

Navab Highway, Southwest Tehran

## THIS MONTH

### Market Overview **2**

Almost all the TSE indices closed in positive territory during December 2006. Most notably, the banking, petrochemical and mining sectors showed strong performances during the month. The outlook for the banking and the petrochemical sector remains positive while the mining sector is believed to be over-valued. The future outlook of the pharmaceutical sector is also viewed positively by the market.

### Turquoise Iran Equity Fund **3**

Turquoise had a remarkable month in December with a monthly performance of over 15%. This was mainly due to announcement of positive adjustment to earnings from two of its largest holdings which resulted in a significant share price increase. Turquoise Investment Committee took necessary measures during December to reduce portfolio risk while maximizing future growth potentials.

### Private Equity **5**

The construction of two high-rises in one of the most rapidly growing areas of Tehran is the private equity opportunity introduced in this edition. The project has strong potential returns and is well placed alongside other development projects that are being carried out in that area of the city.

### Country Overview **6**

This looks at the United Nations Security Council's resolution 1737 which imposes limited sanctions on Iran's nuclear and missile industry. It considers the impact on the Iranian market as well as the Iranian government's decision to switch its business activities from the US dollar to the Euro.

### Economy **7**

News and views on the country's macro economy with special attention given to the recent UN Security Council resolution, investment in the oil industry and bilateral trade agreements.

*Iran Investment Monthly is produced by Turquoise Partners. Distributed electronically by exclusive subscription.  
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The month of December started with investors' growing interest in the pharmaceutical, mining, petrochemical and banking sectors.

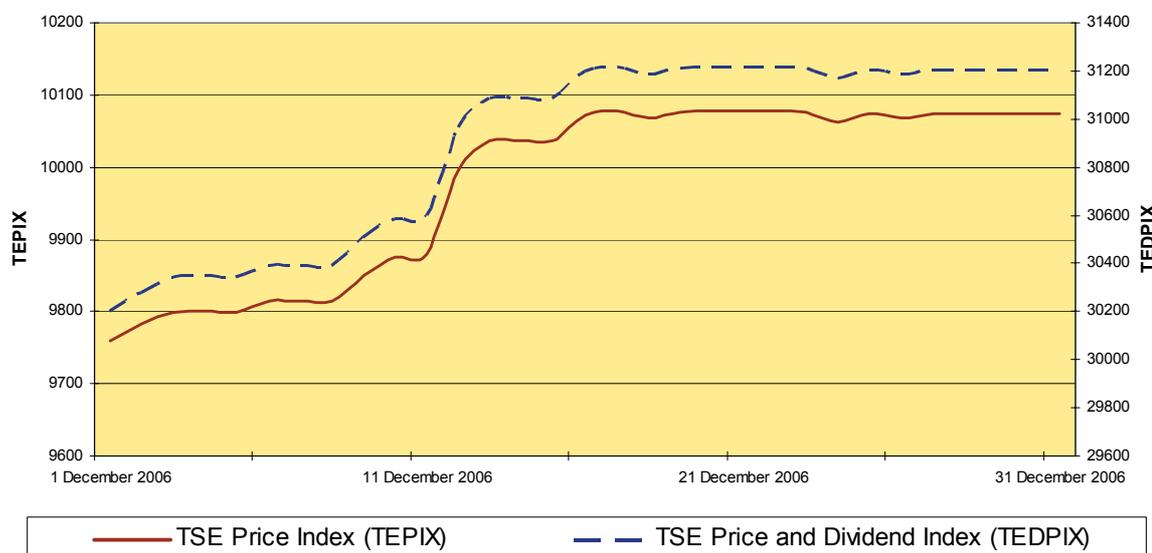
The market value of the mining and metals sector grew by 14% to stand at around \$4.9 billion by the end of the month. This rise was mainly caused by the zinc and the iron related stocks, where share prices grew significantly over this period. The growth in the iron ore industry is driven by speculations that the production capacity of the country's major mining companies will double within a year. However, market analysts believe that these surges in the share prices are exaggerated and a price correction for iron ore mining companies is expected within the next few months. In the case of the zinc companies, the rising price of zinc in international markets over the last few months has contributed to the increased earnings for these companies. Subsequently, positive adjustments to expected earnings were posted and share prices rose. The share prices of the listed zinc companies are directly linked to the global zinc prices and would quickly adjust to the future fluctuations of the global commodity's market.

The pharmaceutical sector also experienced an active trading month. Generally, this sector has limited liquidity and the trade volume is volatile depending on the perception of the market. In December, there was a significant interest in this sector due to two main reasons. Firstly, there is a perception that in the event of internationally imposed sanctions on Iran, this sector will not be hit as it will most likely be excluded from any potential sanctions. Secondly, the tight control of the government on imports of pharmaceutical goods through high tariffs. This creates a comparative advantage for Iranian-made pharmaceutical products.

The growth in the petrochemical sector was mainly caused by the rise in the prices of petrochemical products on global markets. The top gainer in this sector during December was Khark Petrochemical Company which saw a 30% increase in its share price. Following this growth, Khark has become the largest company among the 400 listed companies on the Tehran Stock Exchange with a market value of \$2.3 billion. Khark is the only producer of methanol amongst listed petrochemical companies in Iran. The 65% rise in international methanol prices over the past nine months has helped the company to realize a significant rise in its annual earnings.

Banking has been another outperforming sector on the Tehran Stock Exchange during the recent weeks. The sector is expected to experience significant growth in the final months of the Iranian year ending March 2007. The increasing level of liquidity in the Iranian economy and the limited investment options available to investors has channeled a large amount of capital into the private banks which offer competitive interest rates. As a result, the three listed private banks experienced a significant rise in their deposits during the current year which helped them increase their banking activities and as a result their expected earnings.

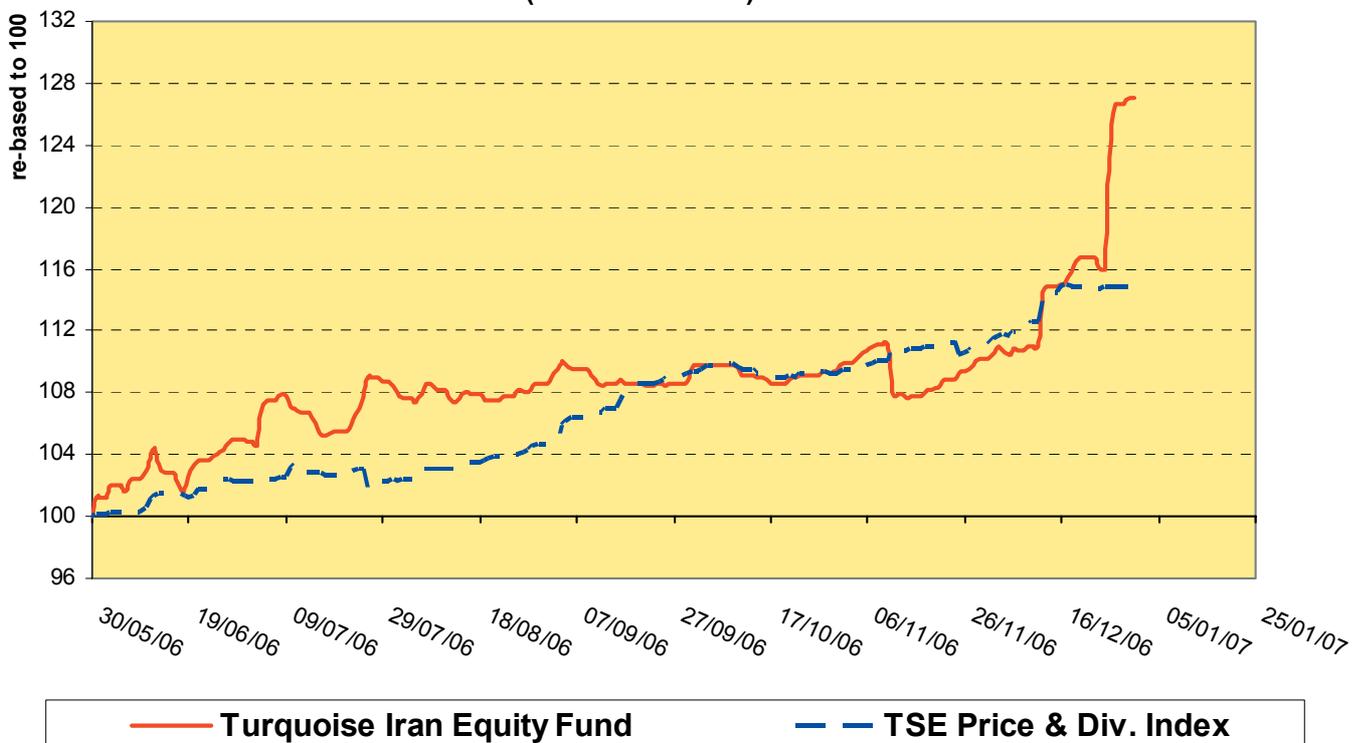
**Performance of TSE Indices (December 2006)**



**Investment Objective** - 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 and risk by investing in equities listed on the Tehran Stock Exchange (TSE) and Iranian-based securities. The base currency of the Fund is Iranian Rial.

**Monthly Report** - The Net Asset Value (NAV) of the Turquoise Iran Equity Fund grew by over 15% during December 2006. On 1<sup>st</sup> January 2007 the Fund's performance index stood at 127.34 beating the benchmark (TSE Price and Dividend Index) by around 13%. This was mainly due to the 50% share price increase of Bank Karafarin, Turquoise's largest holding, and the 30% rise in share price of Khark Petrochemicals. During December, the Turquoise Investment Committee decided to add a few more companies from the auto manufacturing, the leasing and the construction sector to its holdings in order to diversify and minimize the risk of the portfolio. In addition, Turquoise's holdings in Bank Karafarin and Khark Petrochemicals were reduced in order to realize some gain as well as to distribute portfolio risk. The following graph shows the performance of the Turquoise Iran Equity Fund against the benchmark since the launch of the Fund. In addition, the performance of the fund against MSCI Emerging Market and the Fund performance in different currencies is displayed on next page.

**Turquoise Portfolio vs. TSE Price & Div Index (TEDPIX)  
(YEAR TO DATE)**

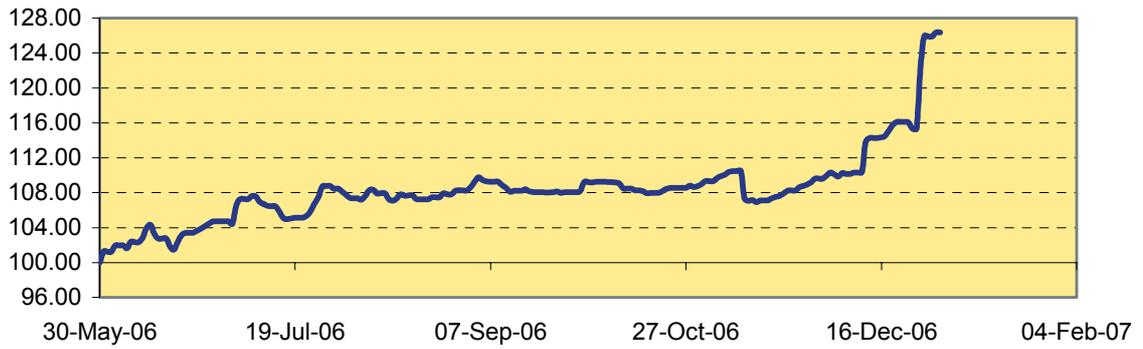


	1 Nov 06	1 Dec 06	1 JAN 07
Turquoise Fund	9.93 %	10.22 %	27.34 %
TEDPIX	9.46 %	11.19 %	14.75 %

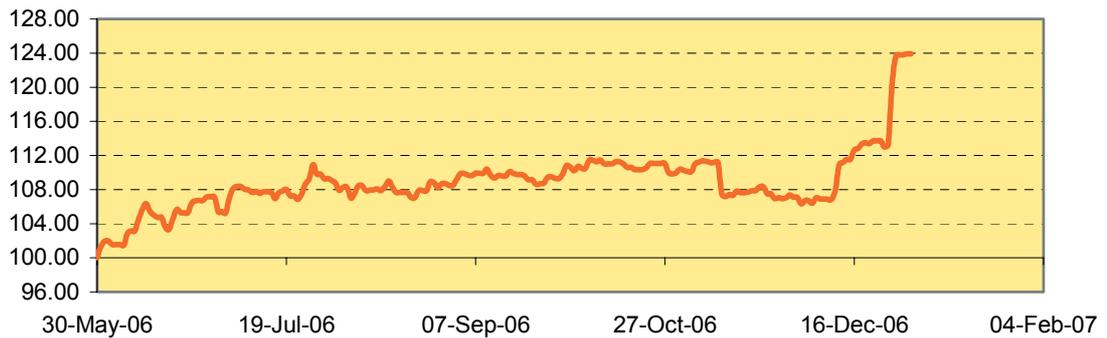
## Turquoise Performance vs. MSCI Emerging Markets



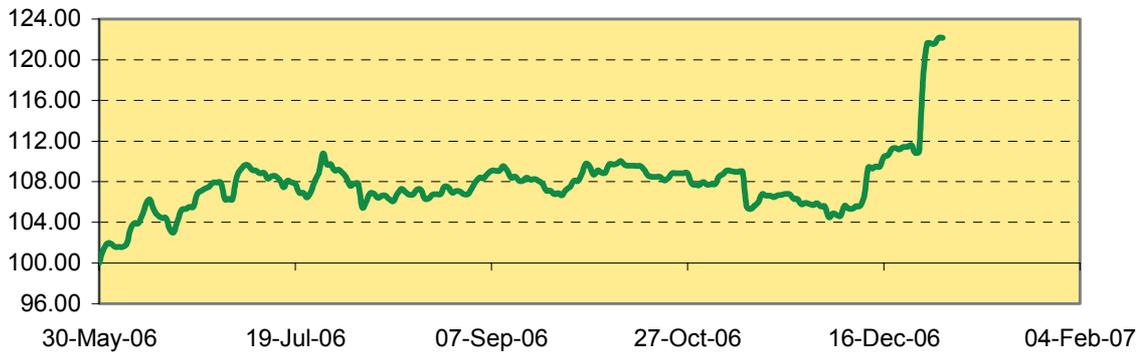
## Turquoise Performance in US Dollar (US\$)



## Turquoise Performance in Euro (€)



## Turquoise Performance in British Pound Sterling (£)



**PROJECT # 1****Title: Construction of Two Residential High-rises in West Tehran****Investment Size:** ~ \$11 million**Sector:** Real Estate**Description:**

This project involves construction of two high rise buildings on a land plot located in West Tehran with an area of around 6,000 square meters. The owners have already secured the building permit which allows the construction of 19,000 square meters of built area in 148 residential units in two separate blocks. Each block is a twenty-storey high-rise building, one consisting of 72 units and the other 76.

The price of the land plot including the building permit is \$3.7 million and an additional \$7.3 million needs to be injected for the construction of the building. Built units in the area are currently sold at around \$1300 per square meter. The project would take around 30 months to complete and would generate a return on investment of around 120%.

The price of apartments in the area continues to rise at a fast rate so returns could be significantly higher.

**Potential:**

District 22 in West Tehran, where this land plot is located, is considered to be the next booming area of Tehran. This region is still under-developed and has great potential for growth. Being located in the West of the city where Tehran's winds originate, it is not facing the air pollution problem that all other areas of Tehran are currently dealing with. In addition, the construction of many highways will, in the future, make this district one of the most accessible areas of Tehran. Very close to this land plot, there is a large park where an artificial lake is to be constructed in near future. This would provide these units with a unique view rarely available anywhere else in Tehran.

The most significant developments in December 2006 were the approval of the United Nation Security Council (UNSC) Resolution 1737, which imposes limited sanctions on nuclear-related and missile-related activities of Iran, and the decision by the Iranian government to switch its currency reserves and the bulk of its business activities from the US Dollar to the Euro.

As expected, Russia and China finally agreed on a watered-down version of the sanction resolution, which was originally proposed by some of the Western countries. As a result, the UNSC unanimously adopted this resolution just prior to the end of 2006. Some of the limitations included in this resolution are a ban on the transfer of sensitive technology and assistance related to Iran's nuclear and missile programs, as well as a freezing of the assets of several Iranian companies and individuals who are directly involved in the Country's nuclear and missile program. The UNSC Resolution gave Iran a 2-month long deadline to suspend its uranium enrichment program and has threatened further sanctions if Iran does not comply. Although it is possible another resolution with expanded sanctions could be adopted in the future, an agreement on such sanctions would take months to complete and its impact on the Iranian economy is expected to be minimal and gradual. Leaving the direct economic impact aside, the psychological impact of the sanction resolution could already be felt in the Iranian market as most industries and stocks on the market closed in negative territory in the days following the adoption of the resolution. Considering that the Iranian stock market and its index are heavily managed, the full impact of the sanction resolution on share prices is expected to be realized gradually within the coming weeks.

The Iranian government's decision to cut its reliance on the US dollar is both a counter measure to America's active policy of financially isolating Iran and also a risk-management move based on speculation the increased US trade deficit could result in a weakening of the US dollar against other major world currencies. Devaluation of the US dollar against the Euro, as happened a few weeks ago, could significantly hurt countries like Iran which export most of their goods in US dollars while importing their goods and services in other currencies such as the Euro. According to a decision by the Iranian government, the base currency of all foreign transactions and the calculations of state budget should switch from the US dollar to the Euro. It is yet to be seen whether this decision can be successfully implemented. Considering the fact that more than 80% of Iran's foreign income is from the export of crude oil, which is usually traded in US dollars, it would certainly be a difficult task for Iran to significantly decrease its reliance on the dollar. However, the decision made by major world banks such as HSBC, ABN Amro, UBS and Credit Suisse to cut their business activities with Iran under US pressure as well as restrictions imposed by US treasury on foreign banks which conduct dollar transactions with Iran have made the decision to switch to the Euro ever more attractive to the Iranian government.

- **UN Sanctions:** the UN Security Council's recently imposed sanction on Iran has had more of a psychological effect on the Iranian economy than a direct financial impact. The stock market reacted to the news of sanctions with long supply queues of stocks in most sectors. This negative atmosphere however, is believed to be temporary given that rumors of sanctions has been going around for months and most amateur investors who feared its impact have already left the market. In addition, most professional investors and market analysts believe that the extent of the sanctions is very unlikely to go as far as including companies unrelated to the country's arms and nuclear industries. Given the complexities of the regulations that govern the stock exchange such as the gain/loss cap imposed on the market, which makes it difficult to purchase attractive stocks at times, institutional investors are looking at the current situation as a good buying opportunity. Once the market adjusts to the news, which might take weeks with the imposed restrictions, most institutional and professional investors are expected to continue their market making activities which would help the Tehran Stock Exchange recover from the news of sanctions.
- **Investment in the Petroleum Industry:** President Ahmadinejad has allocated \$4 billion from the country's Oil Stabilization Fund (OSF) for investments in the country's petroleum industry. Iran's old and aging oil industry requires significant investment in order to keep its current production level and for new developments. According to the official statistics, more than \$100 billion needs to be invested in this industry in order for Iran to achieve its 20-year development plan ending 2025. Given the political tension with the West, Iran has been unable to attract much needed investment for its oil sector and as a result, the government has decided to secure domestic financing for implementations of its development plans for the country's petroleum industry.
- **Zinc Mines:** Iran is to begin development of a major zinc mine in the Zanjan province. Located near the old Angouran mine, the new zinc mine is expected to boost Iran's production of zinc by 100,000 tons per year. The implementation of the project is expected to take three years to complete. In addition, work has begun on another world-class zinc mine in the Yazd province. Mehdiabad mine, which was originally discovered by Japanese experts before the 1979 revolution, was ignored for years until the project was revived in the late 1990s. So far, feasibility and detailed exploration of the reserve have been completed and a production contractor is planned to be named by the government within the next few months. The total reserve of Mehdiabad mine is believed to be around 250 million tons with average metal purity of around 5%. The current operator is Union Resources who are listed in Europe and Australia.
- **Iran-China LNG deal:** According to a deal signed between ParsLNG company of Iran and the Chinese company, PetroChina, China has agreed to buy 3 million tons of liquefied natural gas (LNG) from Iran per year. The Iranian official in charge of Pars LNG has indicated that the pricing of the LNG export will be calculated based on a formula driven by global crude oil prices. ParsLNG is one of Iran's four major LNG producing projects which is owned jointly by National Iranian Oil Company (NIOC), Total of France and Malaysian Petronas.
- **Iraq Loan:** Iran is offering Iraq a loan for one billion US dollars to be used for the country's reconstruction projects. According to the terms of the agreement, this loan will be used by the Iraqi government to employ Iranian contractors and experts for the implementation of infrastructure projects, agreed by both sides, such as power plants, roads, hospitals and schools.
- **Export of Health Products:** Iran's exports of health products during the first eight months of the current Iranian year (ending March 2007) increased by 40% to stand at \$113 million. Major exported products in this sector are: various types of soaps (\$13m), hair shampoos (\$4m), and toothpastes (\$520k). The major destinations of these exports were Afghanistan, Turkmenistan, Tajikistan and the Republic of Azerbaijan.

## 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](mailto:ramin.rabii@turquoisepartners.com)

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