islam. He added that there are different interpretations of Islam, but that understanding of the real nature of Iran and of Islam derives from the Iranian culture and school of thought and that from this point onwards the world must be presented with the school of Iran. His remarks resulted in a great deal of protest from a number of hardline clerics and officials who argued that Mashaei's statements were nationalistic and

disrespectful to Islam. However, President Ahmadinejad defended Mashaie, stating that people are allowed to voice different opinions and that Iran is a country of culture and civilisation which chose Islam as its ideology.

Mashaie has been criticised by hardliners on various occasions for his controversial remarks and actions. In 2008, he stated in a public speech that no nation is Iran's enemy and that Iran is a friend of the American and Israeli people. His statement was widely disparaged by conservative clerics and the Supreme Leader, Ayatollah Khamenei. Following the presidential election in 2009, Ahmadinejad's decision to appoint Mashaie as his Vice President resulted in a great deal of resistance and criticism from the parliament. However, following a direct order from the Supreme Leader, Ahmadinejad reversed his decision and re-appointed Mashaie as the head of the Presidential office and a senior advisor.

Ahmadinejad's strong support for Mashaie has become apparent on numerous occasions. A number of experts speculate that Mashaie is a potential candidate for the next Presidential election, which will take place in 2013. According to the Iranian constitution, Ahmadinejad cannot take part in the next election, as he has already served two consecutive periods as president.

Iran – Iraq Trade

In August, an Iranian trade centre was inaugurated in the city of Sulaimaniya in the Kurdistan region of Iraq. This is the second Iranian trade centre in Kurdistan. Over 45 well established Iranian companies will be operating in both the wholesale and also the retail sectors, including agricultural, technology, housing and food products. The purpose of this centre is to prevent the emergence of low quality goods with forged brands and to create a trustworthy name for products which are transported from Iran.

Iran also announced in August that it is building a 51 kilometre railway, which links the city of Khorramshahr in south-western Iran to the city of Basra in Iraq. This railway is being built in order to facilitate trade between Iran and Iraq, and particularly the export of cement by Iran. Iranian companies have allocated billions of dollars in order to implement a number of investment projects throughout Iraq, especially in the real estate construction sector. Iraq is a major importer of cement from Iran. According to Iran's Economic Ministry, Iran exported 1.5 million tonnes of cement, worth \$456 million, to Iraq in 2009. Also, in the first 5 months of the current year, \$182 million worth of cement has been exported by rail.

Over the past few years, trade between the two countries has increased significantly. In August, Tehran hosted an Iran-Iraq conference on business and investment opportunities. The conference aimed to generate a platform for exchanging ideas and to increase economic relations between the two countries. The two countries have also agreed to hold joint exhibitions in January 2011 in Iraq, where a series of investment opportunities will be presented.

Iran – Venezuela Petrochemical Agreement

Iran and Venezuela have agreed to form a joint methanol venture. VenIran Petrochemical Company (VIPIC), which is a joint venture company between Iran and Venezuela, plans to construct a methanol production unit in the Assalouyeh special economic zone, on the shore of the Persian Gulf. The plant will have an annual production capacity of 1.6 million tonnes. A similar plant is to be constructed in Venezuela. The two parties have agreed upon €500 million of investment for the two plants.

The recent deal comes as part of a wider agreement between Iran and Venezuela to cooperate in the areas of agriculture, industry, technology and energy. In November 2009, the two countries signed a memorandum of understanding (MOU) in Caracas, which forms the basis for joint projects between Iran and Venezuela.

Development of Financial Markets in Iran

In August, the Securities and Exchange Organization (SEO) of Iran announced the development of regulations and mechanisms for the launch of a currency derivatives market in the near future. This comes as part of the law for the development of the financial markets and instruments, which was approved by the parliament in December 2009. Over the past three years, there has been a concerted effort by the government, the capital market authorities and market participants to encourage the expansion of Iran's financial markets and the diversification of products. The establishment of the Iranian OTC market and also a bond market, the implementation of the regulatory framework for mutual funds and the asset management industry, and also the launch of a financial Futures market are some of the key steps taken by the SEO.

The SEO has indicated that as well as currency derivatives, financial Options are also expected to be launched in the near future. Also, regulations for the issuance of several Islamic fixed income products, such as Sukuk and Mortgage Backed Securities, have been put in place. A number of these products are expected to be issued for the first time in Iran by the end of the year.

Foreign Investment in Iran's Power Generation Sector

According to a report published by Iran's foreign investment organisation, OIETAI, Iran has been able to attract approximately \$1.17 billion of foreign investment into its power generation sector. The report states that Germany and the UAE have invested \$450 million and \$720 million respectively, in the construction of three gas-based power stations in central Iran.

Furthermore, according to OIETAI, Iran was able to attract a total of \$3 billion of direct foreign investment into Iran in 2009, a year-on-year growth of 86%. In monetary terms, Iran ranked 6th in the world in terms of annual growth in foreign investment.

About Turquoise

Turquoise is a boutique investment firm 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

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