Iran Investment Monthly

February 2009
Volume 3, No. 29

TURQUOISE PARTNERS

The Tomb of Khayyam, The Famous Iranian Mathematician, Philosopher and Poet, Ancient City of Neyshabour, North-East Iran

THIS MONTH

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

Chief Editor: Ramin Rabii
Consulting Editor: Eddie Kerman
Authors: Shervin Shahriari, Ali Mashayekhi

Turquoise Partners, No. 58 East Gord Alley, Bidar St., Fayyazi (Fereshteh) Ave.
Tel: +98 21 220 35 830 Fax: +98 21 220 49 260
Email: ramin.rabii@turquoisepartners.com
To find out more about Turquoise Partners, visit our website at: www.turquoisepartners.com.

In January, the Tehran Stock Exchange (TSE) reversed its downward trend. With the meltdown in global commodity and crude oil prices, the TSE had fallen over the past few months. However, the recovery in stocks of commodity-focused companies was notable this past month.

The dynamics of the market differed markedly in each of the two halves of January. In the first two weeks of the month, there were large trade volumes because a number of institutional investors returned to the market. Many commodity stocks, such as those in the mining and petrochemical sectors, had lost considerable value since the peaks of the summer. However, many of them attracted huge interest from investors and the selling queues of these stocks disappeared quickly. Consequently, the market index began to stabilise by mid-January. This brought about a degree of positive sentiment in the market and increased buying demand for many other stocks. The result was that, in the third week of January, the main market index posted moderate gains. However, bullish sentiment was short-lived and the market quickly returned to stability as trade volumes fell substantially by the end of the month.

Analysts explain that investors remain concerned about both the profitability prospects of commodity-focused companies and also the macro-economic outlook for the next Iranian calendar year (beginning on 21st March). The government's bill for the removal of energy subsidies (as part of the so-called "economic reform" plan) was reviewed by parliamentary specialist commissions in January; it will be voted on next month. The removal of energy subsidies would have a major impact on production costs for many industries. Meanwhile, details remain unclear regarding the governmental proposal to compensate various industries for the removal of their subsidies. Also, the government's budget for the coming year was submitted this month for parliamentary approval. The outcome of this parliamentary review and the resulting decision, and the subsequent economic, fiscal and monetary policies will have a significant effect on the market. As a result, many investors have taken a cautious attitude towards the equity market and have chosen to remain in defensive investments such as fixed-income products until these issues are clarified.

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

Cement

The most important development in the TSE in January was in the cement sector. After several months of debate and strong lobbying by industry players, the government finally removed the export tariff for cement. This had previously been set at $100 per tonne. Following the liberalisation of the cement price this past summer, most manufacturers began to accelerate their expansion plans and to increase their production volumes. However, the slowdown in the real-estate sector meant that the supply of cement began to outpace domestic demand.

Investors, however, were cautious in responding to this news. Stock price rallies were in a handful of companies and proved short-lived. Cement manufacturers with operations close to Iran's borders could significantly benefit from this development. This is because cement prices in some neighbouring countries are up to 100% higher than the domestic price. However, due to high transportation costs, companies that are located in the centre of Iran cannot export their products profitably.

Banks

The sharp fall in liquidity growth in the economy has resulted in lower growth rates in deposits in the second half of the year for the majority of banks. Therefore, any growth in profits for next year is expected to be lower than for the current year. Over the past two months, the majority of banks have offered 19% interest on one-year term deposits (16% if redeemed prior to maturity) in order to attract new deposits. This plan proved very successful and most banks were able to attract substantial new deposits. Analysts, however, argue that this strategy could act as a double-edged sword for some of these banks. This is particularly true for state-owned banks, the majority of which operate on low profit margins. While the one-year deposits have brought new funds into banking system, the "cost of money" has increased, resulting in lower margins for the banks.

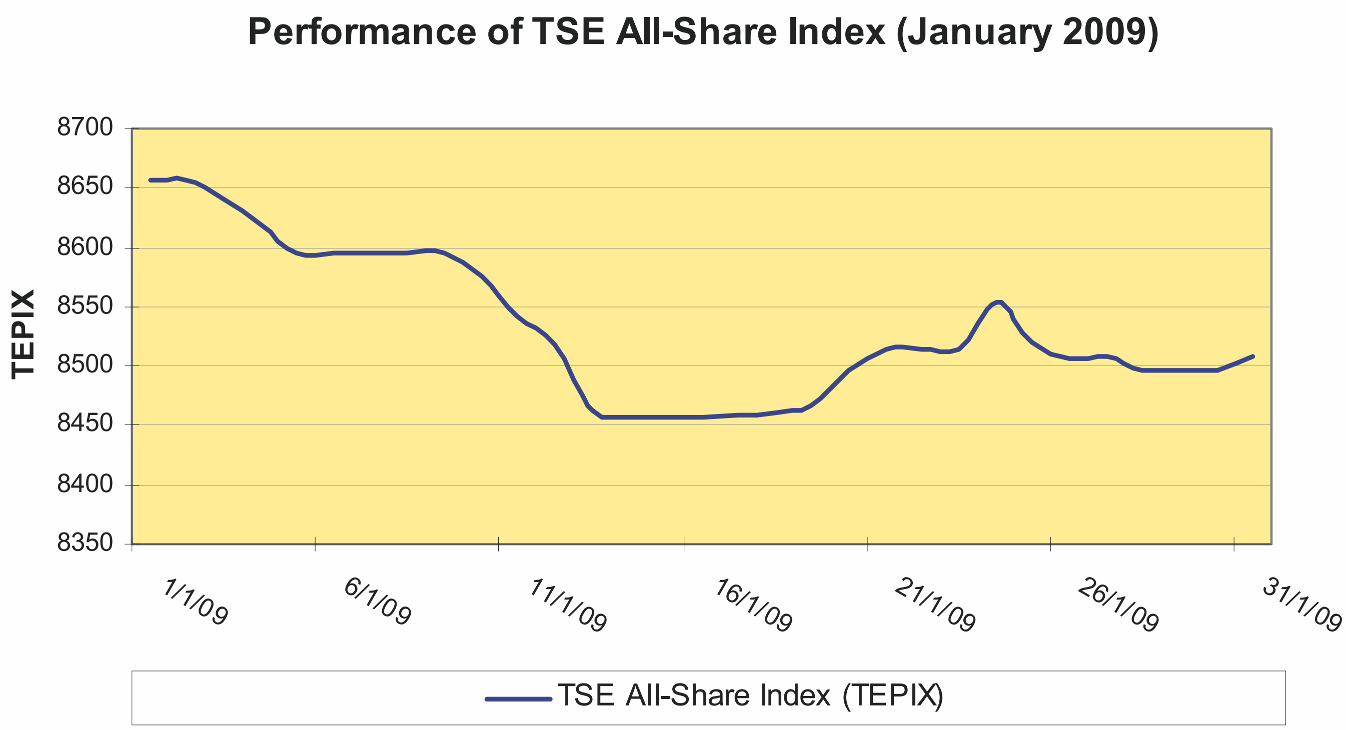
Iron Ore and Steel

Shares of the two listed iron ore companies, Chador Malou and Gol Gohar, have lost around 50% of their value since mid-summer. However, with the introduction of market makers for these two stocks, both stabilised very quickly and experienced buying queues towards the end of the month.

Stocks of steel manufacturers have also been among the worst performing sectors since mid-summer, and experienced a relatively stable month. Mobarakeh Steel Company, the second largest listed company by market capitalisation, is currently trading with a price to earnings ratio of around 2.5.

There is currently much debate between iron ore and steel producers regarding next year's iron ore prices. Despite the domestic iron ore price having been significantly below global prices over the past few years, steel makers are demanding a price cut for next year. The average price of iron ore domestically is $55 per tonne, and it seems that the best scenario for iron ore companies would be for prices to remain unchanged next year.

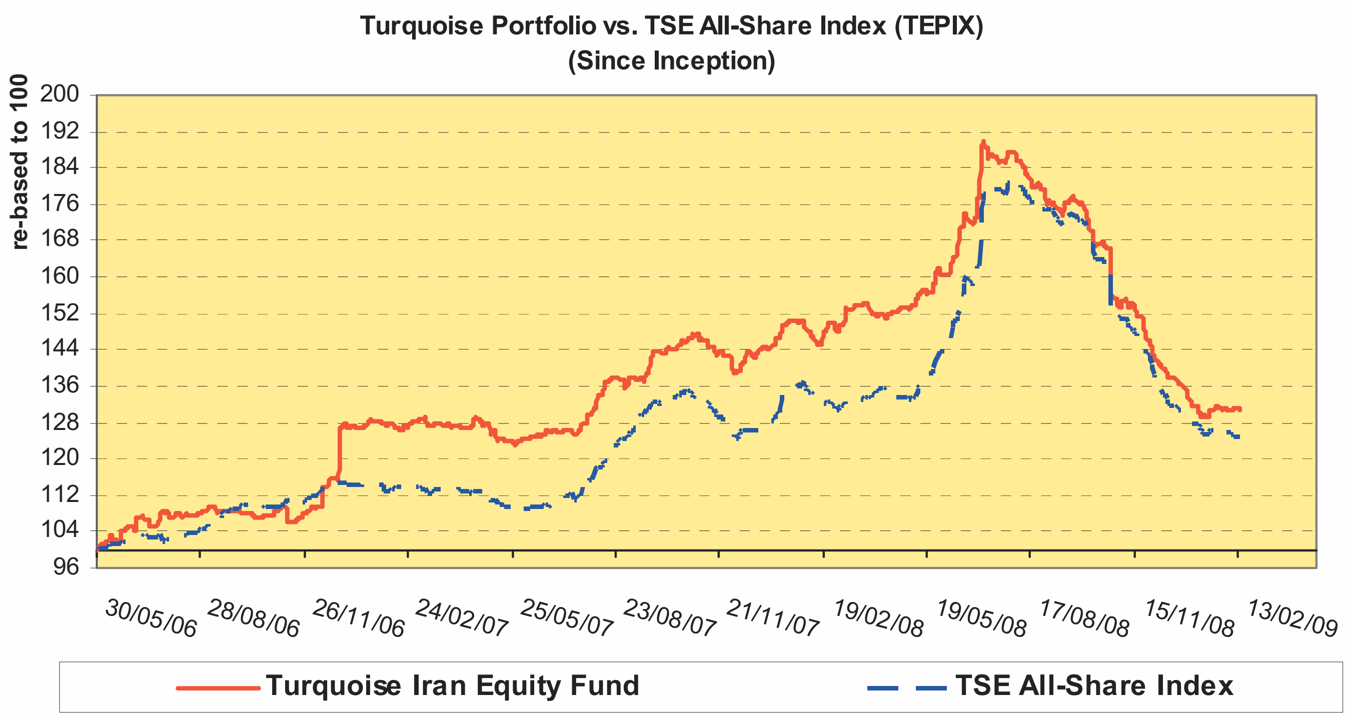
Overall, the TSE experienced a mixed month, with the TSE All-Share Index (TEPIX) losing 1.7% of its value. Trade volume stood at $202 million, showing a 48% decline from the previous month.



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 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. The base currency of the Fund is Iranian Rial.

Monthly Report – The Net Asset Value (NAV) of the Turquoise Fund fell by approximately 2.4% in December to stand at 131.7 by the end of the month. Also, most market indices continued to fall over the course of the month, with the TSE All-Share Index (TEPIX) losing 1.7% in value.

The charts below provide an update up until the middle of February, on the following: the performance of the Fund against both the TEPIX in local currency and also the MSCI 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.

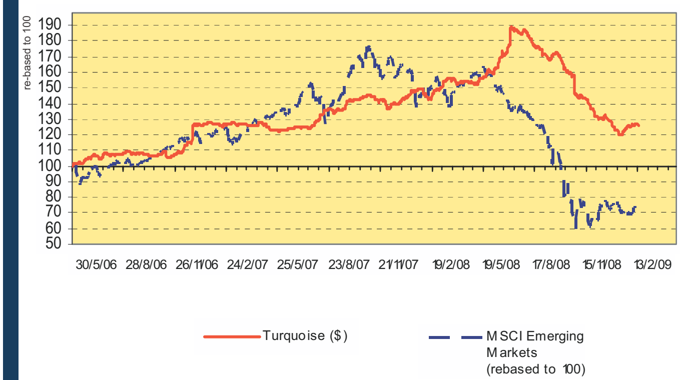


	Nov 08	Dec 08	Jan 09
Turquoise Fund	⬇ 6.6 %	⬇ 7.5 %	⬇ 2.4 %
TEDPIX	⬇ 7.6 %	⬇ 8.5 %	⬇ 1.7 %

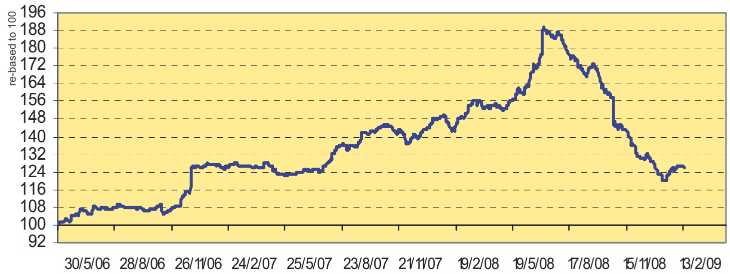
Performance

As of 15 February 2009	
Period	**Fund Return**
Last Month	↑ **0.9 %**
Last 3 Months	↓ **14.9 %**
Last 6 Months	↓ **28.4 %**
Last 12 Months	↓ **10.0 %**
Since Inception (30 May 06)	↑ **30.8 %**

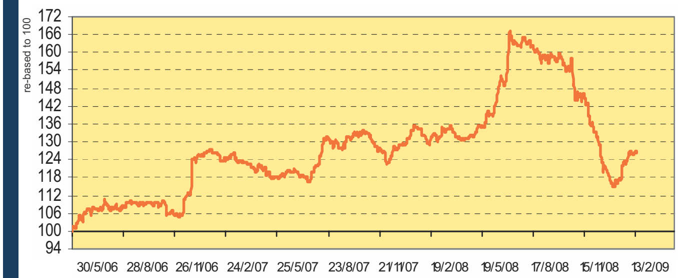
Turquoise Performance vs. MSCI Emerging Markets



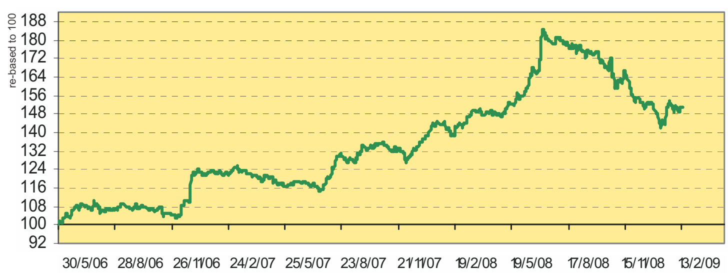
Turquoise Performance in US Dollar (US$)



Turquoise Performance in Euro (€)



Turquoise Performance in British Pound Sterling (£)



The effect of the global economic crisis on the Iranian economy will be the focus of discussion in this edition of Country Overview.

Following several years of benign economic conditions and accelerated growth of asset prices, high levels of consumer and corporate debt in most Western countries (particularly the US and the UK) led to a credit crisis in 2007.

From the beginning of 2008, the credit crisis continued to exert increasing pressure on capital markets and financial services companies, forcing a number of the latter into bankruptcy. The crisis came to a head in the late summer of 2008. With an increasing number of bankruptcies, the crisis spread into both other sectors of the economy and also other countries around the world. Within a few months, many economies were forced into recession. One of the most notable results of the crisis was a meltdown in asset prices, particularly commodities.

Experts argue that because Iran has been relatively isolated from international markets, the effect of the economic crisis on Iran's economy has been limited. While this may be true to some extent, different sectors of Iran's economy have been impacted to varying extents by the global crisis. To assess the real impact of the crisis, we will analyse four distinct areas, namely the financial system, industry, government and macroeconomic factors.

Financial System

Iran's financial system has been isolated from global markets since the Islamic revolution. All international business transactions have been conducted on a simple basis, such as letters of credit and money transfer. Consequently, the influence of the financial crisis on the Iranian financial system itself has been insignificant. In fact, some experts argue that Iran has benefited from the crisis, because some investors, who are seeking diversification from the Western markets have begun to look into the Iranian capital market.

Due to the generally low levels of consumer and corporate debt, most Iranian banks are not confronted with high credit risks. For example, loan to value of mortgages in Iran are rarely above 50% and in most cases are no more than 25%. Also, unsecured lending is not permissible in Iran. This year, doubtful debt in the Iranian banking system has increased to approximately $30 billion, according to the Central Bank. However, the main reason for this is the huge differential of the lending rate and the inflation rate in Iran. This has resulted in an arbitrage in the lending market. Most borrowers, therefore, are reluctant to repay their cheap loans, which are currently harder to find. The result of lower excess liquidity in the economy next year (see Macroeconomic Indicators section) would be a slowdown in the banks' deposit growth rate.

The equity market has lost around 40% of its value since the highs of mid-summer. Nevertheless, falls in the Tehran Stock Exchange have been less than most major indices around the world. In fact, according to statistics released by the World Federation of Exchanges, the TSE was the only member exchange with positive returns in 2008. Overall, the global crisis has not had a significant effect on the health of Iran's financial system.

Industry

The effect of the economic crisis on the industrial sector in Iran is dependent on the specific industry. Industries and mines form approximately 20% of Iran's GDP. Although Iran has a diversified industrial base, minerals and other mining-related commodities comprise the major segment of non-petroleum exports. The slump in prices of metals and mining products (such as steel, zinc, lead, copper and iron ore) has eroded the profitability of these sectors. Moreover, it has created uncertainty about the future prospects of some of these commodity-focused companies. On the other hand, those industries which are consumers of commodities have benefited from lower production costs. This is because the prices of their raw materials have declined significantly. A good example of this is the automotive sector. Factory prices for automotive companies are set by the government and have remained unchanged for several years. Consequently, these companies could potentially enjoy higher profit margins next year.

Statistics show that, unlike in most Western economies, demand in Iran's consumer market remains relatively strong.

The government

Governmental revenues from the sale of crude oil and natural gas have taken a substantial hit from global price falls in these commodities. Although the oil and gas sector constitutes only 10% of Iran's GDP, approximately 80% of Iran's foreign income comes from this source. The result is that the government budget is heavily dependent on this income stream.

The rise in the crude oil price over the past few years resulted in the government having significant excess revenue beyond its budgetary requirements. Since it came to power in 2005, this current government has pursued aggressive expansionary fiscal policies, and has substantially increased its capital and operating expenditures. Analysts believe that the government will now be compelled to reverse its policies of the past few years, although doing this will prove difficult. As a result, there is a realistic possibility that the government will be faced with a budget deficit next year. Predictions for next year's budget deficit are in the range of $15 - $30 billion, based on an average oil price of $37.

In 2000, Iran set up an account known as the Oil Stabilisation Fund (OSF) as a safe haven for crude oil surplus revenues. The aim of this was to insure the government's revenues against fluctuations in the oil price. The government does not disclose the exact amount of reserves in the OSF, but analysts predict that there is currently $25 - $35 billion in this fund. Therefore, the government cannot solely rely on the OSF to cover the potential budget deficit. A number of plans have been introduced in order to increase governmental revenues and reduce expenditure. One example is a major reform in the taxation system. For example, the introduction of both capital gains taxes for the real-estate sector and also Value Added Tax on goods have been proposed. Also, the bill for the so-called "targeted subsidies", which has been subject to criticism by some experts, is currently under review in the parliament. This bill proposes the removal of energy subsidies and the provision of partial compensation through cash payments to the public.

Macro-economic Indicators

As mentioned above, the government's injection of excessive oil revenues into the economy had resulted in significant excess liquidity. Consequently, the inflation rate had soared to approximately 30% by the end of summer 2008. The slump in the oil price meant that liquidity growth in the economy would diminish, as has occurred over the past few months. This, along with lower commodity and consumer goods prices, is expected to result in a downward trend in the inflation rate. Subject to all macro-economic and government policies remain unchanged, analysts predict that the inflation rate will fall to 22% by the end of the Iranian calendar year (20th March) and to 18% by the end of the 1st quarter of the next Iranian calendar year (20th June).

Iran's economic growth has been strong over the past few years. Last year (Iranian year 1386, which ended 20th March 2008), Iran's real GDP growth stood at 6.9% and experts predict a growth rate of 5.9% for the current year. However, forecasts indicate a lower growth rate for next year because of the reasons mentioned above. In addition, 5% of Iran's GDP comes from the real-estate sector. The slowdown in the Iranian property sector began earlier this year and is expected to continue next year. Analysts' predictions for next year's economic growth range from 3% to 4.5%.

Third Mobile Phone Operator License

In January, Iran's Communications Regulatory Authority (CRA) formally announced the winner of the third mobile phone operator license in Iran. It announced that a consortium of Etisalat of the UAE (49% share) and Tamin Telecom (51% share), a subsidiary of Iran's Social Security Organisation, was the highest bidder. The upfront license fee is €300 million ($402 million). The license tenure is 15 years and is renewable for two further periods of 5 years. The license gives 2 years of exclusivity for offering third generation mobile phone technology, also known as 3G.

According to the press, consortiums headed by Zein of Kuwait and Oman Telecom came second and third respectively. Other tenders came from Indian and Malaysian consortiums. Currently, Telecommunications Company of Iran (TCI) and IranCell MTN hold licenses for offering 2G services and have 40 million subscribers collectively. Iran is viewed as one of the most attractive telecom markets in the world. This is because it has a population of around 70 million, an underdeveloped telecom infrastructure and a mobile phone penetration rate of below 40%.

Iran and China Oil Field Development Contract

In mid-January, the National Iranian Oil Company (NIOC) and China National Petroleum Corporation (CNPC), China's largest oil and gas company, signed a $1.7 billion deal for the development of Iran's North Azadegan oil field. North Azadegan, which is situated in the south-western province of Khouzestan, is one of Iran's largest oil fields. This oil field has recoverable reserves in excess of 5 billion barrels of crude oil and was first discovered in 2000.

According to Iranian officials, the first phase of the development project will take 48 months to complete and the production rate will be 75,000 barrels of crude oil per day. Iran is expected to earn $16 billion in revenues within 25 years of the initial development. The contract is based on a buyback scheme, with a repayment period of 12 years for the first phase. Also, upon successful completion of the first phase, the second development phase is to be awarded to CNPC.

Despite sanctions and US efforts to isolate the country, Iran has been able to attract considerable foreign investment for the development of its oil and gas fields. Last year, Iran signed development contracts with Sinopec of China, SKS of Malaysia and Edison International of Italy.

Expansion of Mining in Iran

According to the Ministry of Industries and Mines, mining extraction in Iran has increased by 53% over the past 4 years. Total annual extraction volume stood at 150 million tonnes per annum in 2005, and is expected to reach 230 million tonnes per annum by the end of the current Iranian calendar year (20th March). Iran's total mining reserves amount to approximately 57 billion tonnes, or 7% of the world's total reserves. The government plans to increase extraction volumes to 500 million tonnes per annum.

Statistics released by the Central Bank show that in the first 8 months of the current Iranian year (March – October 2008), the total value of exported minerals and products of related industries stood at $11.3 billion. This shows an increase of 40% in earnings and 3% in volume. This figure amounted to 87% of Iran's non-oil and gas-based exports. The UAE, China, Iraq, India and South Korea were the main destinations for Iran's mining products.

Iran's Economic Freedom Rating

In the latest Economic Freedom of the World ranking table published by the Fraser Institute, Iran has moved up 12 places, from 92nd to 80th, in comparison to the previous year. This table ranks 141 countries based on five factors. These include the following: size of the government, legal structure and security of property rights, access to sound money, freedom to trade internationally, and regulation of credit, labour and business. Each country is given a score of up to 10 in each of these categories. In this report, Iran's overall score stood at 6.46, an improvement of 3% from the previous year. Hong Kong remains at the top of this table.

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

Disclaimer

This material is for information purposes only and does not constitute an offer to sell, nor a solicitation of an offer to buy any specific shares.

The analysis provided by this publication is based on information that we consider reliable and every effort is made to ensure that the facts we publish are correct. However, we do not represent that all facts and figures are complete and accurate; therefore, we can not be held legally responsible for errors, emissions and inaccuracy.

This publication does not provide individually tailored investment advice and may not match the financial circumstances of some of its recipients. The securities discussed in this publication may not be suitable for all investors. The value of an investment can go down as well as up. Past performance is no guarantee of future success.

Copyright Notice