



Tomb of Hafez, the Legendary 14th Century Persian Poet; Shiraz , Fars Province , Southern Iran

## THIS MONTH

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The Tehran Stock Exchange (TSE) experienced sharp growth in trade volumes and stock prices in a number of key sectors in this month. Positive political developments and the widening of the daily fluctuation cap in stock prices moved the market upwards. This section provides an analysis of the market and some of the main sectors.

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Turquoise Fund experienced a positive month in May with its NAV gaining over 5% during this period. This section provides various data and charts on the performance of the Fund.

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### Economy

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The first foreign bank in Iran, interest rates, surplus liquidity and a new mobile phone operator license in Iran will be the topics of discussion in this section.

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*Chief Editor: Ramin Rabii  
Consulting Editor: Eddie Kerman  
Authors: Reza Moradi  
Shervin Shahriari  
Ali Mashayekhi*

*Turquoise Partners, Second floor, Mottahari Street, No.248, Tehran, Iran  
T: +98 21 88 30 40 79, F: +98 21 88 82 68 36  
Email: [ramin.rabii@turquoisepartners.com](mailto:ramin.rabii@turquoisepartners.com)  
To find out more about Turquoise Partners, visit our website at:  
[www.turquoisepartners.com](http://www.turquoisepartners.com).  
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In May, the Tehran Stock Exchange (TSE) experienced sharp growth in trade volumes and stock prices in a number of key sectors. Market activity increases every May, as Annual General Meetings (AGM's) of around 80% of the listed companies take place around this time. The election of Dr. Larijani as the Chairman of the new parliament (see Country Overview) was seen as a positive development by market analysts. This was because it increased the likelihood of improvements in the government's economic policies.

Liquidity and availability of funds in the market also improved this month. This improvement stems from the settling in March and April of the first instalment for several blocks of shares of the National Iranian Copper Industries Co. (NICIC) and Mobarakeh Steel Co. Over the past year, the Iranian Privatization Organization has been offering blocks of shares of companies for cash and/or instalments. The instalment payments, amounting to approximately \$45 million per month, have been putting considerable strain on the market.

A significant event in the market in May was the increase in the daily fluctuation limits of stock prices. As per exchange regulations, the daily upward/downward movement of a stock price is restricted to pre-defined universal limits. Previously, daily fluctuation was capped at  $\pm 2\%$ ; however, in early May the TSE increased it to  $\pm 3\%$ . This change was welcomed by the market and improved the flow of trading, in comparison to previous months.

On 18<sup>th</sup> May, 2.5% of the shares of the Islamic Republic of Iran Shipping Lines Co. were offered by the Iranian Privatization Organization, as part of the ongoing privatisation scheme. The IPO took place at the price of 3521 Rials per share, thereby putting the value of the company at \$1.9 billion. However, this price was significantly above the market expectation. Consequently, the take-up level did not reach the threshold set by the Securities and Exchange Organisation (SEO), and the deal was cancelled. The next day, the offering was repeated at a 30% discount to the previous day. At the same time, the Iranian Privatization Organization announced that there would be no further offerings of this company in the pipeline. Therefore, the entire offering was bought, with the stock experiencing large buying queues and sustained price increases throughout the rest of the month.

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

### **Steel Manufacturers**

The debate on the government's pricing policies for steel products continued in early May. Last month, steel products were traded on the metal exchange at prices equal to those of last year, as prescribed by the government. However, in mid-May, following pressure from key players in the sector, trade prices increased by an average of 20%. In response to this, the price of almost all stocks in this sector rallied for the rest of the month. Mobarakeh Steel Company, the largest listed company by market capitalisation, gained 26% in price. It is worth noting that, despite the increase in the price of steel products, they are still trading at a 10% discount to FOB prices of the Persian Gulf.

### **Petrochemicals**

The unprecedented increase in the price of oil over the past few months has benefited most companies in this sector. Khark, the largest listed petrochemical company in Iran, enjoyed significant increases in its share price in May. This was due to the sharp rises in the price of sulphur and methanol in China, its main customer, following the recent earthquakes.

The situation is not the same for all companies in the sector. Following the opening of the Iranian International Petroleum Exchange (IIPE) in February and the liberalisation of the prices of finished products, the government removed all discounts that these companies used to receive on their feedstock. Historically, those companies using non-gas based feedstock bought their raw material at a 30% discount to the FOB

prices of the Persian Gulf. However, the removal of the government discount has caused a number of these companies to become loss-making.

**Cement**

There was much speculation about a potential price liberalisation of cement by the government in May. This resulted in an increased investor interest and accelerated the growth of stock prices in this sector. The result was that the sector index ended the month 11% up from April. For the past 3 years, cement has been in a basket of products, the sale prices of which are set by the government. Rumours about a liberalisation of the cement price periodically enter the market, but no change has ever been confirmed by the government. This time was no exception. In the final week of May, due to the lack of any news from the government on a potential price liberalisation, buying queues for the stocks began to turn into selling queues and stock prices started to tumble.

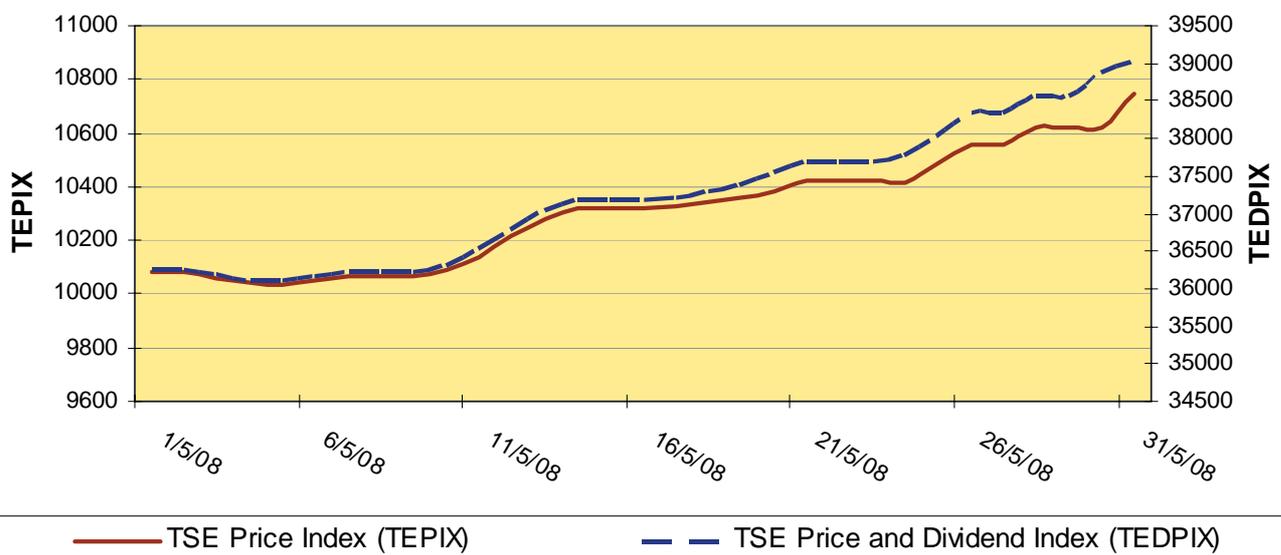
**Mining and Iron Ore**

In May, Chador Malou, the largest iron ore company in Iran, announced that this year it will have around 1 million tonnes of Concentrate in excess of the domestic need. This figure is likely to rise to 2 million by the end of next year, and the excess can be exported. This news moved the whole sector upwards. The government requires iron ore companies to supply the entire domestic requirement at a prescribed price, and then the excess can then be exported at global prices. The prescribed domestic prices of these products are currently at a 50-65% discount to global prices.

The stocks of lead and zinc companies, which were among the best performing in the TSE over the past two years, are now experiencing significant price declines. With the global prices of lead and zinc falling and raw material prices increasing simultaneously, profit margins are tightening for these companies. Furthermore, the continuing problems with the Angouran Mine, the largest Zinc mine in the Middle East, following its partial structural collapse in late 2006, have put further pressure on this sector.

Overall, the TSE experienced strong growth in May, mainly driven by the steel and cement sectors. The dividend and price index (TEDPIX) gained 7.2% in value and trade volumes grew by 80% from April, reaching \$720 million.

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

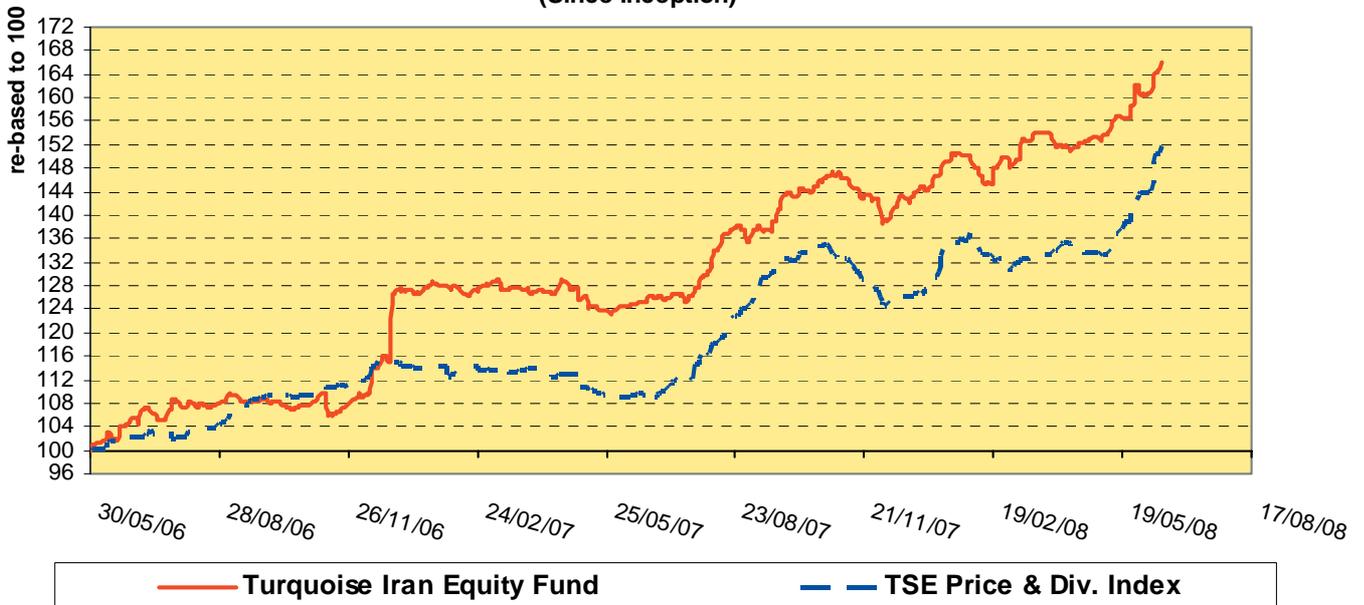


**Investment Objective** – The Turquoise Equity Fund seeks superior long-term capital growth by investing in the consumer and commodity potential of Iran, one of the most under-valued emerging markets in the world. Combining international experience with local expertise allows Turquoise to provide superior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

**Monthly Report** – The Net Asset Value (NAV) of the Turquoise Fund grew by approximately 5.1 % during May to stand at 161.2 by the end of the month. Most market indices also gained during this month with the TSE Price and Dividend Index (TEDPIX) growing by around 7.2% while the TSE Price Index (TEPIX) gained around 5.3%.

The charts below provide an update up until the middle of June, 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)**



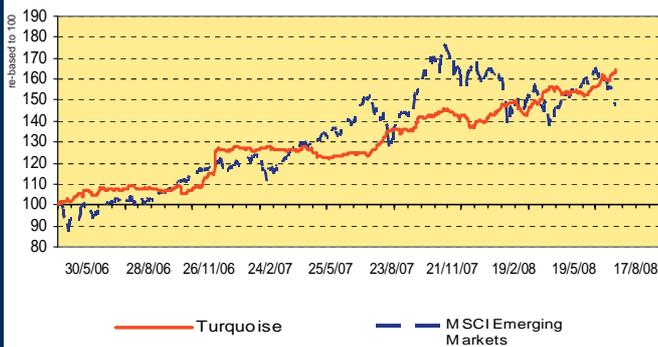
	Mar 08	Apr 08	May 08
<b>Turquoise Fund</b>	↑ 2.2%	↑ 0.3%	↑ 5.1%
<b>TEDPIX</b>	↑ 1.3%	↑ 0.2%	↑ 7.2%

## Performance

As of 15 June 2008

Period	Fund Return
Last Month	↑ 5.8%
Last 3 Months	↑ 8.7 %
Last 6 Months	↑ 16.0 %
Last 12 Months	↑ 33.0 %
Since Inception (30 May 06)	↑ 66.1 %

### Turquoise Performance vs. MSCI Emerging Markets



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



### Turquoise Performance in Euro (€)



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



The election of Dr. Ali Larijani as the new Chairman of the Parliament, and the latest progress report by the International Atomic Energy Agency (IAEA) on Iran's nuclear programme will be discussed in this edition of Country Overview.

The eighth parliament of the Islamic Republic of Iran commenced its work in May. Dr. Ali Larijani, winning a vast majority of votes cast, was elected as the Chairman (Speaker) of the new Parliament. Dr. Larijani, a candidate from the religious city of Qom, is the second non-clerical parliamentary chairman since the 1979 revolution. He is regarded as a conservative figure who is close to the Supreme Leader, Ayatollah Khamenei. He is a graduate in mathematics from Sharif University of Technology and has a PhD in Western Philosophy from Tehran University. As the Secretary of the Supreme National Security Council of Iran, Larijani was the Chief Negotiator on Iran's nuclear programme from August 2005 until his resignation in October 2007. Prior to this, Larijani held a number of significant governmental positions, including the Head of Islamic Republic of Iran Broadcasting and the Minister of Cultural Affairs.

The general consensus is that Larijani's election as the chairman was not the preferred outcome for the government of President Ahmadinejad. Although both Larijani and Ahmadinejad are from the conservative camp, the two hold differing views on a number of domestic and economic affairs. It is thought that Larijani may be able to weaken Ahmadinejad's position prior to the presidential election in 2009. Larijani himself was a candidate in the presidential election in 2005, and some commentators feel that he may stand again for the presidency next year. Larijani is seen as having a more pragmatic approach than Ahmadinejad on a number of issues. These issues include Iran's foreign policy and its approach towards the West, particularly with respect to the nuclear programme. He played a vital role in ending the detention of the British soldiers captured by Iran's Revolutionary Guards in the Persian Gulf in 2007. Mr. Ahmadinejad is now in the final year of the first round of his presidency. It appears that, during the course of this year, he will be faced with a parliament that, although dominated by conservatives, will not necessarily support his government's policies.

In May, the IAEA published a new progress report on Iran's nuclear programme. Mohammed El-Baradei, the Director General of the IAEA, explained in this report that, despite the third round of sanctions (which came into effect in March), Iran has not suspended its uranium enrichment programme. He added that Iran has 3,500 centrifuges active in the Natanz site. Also, Iran has not granted the IAEA access to the sites it had asked to inspect in its April progress report. He reiterated his conclusion that, based on the information received, he cannot say with confidence that Iran's nuclear programme is entirely for peaceful purposes.

Iranian officials called this report ambiguous, arguing that Iran has responded to all of the IAEA's outstanding questions. In response to the section of the report that requests access to a number of sites in Iran, they warned that the IAEA must not take advantage of Iran's willingness to cooperate, by trying to gain access to all military sites. The US responded to the IAEA report by stating that it formed the basis for a long list of outstanding questions to which Iran has yet to respond.

Since the implementation of the third round of sanctions, the group of 5+1 (permanent members of the UN Security Council plus Germany) has been working on an incentives package to offer Iran. These incentives include the lifting of a number of US sanctions, expansion of diplomatic relations with the West, and economic and trade cooperation. They would be in exchange for Iran halting its nuclear enrichment. This

group has indicated that the package is now ready and will be presented to Iranian officials during a visit to Tehran in June. A similar package was offered in 2006, but was rejected by Iran. The basis of the new package is believed to be the one offered previously, but with additional measures to make it more acceptable to Iran. Meanwhile, Iran has also submitted a package to the UN, offering its cooperation and a series of solutions for problems in the Middle East and worldwide. Iran has also indicated its willingness to hold talks with the 5+1 group on a number of economic, political, security and nuclear issues. So far, there has been no reaction to Iran's package from the group. Analysts expect both Iran and the 5+1 group to reject each other's packages. The 5+1 group has set the suspension of Iran's uranium enrichment, at least while negotiations are taking place, as a pre-condition for talks. However, Iranian officials have expressed firmly that they will not accept any pre-conditions for talking to the group.

### First Foreign Bank in Iran

The Tehran branch of the Europe-Iran Commercial Bank (Europaisch Iranish Handels Bank (EIH)) opened for business in early May. This is the first branch of a foreign bank that has been established in Iran since the Islamic revolution. According to the Central Bank, 5 other foreign banks are in the process of opening branches in Iran.

EIH bank was established in 1971 by a group of Iranian businessmen in Germany and was registered as a private limited company and under the name of Bank of Iran and Germany. The EIH head office is based in Hamburg and its major shareholders are the Bank of Industry and Mines, Mellat, Tejarat and Refah banks of Iran. Officials at the Central Bank confirmed that EIH (and all other foreign banks with a banking license from the Central Bank) can offer the same products and services as domestic banks in Iranian Rials or other currencies, in accordance with the Islamic banking rules of Iran (Sharia) and other Central Bank regulations.

The opening of the EIH branch in Tehran indicates that there are no obstacles to foreign banks entering the Iranian financial markets, subject to the Central Bank's regulations. Currently, the Iranian banking sector is dominated by state-owned banks, although there is an increasing presence from privately-owned banks and credit institutions. Analysts believe that the presence of foreign banks in Iran will improve the competitiveness and the quality of the services offered by domestic banks, and will bring about innovation and diversity in financial products.

### Interest Rates in Iran

Interest rates for banks' lending facilities have been debated between the Government and the Central Bank for a number of months. In line with the Islamic banking regulations in Iran, there are typically two structures used by the banks for lending facilities. The first structure, known as Mobadeleh, has a structure similar to that of conventional loans. The second structure, known as Mosharekat, is a type of participation in a project and is comparable with project finance. The rate charged by the lender in the latter structure is dependent on the profitability of the project, and is mutually agreed between the bank and the borrower. In Iran, however, the interest rate (or profit rate) charged by the banks on the former structure is set by the Central Bank and approved by the Money and Credit Council (MCC).

In its annual monetary policy, the Central Bank proposed that in the year 1387 (2008-2009) the profit rate for Mobadeleh lending, which was set at 12% for the year 1386, should be set in accordance with the rate of inflation. Based on the current rate of inflation, profit rates should be increased. However, the government, which has now taken over the responsibilities of the MCC, has decided to cut the rates from 12% to 10%, arguing that lower borrowing rates will stimulate production, boost industry and reduce the unemployment rate. However, the Central Bank and many experts opposed this decision, explaining that cutting rates will cause a flow of deposits out of banks, thereby increasing surplus liquidity in the economy, and in turn an already high rate of inflation.

In early May, the government announced its final decision on the profit rates. Rates were cut to 10% for lenders to the real estate development, agriculture, industries and mining sectors and kept at 12% for services and commercial sectors. The Central Bank has yet to implement these new rates and is believed to be in discussions with the government about the feasibility of the new policy. Last year, the government reduced profit rates from 14% to 12%. The Central Bank had initially opposed the government's decision. If the rate cut for this year materialises, it will be the third consecutive year that the government has prescriptively lowered profit rates.

### Surplus Liquidity

The Central Bank of Iran announced that following the implementation of the Bank's monetary and fiscal policies towards reducing surplus liquidity and inflation, the rate of growth of surplus liquidity at the end of Iranian Calendar year 1386 (20<sup>th</sup> March 2008) has fallen to 27.7%. This figure stood at 39.4% at the end of 1385. This was the first time since 1383 that the growth in surplus liquidity had slowed, indicating that the Central Bank's policies are starting to become effective. Analysts explain that the main reasons for the hikes in surplus liquidity, and consequently, the rate of inflation, are the surge in the oil price over the past few years, and the government's injection of oil revenues into the economy beyond its capacity to absorb the new funds.

The Central Bank added that total bank deposits from the private sector (retail and institutional) grew by around \$3.6 billion, of which 69% was deposited with state-owned banks and the remaining 31% with privately owned banks and credit institutions.

### New Mobile Phone Operator in Iran

In May, Megaphone of Russia opened an office in Tehran. Megaphone is known to be one of the operators competing to implement the third generation mobile phone network, G3, in Iran. The CEO of Megaphone has said that he plans to invest around €3 billion in Iran. He sees Iran as a stable economy and believes that Iran has an attractive telecommunications market. Currently, two non-governmental operators, namely IranCell and Taliya, as well as the state-owned Telecommunications Company of Iran, offer mobile phone services in Iran.

## 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.

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