



The Grand Bazaar (market), City of Tabriz, North Western Iran

THIS MONTH

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In August, the Tehran Stock Exchange (TSE) experienced a slowdown in trading and price falls in underlying stocks. The reduced possibility of further sanctions against Iran (due to US-Russian tensions over Georgia) and the IPO of the Telecommunication Company of Iran (TCI) caused some excitement in the market. However, the bearish sentiment of investors generally overshadowed any positive news. There were two main reasons for the slow market of this past month. Firstly, the IPO of TCI absorbed in excess of \$300 million liquidity from the market and placed pressure on other stocks, as investors sold off their other holdings to obtain cash for the IPO. Secondly, and perhaps more importantly, significant falls in the global prices of most commodities (such as steel and copper) caused investor concern regarding the profit margins of commodity-based companies. In particular, Mobarakeh Steel Company and the National Iranian Copper Industries Company (NICIC), the second and the third largest listed companies by market capitalisation, were the worst affected.

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

Initial Public Offering of Telecommunication Company of Iran

On the 10th of August, after much anticipation and speculation, the IPO of TCI finally took place. 5% of TCI shares were offered to the market at a price of 1,500 Rials per share. This put the total market capitalisation of TCI at \$7.2 billion, making TCI the second largest listed company upon listing, and increasing the total market capitalisation of the TSE to approximately \$70 billion. This price was below analysts' expectations of around \$10 billion. For the rest of the month, this stock had extremely heavy buying queues for numerous reasons. Firstly, the stock was offered at a significant discount to analyst's predictions and some quick gains were expected in the price. Secondly, TCI runs a monopoly in providing fixed telephone line services in Iran and holds an 85% share of the mobile phone market. The latter part of its business is one of the fastest growing and most profitable parts of its business. Many analysts predict astronomical rates of growth in the earnings of TCI over the next 5 years. Thirdly, TCI has little dependency on global prices and markets, as well as political risk. Hence, its commercial risk is relatively low in comparison to many other blue-chip companies.

By the end of August, the TCI share price was up 14.5% from its IPO value. This, along with falls in the Mobarakeh Steel share price, resulted in TCI becoming the largest listed company on the TSE.

Iron Ore

The recent slowdown in global consumption and consequently the price of iron ore, and expansion plans of major iron ore producers for increasing production by 10-15%, have put pressure on spot prices of iron ore in the domestic market. Also, unlike many other metal and mineral commodities, iron ore is not traded on the commodity exchange. This combination means that conditions are more difficult for companies in this sector. Consequently, the TSE witnessed falls in the share prices of Chador Malou and Gol Gohar, the two largest listed iron ore companies, in August. Currently, companies in this sector sell their product domestically at a 40% discount to global prices. These companies are required to meet the domestic demands of steel manufacturers. Any excess production can then be exported at global prices. Therefore, there is huge potential for an increase in the profitability of these companies.

Towards the end of August, the market learnt of an agreement between steel manufacturers and iron ore companies to increase the price of iron ore. Details and mechanism of the increase are expected to be announced in September.

Steel Manufacturers

The steel sector has performed very well since the beginning of the Iranian calendar year (which started on 21st March), but was the biggest faller in August. With the sale price of steel products falling globally and

domestically, there was a quick erosion of investor expectations of steel makers outperforming their earnings forecasts. In this month, 5% of Mobarakeh Steel Company's shares were awarded by the government to the country's top exporters at a discount. This resulted in a huge selling queue and significant price falls in the company. Shares of Mobarakeh and Khouzestan, the two largest steel manufacturers in Iran, fell by 21% and 29% respectively this month.

Construction

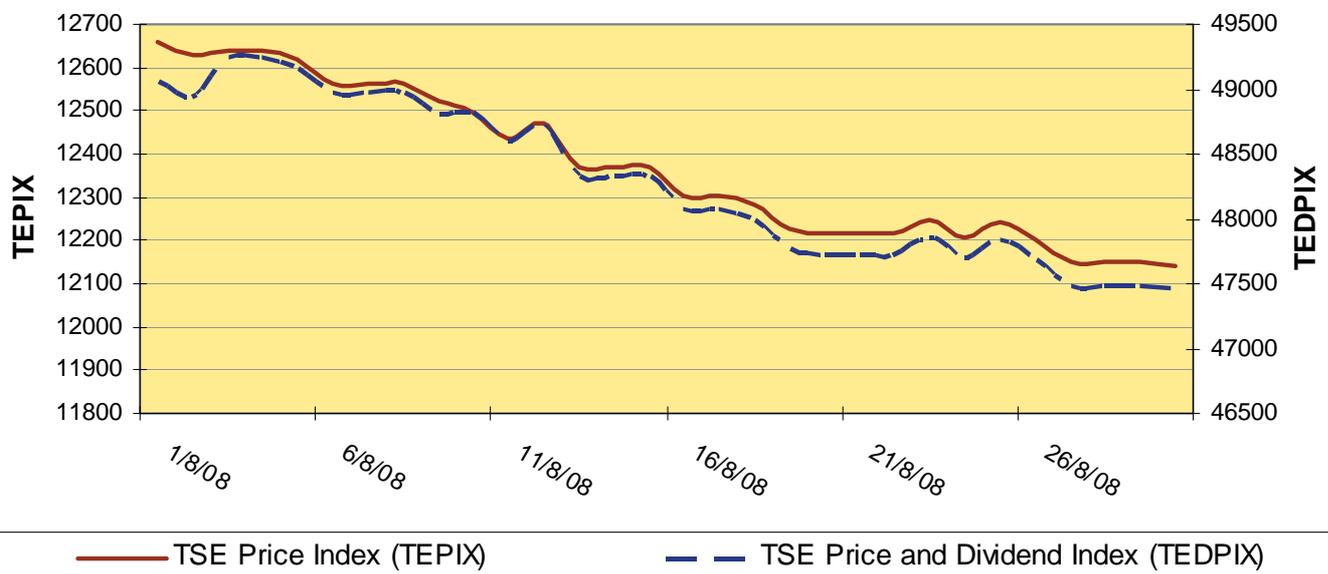
Despite the extraordinary boom in real estate prices in Iran over the past 2-3 years, companies in this sector have failed to provide solid returns to shareholders. The construction sector experienced a very calm month in August, with the sector index losing just 0.1% of its value. However, as the financial year-end of most companies in this sector falls in September, trading activities are expected to gain momentum over the next few months.

Auto Manufacturers

The auto manufacturing sector can be regarded as the "fallen angel" of the Tehran Market. This sector, which was the star performer of the TSE around 5 years ago, is now facing serious doubts about its future profitability. The sale price of cars in Iran is fixed by the government. The continuous growth in raw material prices is squeezing the profit margins of these companies to the point where certain products are becoming loss making. Iran Khodro, the largest auto manufacturer in the Middle East, has also taken a further hit from the establishment of a number of politically motivated unprofitable production lines abroad. The difficulties have moved into related sectors such as part makers. The average P/E ratio of this sector is now as low as 2.4.

Overall, the TSE experienced a slow month with the TSE Dividend & Price Index (TEDPIX) losing 3.3% in value. Trade volumes rose by 13% compared to July, mainly due to the offering of TCI, and they reached \$1.7 billion in value.

Performance of TSE Indices (August 2008)

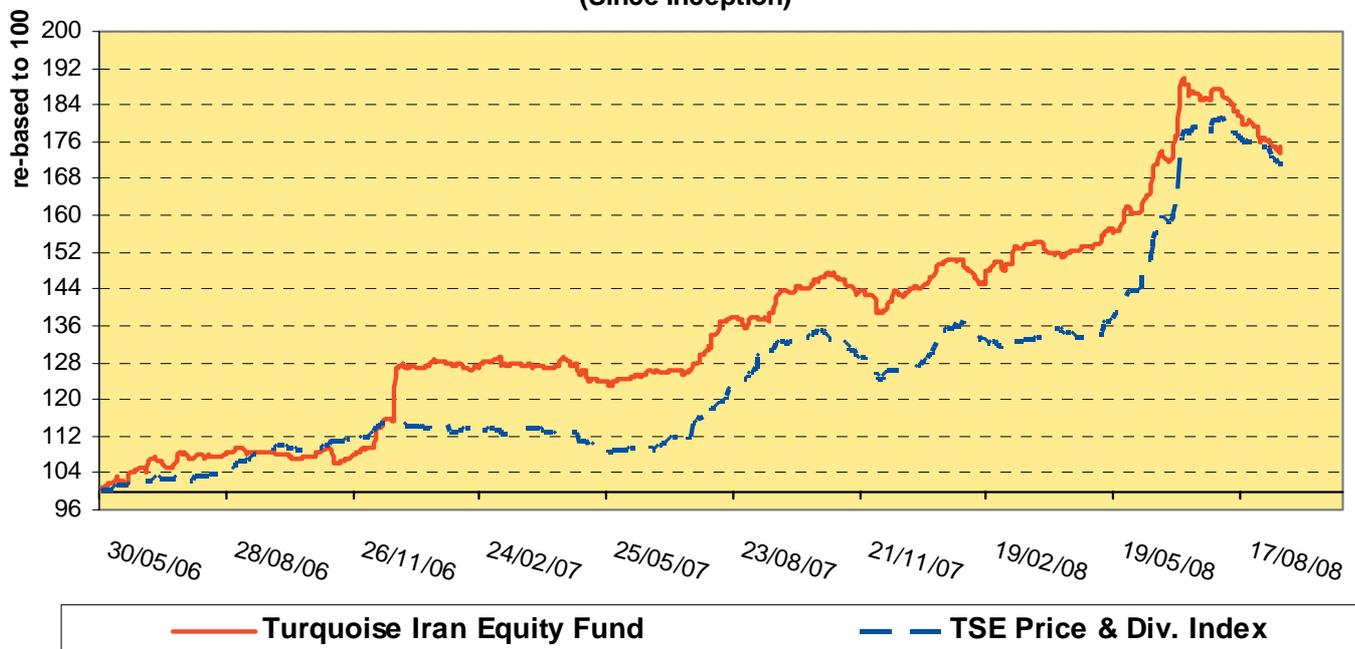


Investment Objective – The Turquoise Equity Fund seeks superior long-term capital growth by investing in the consumer and commodity potential of Iran, one of the most under-valued emerging markets in the world. Combining international experience with local expertise allows Turquoise to provide superior 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 fell by approximately 6.6% in August to stand at 175.8 by the end of the month. Most market indices also experienced falls during this month, with the TSE Price and Dividend Index (TEDPIX) losing 3.3% in value while the TSE Price Index (TEPIX) fell by 4.2%.

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)**



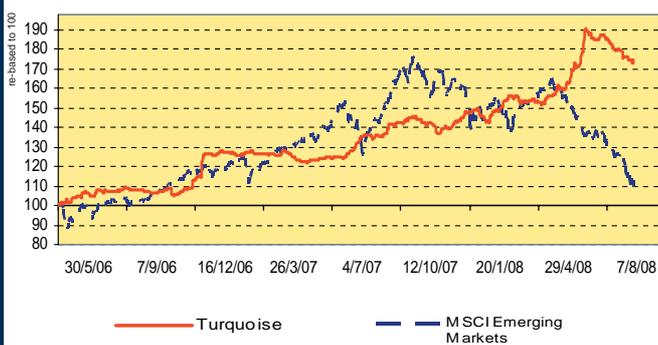
	Jun 08	Jul 08	Aug 08
Turquoise Fund	↑ 7.3%	↑ 8.5 %	↓ 6.3 %
TEDPIX	↑ 11.1%	↑ 13.1 %	↓ 3.3 %

Performance

As of 15 September 2008

Period	Fund Return
Last Month	↓ 4.2 %
Last 3 Months	↑ 5.3 %
Last 6 Months	↑ 14.5 %
Last 12 Months	↑ 27.1 %
Since Inception (30 May 06)	↑ 74.9 %

Turquoise Performance vs. MSCI Emerging Markets



Turquoise Performance in US Dollar (US\$)



Turquoise Performance in Euro (€)



Turquoise Performance in British Pound Sterling (£)



The potential opening of a US interests section in Tehran, and Iran's launch of a satellite carrier rocket into space will be the focus of this edition of Country Overview.

Last month, US officials indicated that they are considering opening a US interests section in Tehran in the near future. Many analysts saw this as a major shift in US foreign policy by the George W Bush government. This development was viewed as a positive step towards resolving the tensions between Iran and both the US and also its Western Allies. In response to this the Iranian President, Ahmadinejad, said that Iran had not yet received any formal requests from the US. However, he went on to say that Iran would welcome any actions that could improve relations between the two nations.

Since the Islamic revolution in 1979, the US has had no diplomatic presence in Iran. The Swiss embassy in Tehran has been conducting the function of an interests section for the US in Iran. However, all of its staff are Swiss and its functions are very limited. The special interests section would carry out all of the functions of an embassy, including visa applications and consulate affairs, and it would be staffed by American diplomats. Currently, visa applications for Iranians are dealt with by a small office in Dubai. Also, many Iranians travel to Europe and other countries in the region to apply for US visa. The US government has admitted that the operation of the Dubai office is inadequate, and that it is sometimes difficult for Iranians to gain access to it. Moreover, US officials have said that they are keen for more Iranians to visit the US. Iran has had an interests section in Washington for several years, and this increases the justification for the US to open such an office in Tehran.

In August, Iran carried out its second test of launching a satellite carrier rocket into space. The Iran Space Agency reported that it had successfully test-fired a two stage rocket. According to this agency, the rocket launch, which carried a dummy satellite named "Safire Omid", went according to plan, with the rocket completing its mission and reaching the Low Earth Orbit (LEO). The rocket manoeuvres were controlled from the ground and it was equipped with instruments sending flight data back to the base. The launch of this rocket was aimed at testing remote sensing, satellite telemetry and geographic information system (GIS) technology, as well as remote and ground station data processing. The Iran Space Agency added that a number of research centres and universities have been working on this programme for the past three years. This event sparked mixed reactions around the world. The US officials said that although the test was a major step forward for the Iranian space programme, the launch of the rocket was a failure and it did not reach its planned target.

The reasons that Iran gives for putting its own satellite into orbit are to study natural disasters (such as earthquakes), to help its disaster management programmes, and to better its telecommunication facilities. The Iran Space Agency indicated that two more tests are to be carried out before Iran's domestically made satellite, Omid, is placed into orbit.

National Development Fund

In August, the Iranian Expediency Council, which is a powerful supervisory body chaired by the ex-president Rafsanjani, endorsed the establishment of the National Development Fund. This fund has similarities in its structure to the Oil Stabilisation Fund (OSF). However, a key difference is that its funds can only be used for long-term development plans and the government cannot withdraw from it for short-term programmes or for the budget deficit. The OSF was established in 1998 to insure Iran's national income against fluctuations in the global oil price. However, despite the record high oil prices, this fund currently holds less than \$10 billion due to excessive withdrawals by the government.

In the terms of the National Development Fund, the Expediency Council has allocated 30% of all revenues from the export of oil and gas to this fund. The government can use the other 70% of revenues for its capital expenditure and budget deficit. However, the Council has stated that the government must reduce its dependency on oil and gas revenues, so that by the end of the Fourth Five-Year Development Plan (March 2010), its dependency on these revenues is reduced to 40%.

IMF Country Report on Iran

In August, the International Monetary Fund (IMF) published a report on Iran's economy. In this report, the IMF expressed concern over the Iranian government's expansionist fiscal and credit policies. This report identified the growing rate of inflation as a direct consequence of the government's policies and as a key risk to Iran's economic prospects. According to this report, Iran's rate of inflation increased from 16% in April 2007 to 24% in April 2008. It added that unless reforms are introduced, inflation could stay as high as 25% in the next 2-3 years and economic growth, which is currently at around 6.5%, could slow down to 4%.

The IMF report makes a series of recommendations that aim to reverse the current trend and ensure the long-term growth and resilience of the Iranian economy. The most important recommendation is a prompt increase in the banks' lending interest rate. The interest rate, currently set at 12%, is significantly below the rate of inflation and has created huge demand for lending facilities and further inflationary pressure on many sectors. The government's excessive budgetary expenditure (another reason for the rising inflation) needs to be reduced by the implementation of the planned economic reforms, such as reducing the subsidies and targeting them at priority sectors. The IMF also recommends a more flexible foreign exchange mechanism, where the exchange rate fluctuations are more dependent on market factors such as the rate of inflation.

Third Generation Mobile Phone

In July, Iran's Ministry of Communication and Information Technology (MCIT) announced that it expects the process for auctioning the third mobile phone operator license in Iran to begin next month. According to this ministry, Megaphone of Russia and a large consortium of domestic telecom companies are the main competitors for this license so far. Also, a number of other companies, including Etisalat of the UAE, have expressed their interest in taking part in the auction.

Currently, two mobile phone operating licenses have been granted to the newly-privatised Telecommunications Company of Iran (TCI) and IranCell, a joint venture between an Iranian consortium and MTN of South Africa. The third license will be for the third generation mobile phone, also known as 3G. Currently, the MCIT is developing the infrastructure for the 3G technology. Iran, with a population of around 70 million, an underdeveloped telecom infrastructure and a mobile phone penetration rate of below 40%, is viewed as one of the most attractive markets in the world. Analysts expect fierce competition for the third operator license.

Iran and Germany Gas Deal

In February 2008, German firm Steiner Prematechnik Gastec received an export license from Germany's Federal Office of Economics and Export Control (BAFA) for a gas contract with Iran. This deal, which is worth €100 million, is for the development of three high-tech plants for liquefying natural gas in the south of Iran. Despite heavy criticism from the West and intense pressure from the US, the deal is progressing as planned. The US and its allies claim that the deal contravenes the UN Security Council Sanctions imposed on Iran. However, Germany rejects the claims, arguing that BAFA has carried out extensive examination and has not found any links between this deal and any military programmes.

Since the beginning of the year, Iran has signed a number of major deals with several countries including China, Russia, Malaysia, Italy and Switzerland, as well as Germany. Iranian officials argue that, this further demonstrates that the UN Security Council and the US economic sanctions have not had the impact that the US and its Western allies envisaged.

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

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