

Kalat Naderi Palace, North Eastern Province of Khorasan, Iran

Market Overview _____ **2**

In June, stock sell-offs across many sectors of the market continued, as investors reduced their exposure to the equity market. The Tehran Stock Exchange delivered its worst monthly performance in 2012. Concerns about the political tensions and economic pressure, following the unsuccessful nuclear negotiations between Iran and the 5+1 in Moscow, were the main reasons for the sell-offs.

Country Overview _____ **5**

The impact of the latest rounds of sanctions on Iran's economy will be examined in this section.

Economy _____ **7**

Growth in Iran's construction sector, growth in liquidity in the first quarter of 1391 and NIOC's power deal with MAPNA will be covered in this section.

Turquoise Iran Equity Investments _____ **9**

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

In June, stock sell-offs across many sectors of the market continued, as investors reduced their exposure to equities. Also, fixed income instruments, which have been in strong demand for the past year or so, were out of favour this past month, as funds flew out of the capital market and into gold, foreign currency and real estate. The Tehran Stock Exchange (TSE) delivered its worst monthly performance of 2012, with the TSE All-Share Index losing 5.9% of its value in Rial terms. The 2012 year to date performance of the TSE stood at 1.8% at the end of June, its weakest performance for 6 years. Trade volumes also suffered a decline in comparison to the previous month.

Optimism earlier this year about a potential breakthrough in Iran's long standing tensions with the West over its nuclear programme had led to sharp rises in stock prices throughout March and April. However, investor excitement quickly dissipated, as negotiations between Iran and the so-called 5+1 Group in May in Baghdad and then in June in Moscow proved fruitless. The outcome of the talks in Moscow on 18th June was described as 'unclear' at best. The change in sentiment took its toll on the foreign exchange market too, as the unofficial US Dollar exchange rate against the Rial gained 5%. As at the end of June, the unofficial rate of Rial against the US Dollar had lost all of its March and April gains and was back at the early March level, and at a 55% premium to the official Central Bank rate.

In the final week of June, strong support from quasi-governmental investors and other large institutional investors stabilised the market and calmed the selling pressure. The weighted average price/earnings ratio of the market stood at 5.4 at the end of June. Stocks in several major sectors of the market are now trading at P/E's of below 5. Analysts believe that while these stocks are now attractive investment opportunities from a fundamental perspective, the challenging political and macro-economic environment will keep investors reluctant to increase their exposure to the equity market for the time being.

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

IPO's and Privatisations

On 24th June, a 5% stake in Bandar Abbas Refinery was offered on the TSE main board and successfully sold, as part of the state's privatisation programme. Bandar Abbas Refinery was the third refinery to be listed on the TSE. The IPO took place at a market capitalisation of \$1.3 billion and a P/E ratio of 8.1. Despite a higher than the market average P/E ratio, Bandar Abbas attracted significant interest from investors and the stock price ended the month 8% higher than the IPO value. Bandar Abbas Refinery has forecasted net earnings of \$160 million for the current financial year.

Also in June, a 15% block in Isfahan Zob Ahan (iron smelting) and a 20% block in Persian Gulf International Transportation Co. were offered on the TSE at a 20% premium to their market prices. However, these blocks failed to attract any investors and were unsold.

Base Metals

The base metals sector was among the worst performers of June. In May, sharp declines in the global prices of base metals and also concerns about the political and macro-economic situation had led to reduced demand for products of companies in this sector on the Iranian Mercantile Exchange (IME), and consequently, falls in the prices of steel, copper and aluminium. However, in June, a further weakening of the Rial against major currencies led to a sudden rise in demand for base metals. Consumers were concerned that possible subsequent rises in the exchange rate could result in the prices of base metals increasing even further. In particular, approximately 30,000 tonnes of aluminium was traded on the IME, equivalent to 10% of the entire country's annual consumption of aluminium. Prices of copper, steel and aluminium rose by 5%, 3% and 0.8% respectively.

Increased product sales and prices, however, failed to slow down the sell-offs of stocks of these companies and the sector index fell by 11.3%. Given the profitability prospects and the low P/E ratio's of companies in this sector, the base metals sectors is now one of the most attractive from a fundamental perspective.

Mining

Over the past year, iron ore producers have been engaged in a dispute with the government over tariffs for their excavation licenses. In June, it was announced that an agreement has been reached between the government and these companies. Accordingly, iron ore companies will now pay 2% of the price of a tonne of steel billet for every tonne of iron ore that they sell. In return, they will be permitted to sell part of their product at global prices. Prior to this agreement, the government had enforced a price cap on the domestic sale of iron ore, which was almost half of the average of global prices, based on the unofficial exchange rate. While this news was viewed as a positive development for iron ore producers, it did not stimulate investor demand for stocks of these companies and the mining sector index lost 6% of its value. The average P/E of mining companies as at the end of June stood at 6.5, its lowest level for over 3 years.

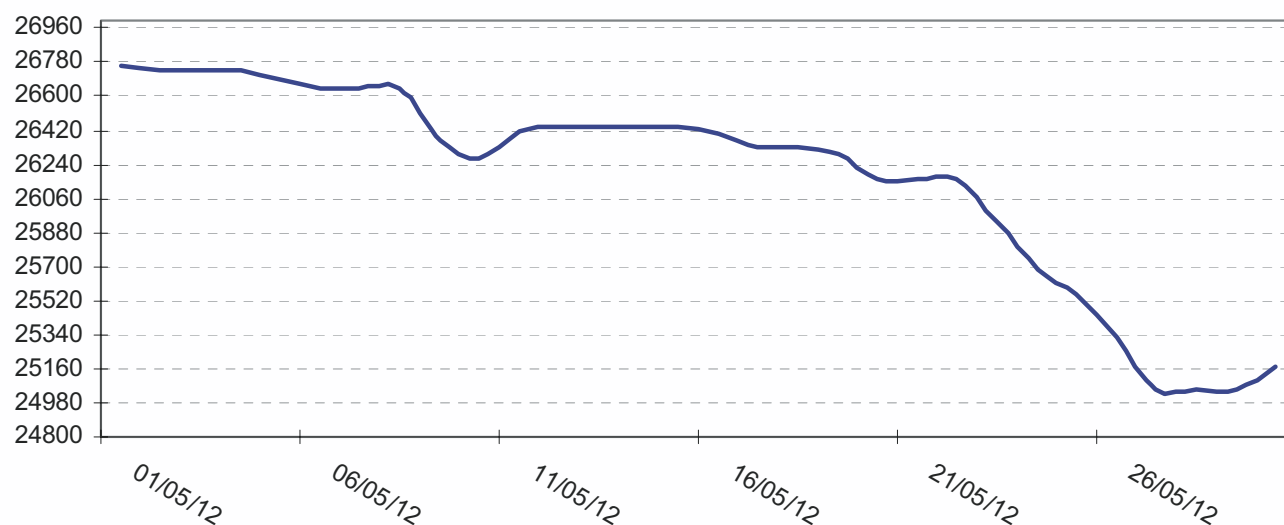
Overall, the TSE All-Share Index lost 5.9% of its value in Rial terms. Trade volumes stood at just under \$800 million, 27% lower than the previous month.

Sugar & by-Products

While this sector comprises only 1% of the market, it has attracted significant attention from investors and speculators over the past year. In the calendar year 1390 (which ended on 19th March), and on the back of an astronomical jump in the domestic price of sugar, resulting from the devaluation of the Rial, the sugar & by-products sector became the top performing sector of the TSE by a long way. The sector index had gained over 340% in value by the end of the year. However, since the beginning of 1391, the situation has been completely the opposite. A 20% fall in the global price of sugar, alongside increased domestic production and also imports of sugar, has changed the business environment for sugar producers. Analysts predict that at the current production and import levels, the country will be faced with considerable excess product at the end of 2012 and into 2013. However, the situation could change drastically if a further devaluation of the Rial occurs in the coming months, as imports will likely decline sharply.

The sugar & by-products sector index lost 11.5% of its value in June, bringing its 1391 first quarter losses to 37%.

Performance of TSE All-Share Index (June 2012)



Market Statistics

Average P/E	5.4
Trade Volume (\$ Billion)	0.8
Trade Value Monthly Change (%)	- 27.0
Market Cap (\$ Billion)	97

Top 5 Traded by Value

Rank	Company Name	Turnover Value (\$Million)	% of Total Turnover
1	Bandar Abbas Oil Refining Co.	82	10
2	Pasargad Bank	60	8
3	National Iranian Copper Industries Co.	49	6
4	Parsian Oil and Gas Development Co.	45	6
5	Fars and Khuzestan Cement Co.	40	5

Top 5 Companies by Market Cap

Rank	Company Name	Market Cap (\$Million)	% of Total MC
1	Telecommunications Co. of Iran	9,107	9
2	National Iranian Copper Industries Co.	5,609	6
3	Isfahan Mobarakeh Steel Co.	5,299	5
4	Ghadir Investment Co.	3,615	4
5	Pasargad Bank	3,333	3

All figures quoted in USD in this Newsletter are calculated based on the Central Bank of Iran's official USD/IRR exchange rate of 12260, as at 30 June 2012

This edition of Country Overview aims to examine the impact of the recent sanctions imposed by the West on Iran's economy.

Iran's dispute with the US and its Western allies over its nuclear programme is now very much into its second decade. Over this time, the US, EU, UN Security Council and several states unilaterally have imposed various sanctions and trade embargoes on Iran. However, the sanctions imposed over the past 8 months or so have targeted the heart of Iran's economy – namely – Iran's oil exports.

While the toughest sanctions have been imposed over the past year, the history of sanctions on Iran dates back to 1979, when the US froze a significant amount of Iran's assets in the US (the amount is disputed by both countries), after the US embassy in Tehran was stormed by a group of Iranian students and many of its staff were taken hostage. The US sanctions gradually increased after the Iran – Iraq war and into the mid – 1990's, to the point that most trade with Iran was banned. In 2000, during the presidencies of Khatami and Clinton, relations between Iran and the US improved and sanctions were slightly eased. However, with the escalation of the dispute over Iran's nuclear programme, the US and its European allies took Iran's case to the UN Security Council and began to push for wider sanctions. The first round of UN Security Council sanctions against Iran came into force in 2006. Between then and June 2010, 3 other rounds of sanctions were imposed on Iran by the UN Security Council, with the aim of persuading Iran to halt its uranium enrichment programme, something that the sanctions failed to achieve. With resistance from Russia, China and several other states with good relations with Iran, against tougher sanctions, Western states began to impose their own unilateral embargoes on Iran outside the UN framework.

In January 2012, the EU voted on a ban on the purchase of crude oil from Iran by all EU members. Although the ban did not become effective until July, its announcement had a psychological impact on the price of oil and Iran's unofficial foreign exchange market, causing a surge in the price of oil to above \$120 per barrel in March

and the exchange rate of all hard currencies against the Rial. Between January and July, EU members gradually reduced their purchase of oil from Iran and from the beginning of July, stopped the purchase of Iranian oil altogether. In 2011, Iran sold 40% of its crude oil to European states. Iranian officials have repeatedly said that they will be able to find new purchasers to replace their European customers. In parallel with this, the US has also exerted considerable pressure on many other countries to reduce or stop their purchase of crude oil from Iran. Some of Iran's key customers such as Japan, India and Turkey have reduced their oil imports from Iran. China is the only country to have increased its purchase of oil from Iran by 20% this year. This, however, will not compensate for the lost sales to the EU and Asian countries.

The sanctions are far wider reaching than just the purchase of oil. They target the transportation and insurance of oil transportation too. Typically, oil shipments can only be insured by a limited number of insurers, which are mainly European-based and they are banned under the new sanctions from insuring any shipments of oil from Iran. This has created significant problems for existing buyers of Iran's oil, such as China and India, in buying oil from Iran. Additionally, strict financial sanctions have made the transfer of funds to and from Iran very difficult indeed; this means that Iran is now facing major difficulties in receiving its oil revenues.

The latest data reveals that Iran's oil exports have fallen from 2 million barrels per day in June 2011 to below 1.3 million barrels per day in June 2012, showing a 35% decline in volume. While the higher price of oil has partly compensated for the fall in volume, Iran's revenues from the export of oil has declined by more than 25% year-on-year. Consequently, Iran has had to reduce its oil production from 3.5 million barrels per day last year to around 2.9 million. With an expansionary state budget, the loss of revenues will most likely result in a considerable budget deficit this year. Iran's trade balance, which stood at approximately \$6.5 billion in June 2011, has now become negative, as a result of lower oil revenues. Additionally, strict financial sanctions mean that Iran is unable to access or move its petrodollars. This means

that the government is now facing a shortage of hard currency and cannot meet the demand from importers and also market speculators. The Central Bank has been forced to prioritise the allocation of hard currency at official rates, now only providing currency to the importers of essential food and medicine items and a handful of other strategic goods. All other imports are now done at unofficial rates. Unsurprisingly, this has exacerbated the growing inflation, as the prices of many products have soared. In particular, the price of food has risen drastically since the beginning of the Iranian calendar year. To overcome the financial sanctions, Iran has entered into barter trades with several countries, receiving goods and gold in exchange for its oil. In particular, Iran is now importing large quantities of rice from India in exchange for a part of the crude oil that it sells India. Rice is a key ingredient in the Iranians' household food baskets and among the very few goods that haven't experienced a price hike.

Since the talks of embargo on Iran's oil first surfaced, Iran has, on several occasions, threatened to close the strait of Hormoz in the Persian Gulf. After the announcement of the EU sanctions in January this year, Iran repeated its threat. This had a short-term adverse impact on the global price of oil, but the market quickly stabilized. After the EU embargo came into force in July, Iran repeated its threat and the parliament made a public statement that it is urgently reviewing a bill to instruct the government to close the strait of Hormoz. However, no further action was taken after this. With the 3 rounds of nuclear talks between Iran and the 5+1 Group delivering no substantial result, pressure from the West is expected to continue to grow. Experts believe that while the threats from Iran are highly unlikely to materialize, they convey an important message that Iran's regime is under intense pressure and is gradually running out of options.

Growth in Iran’s Construction Sector

Following approximately 4 years of cyclical stagnation, construction activity in Iran reached an unprecedented record in the Iranian calendar year 1390 (which ended on 19th March). According to the Tehran Municipality, the number of construction permits issued for residential units in Tehran exceeded 229,000 in 1390. This represents a 53% rise in permits issued in comparison to the previous year. Also, on average, 19,000 residential units per month were built in 1390, compared to 10,000 units per month in 1389. Prior to this, the highest number of permits issued in Tehran was in the year 1386 when permits for 183,000 (a 71% increase in comparison to the previous year) residential units were issued. Interestingly, despite the significant increase in construction activity last year, prices did not grow at the same pace, whereas in 1386 the boom was accompanied by a 90% jump in prices.

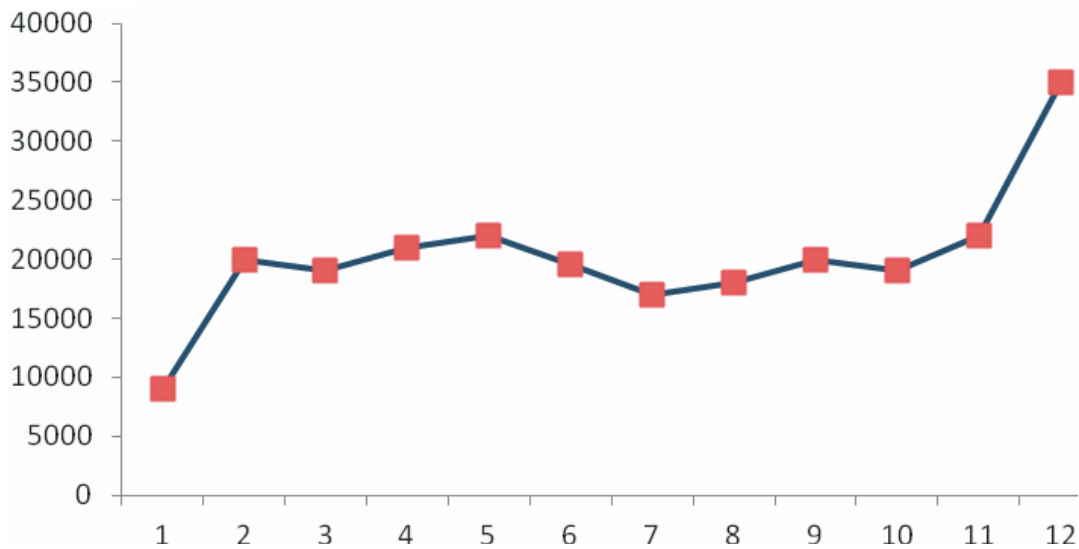
Construction in the previous year has increased the volume of residential units in Tehran by

approximately 10%. Currently, there are 2.5 million residential units in Tehran and this figure is expected to increase to around 3 million shortly. However, Tehran’s construction activity needs to continue in the same way as 1390 for the next 2 to 3 years in order to be able to meet the market’s demand.

Run-down neighborhoods played an important role in the growth of the construction sector. Last year, more than 24% of total construction took place in these neighborhoods. Around 45,000 residential units were rebuilt in these areas. This was an 86% increase in comparison to the previous year.

According to the Ministry of Housing and Urban Development, over \$20 billion worth of new investment has been made in real estate and construction across the country in 1390. This accounts for almost a third of all new investments in the country. Also, private sector investment in this sector has grown by 40% year on year.

Number of Residential Units in Tehran built each month



1389			1390			Growth Rate
New Areas	Rundown Areas	Total construction	New Areas	Rundown Areas	Total construction	
125,489	20,041	149,530	184,361	44,779	229,140	53 %

Growth in Liquidity in the First Quarter of 1391

According to the latest data published by the Central Bank of Iran, liquidity in the economy grew by 6.5% in the first three months of the Iranian calendar year 1391. The Central Bank Governor, Mahmoud Bahmani, expressed his concerns and said that the continuation of liquidity growth at this pace will have an adverse impact on the economy. The government's economic and fiscal policies came under heavy criticism for helping to cause the increasing liquidity, which has triggered mounting inflation.

According to the Central Bank report, total liquidity amounted to IRR 3,740 trillion in the spring of 1391 (\$305 billion). At the end of 1390, liquidity in Iran was recorded at IRR 3,520 trillion. Growth in liquidity in the first quarter of 1390 was 2.7%. This means that the growth rate has more than doubled this year. The value of liquidity at the end of 1389 was around IRR 2,940 trillion. This figure reached IRR 3,020 trillion by the end of the third month of 1390.

The annual inflation rate is currently estimated to be close to 26%, its highest figure for almost 4 years. The devaluation of the unofficial rate of the Rial against major currencies, which has resulted in a surge in the prices of many imported and domestically made goods, as well as the disproportionate injection by the government of money into the economy, have been identified by experts as the main reasons for the rise in liquidity and inflation.

The Central Bank has announced that it plans to issue IRR 100 trillion worth of bonds by the end of this year in order to control the excess liquidity in the market and inflation.

NIOC and MAPNA sign a EUR 350m Power Deal

The National Iranian Oil Company (NIOC) and the Iran Power Plant Projects Management Company (MAPNA) signed a BOO (Build, Own and Operate) contract worth EUR 350 million. The agreement is to build a power station in order to put in place an oil and gas field development plan in the south-west of the country. The power plant will have the capacity to generate 484 megawatts (MW) of electricity.

The power plant will be constructed in three phases. The first phase of the project is scheduled to come on stream within 15 months. Phases 2 and 3 are estimated to take around 18 and 32 months respectively to reach completion. North Azadegan, South Azadegan, Yadavaran, Jofeir, Darkhovin, Sepehr and Arvand are amongst the major oil fields located in the southwest of Iran, which will benefit from the new power plant.

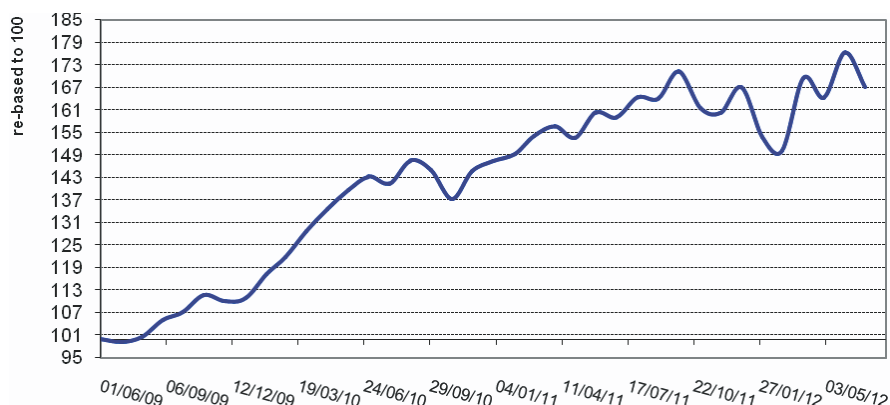
According to the Deputy Energy Minister, the Ministry of Energy is planning to increase the electricity generation capacity of national power plants by 5,000 MW in 1391. Additionally, over 10,000 MW is planned to be added to the power generation capacity of hydroelectric and thermal power plants by 2013, and a further increase of 15,000 MW is planned for 2014 and 2015.

Period	Liquidity Value (IRR trillion)	Liquidity growth rate (%)	Increase in Liquidity (IRR trillion)
12/ 1390 – 3/1391	3,740	6.5	220
3 / 1390 – 3/1391	3,740	23.8	720
12/1389 - 3/1390	3,020	2.7	80

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 = 167.0
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 30th June 2012



Period	Portfolio Return
Last Month	- 5.3 %
Last 3 Months	- 1.5 %
Last 6 Months	0.0 %
Last 12 Months	4.9 %
Since Inception (01 June 09)	67.0 %



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About Turquoise

Turquoise is a boutique investment firm based in Iran. 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 with a wealth of international expertise enables Turquoise to benefit from coupling a network of global expertise with an enviable reputation for local knowledge, professionalism and integrity.

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: info@turquoisepartners.com

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