Iran Investment Monthly

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TURQUOISE PARTNERS

World's tallest ***Baadgir*** (34 meters) - Dowlat Abad Garden , Yazd , Central Iran
These traditional air-conditioning towers are called ***Baadgir*** in Persian, which literally translates to Wind Catcher

THIS MONTH

Due to the New Year's holiday in Iran, the April and May editions of the *Iran Investment Monthly* are published jointly in this copy of the newsletter.

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Further information and detailed analysis of reports in this publication can be purchased directly from Turquoise Tehran office.

March 2007

At the beginning of March, the mood of the Tehran Stock Exchange (TSE) was heavily influenced by the announcement of the Initial Public Offering (IPO) of Mobarakaeh Steel Complex (MSC). This was to become the TSE's largest IPO in its 40 year-long history. On 11 March, 3% of the shares of MSC were offered to the market raising approximately $98 million. The size of the IPO was considered large compared to the TSE's average daily trade volumes of around $10 million whilst the Iranian year was ending which historically results in large sell offs by the institutional investors. Following the IPO therefore, the exchange went through a few days of weak performance both in terms of volume and price. The share price of the MSC slid by two percent from its initial price after only a week.

The fate of another IPO, which occurred before March, was rather more positive. The demand for the shares of the National Iranian Copper Industries Company (NICIC) grew significantly in recent weeks following the rise in international copper prices from the previous $5,800 per ton to around $7,000 per ton. NICIC, the second largest listed company on the TSE, currently owns and operates copper reserves, considered to be some of Asia's largest. NICIC's reported forecasted earnings for the current Iranian year (ending March 2008) are based on global copper prices of $5,200 per ton. Continued strength in world copper prices would indicate a significant upward revision to NICIC's forecasted earnings.

Other previously attractive sectors on the market such as iron ore mining, petrochemicals and zinc production experienced weakness in March, evidenced by share supply queues. The overall trade volume of these sectors fell by 31% and 53% compared to February and January respectively. One of the only sectors which remained attractive in March was the auto and parts manufacturing sector. Stocks of this sector usually see growth in spring when Annual General Meetings are approaching and their significantly high dividends are distributed.

Another development in March was the approval of the second set of sanctions against Iran by the United Nations Security Council. However, due to the New Year holidays in Iran and limited trade on the market, the impact of the resolution on the TSE was not felt immediately. In fact, many analysts believe that the market has been immunized against news regarding the disputed nuclear issue since the stand-off has continued for such an extended period and concerned investors have already left the market. Overall, the market saw little activity and as a result little change to prices during March.

April 2007

The month of April has historically been a very significant and strategic month for investors on the Tehran Stock Exchange (TSE). In April trade volumes usually increase and fresh money is injected into the market. This is due to the fact that around 80% of the more than 400 listed companies on the TSE have their fiscal year ending on March 20th and their annual performance announced in April. This year however, the market experienced a very slow and declining month in April with daily trade volumes at record lows and most stocks closing in negative territory. Aside from the greater political uncertainly that currently looms over the exchange, there are significant economic reasons behind the current recessionary market climate which are analyzed below:

1. The Iranian Privatization Organization decided to bring to the market another 2% of the shares of the National Iranian Copper Industries Company (NICIC), currently the largest listed company, which amounted to 110 million shares valued at around $59 million. Considering that the total average daily trade on the market stood at around only $7 million at the time, the market was not able to absorb new liquidity of such high magnitude and as a result, the offering of these new stocks exerted enormous pressure on the other sectors and companies. In addition, increasing prices of copper on global markets

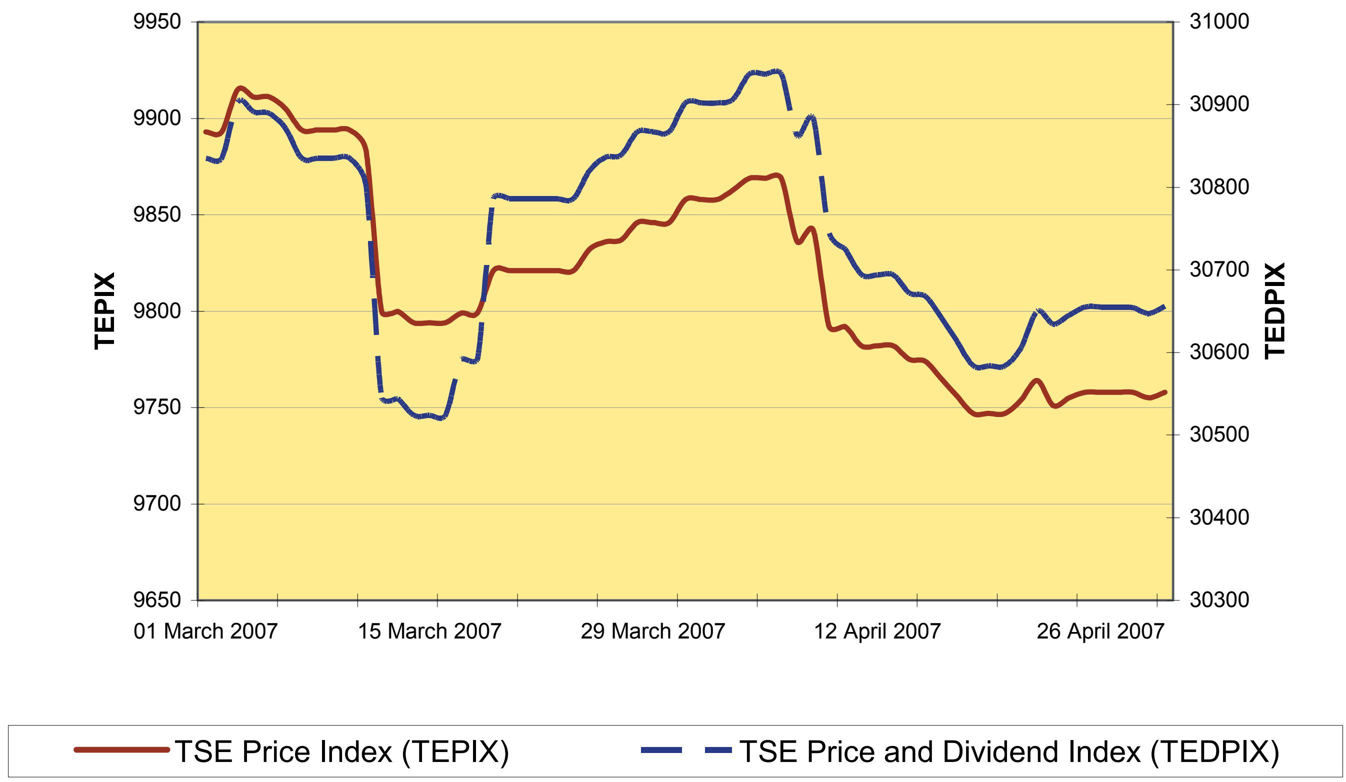
has made shares of the NICIC ever more attractive and placed the market in a unipolar dynamic with investors cashing out other holdings to secure liquidity for the purchase of NICIC shares.

2. The announcement of the government decision to cut interest rates for a second consecutive year had a negative impact on the market and particularly on the financial sector. Given the expansionary and inflationary policies of the government during the past year, many economists and business leaders oppose the compulsory slashing of interest rates imposed by the government.
3. The automotive sector has been hit by the joint decision of the government and parliament to ration gasoline consumption. Enormous government subsidies on gasoline over many years have resulted in gasoline consumption, urban traffic and air pollution reaching critical levels. This decision in addition to the fact that the Iranian auto market is nearing saturation has resulted in a slow month for this sector at a time of year when historically this sector outperformed others due to its high dividend yield.
4. There are rumours in the market that the government is planning to impose a 30% tariff on the export of metal bullion. These rumours have had a negative impact on the attractiveness of commodities stocks which are usually highly dependent on earnings from exports.

Overall TSE investors experienced a bitter month in April with the TSE Price Index sliding by 1.13% to stand at 9753 and monthly trade volume declining by 20% compared to the March figure to rest at the $280 million level.

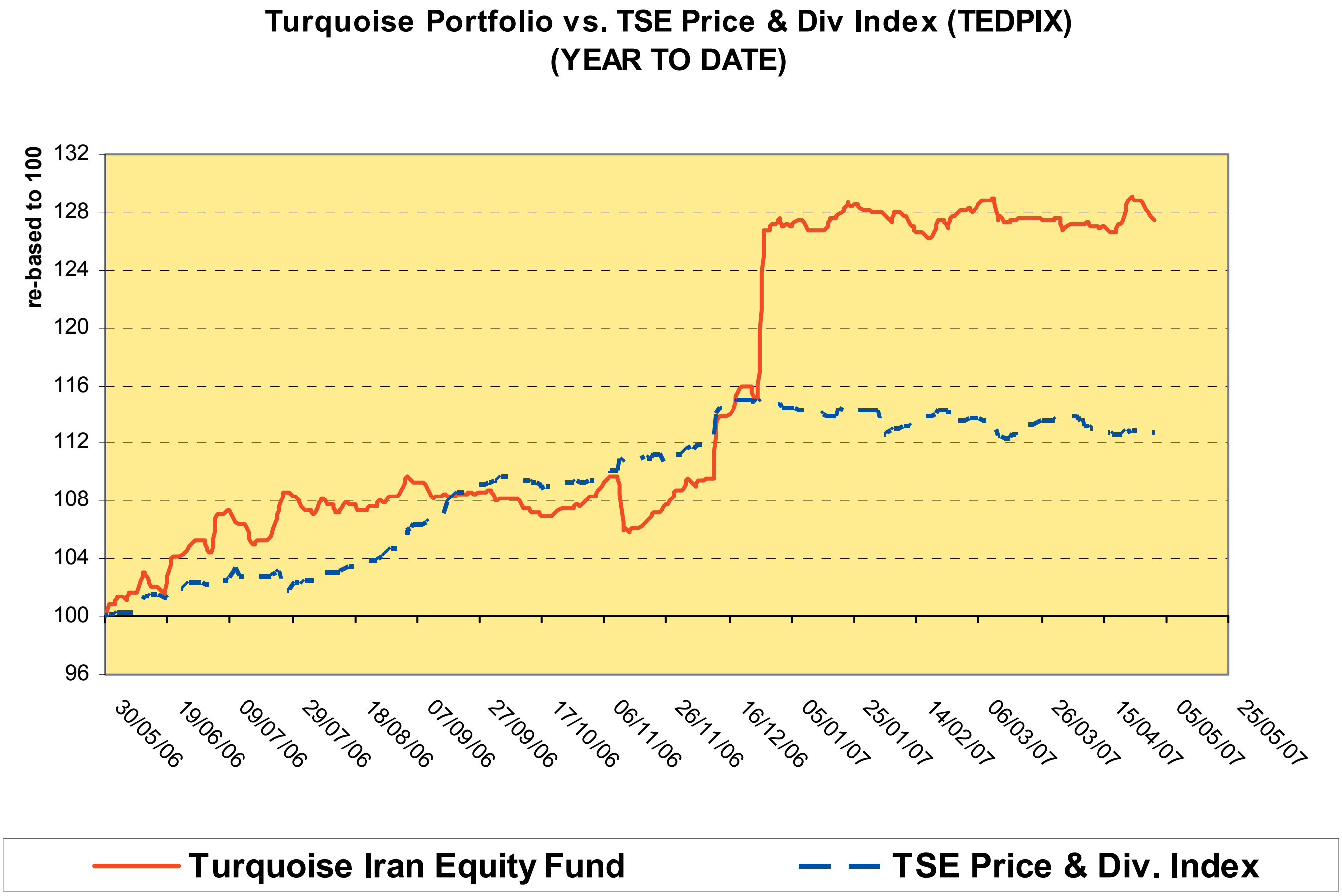
The performance of the TSE indices in the months of March and April 2007 are demonstrated below.

Performance of TSE Indices (March & April 2007)



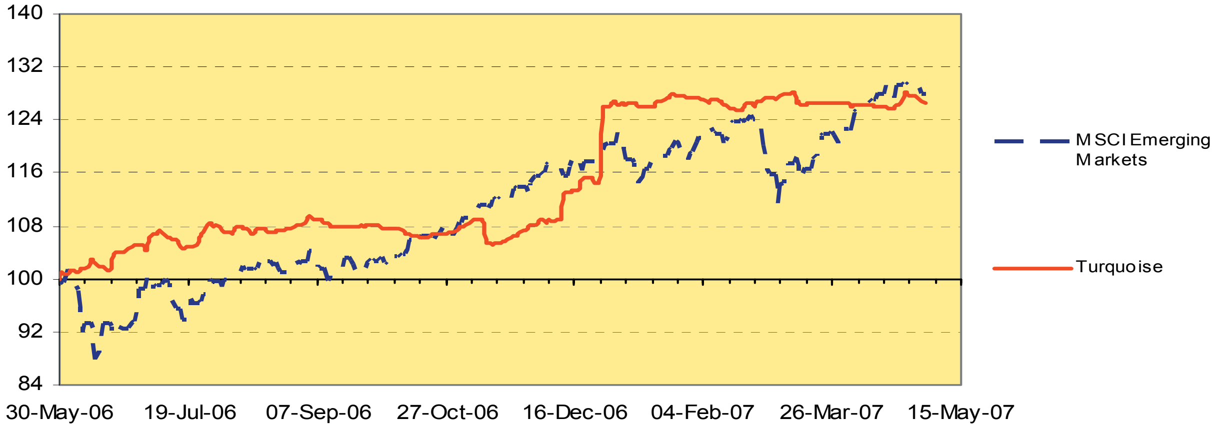
Investment Objective - Turquoise Equity Fund seeks superior long-term capital growth by investing in the consumer and commodity potential of Iran, one of the most under-valued emerging markets in the world. Combining international experience with local expertise allows Turquoise to provide superior returns, with greater diversification and lower volatility 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 slow and declining market in the months of March and April also had an impact on the Fund's performance resulting in little change to its Net Asset Value (NAV) in the past two months. Turquoise's NAV dropped from 128.18 at the beginning of March to 127.41 at the beginning of May while the TSE's Price and Dividend Index (TEDPIX) fell by 0.6% in the same period to stand at 30,640. In March, a European group entered the Turquoise Iran Equity Fund. New capital has now been fully invested into the Fund's portfolio. The Fund's investment committee met several times during this period and formulated the Fund's strategy for the start of the new Iranian year. The following chart shows the performance of the Fund against TEDPIX since the Fund's inception. In addition, the performances of the Fund against the MSCI Emerging Market and also in different currencies are displayed on the following page.

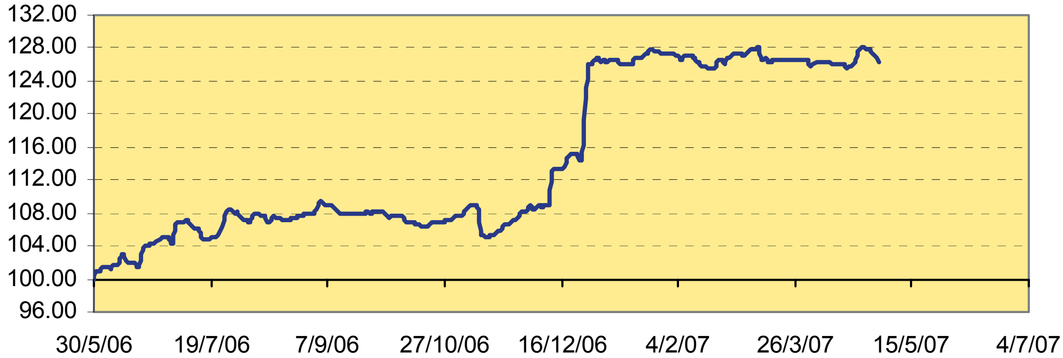


	1 Mar 07	1 Apr 07	1 May 07
Turquoise Fund	28.18 %	27.57 %	27.41%
TEDPIX	13.53 %	13.77 %	12.81 %

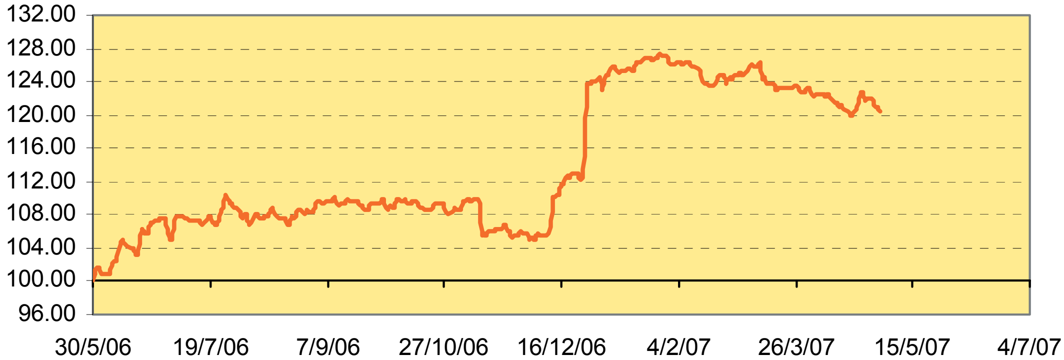
Turquoise Performance vs. MSCI Emerging Markets



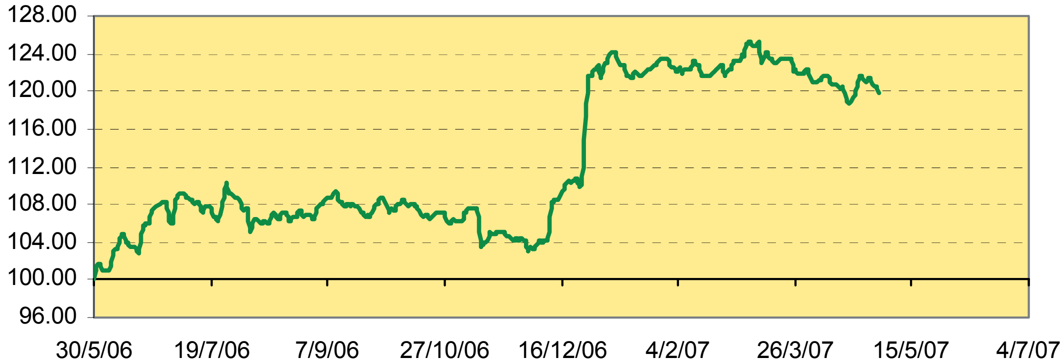
Turquoise Performance in US Dollar (US$)



Turquoise Performance in Euro (€)



Turquoise Performance in British Pound Sterling (£)



March 2007

According to the latest report on Iran published by the International Monetary Fund (IMF) in March 2007, Iran's economy is continuing its robust growth and improved external current accounts position amid high oil prices and the strong performance of the non-oil sector. The economy's future growth outlook, according to the report, could be jeopardized in the event of a drop in international oil prices and the continued expansionary and inflationary policies of the Iranian government which has been a source of worry for many economists. The IMF indicated that Iran's transition towards a viable and efficient market economy, and the sustainable growth required to provide employment for the country's fast-growing labor force, represent the main challenges faced by the Iranian economy. The report also included suggestions to help overcome these challenges. These suggestions include but are not limited to phasing out energy subsidies gradually while protecting the poor, strengthening the role of the annual budget as the main instrument of fiscal policies, avoiding frequent withdrawals from the country's Oil Stabilization Fund (OSF), tightening monetary policies, greater independence of the Central Bank, and providing greater exchange rate flexibility.

Another development in March was the approval of resolution 1747 by the UN Security Council to expand the sanctions regime imposed on Iran for its defiance of previous UN resolutions requiring a halt of its uranium enrichment activities. Iran responded by reiterating its right under the Non-Proliferation Treaty (NPT) to enrich uranium for peaceful purposes and asked the UN Security Country to avoid politicizing the issue while describing the recent resolutions as "illegal". The new resolution expands the list of companies and individuals that were sanctioned by the previous resolution while calling on international institutions to observe restraint in providing financial credits to Iran. This resolution also gives the Iranian government another 60 days to comply with UN demands or face further sanctions. According to a number of analysts, the magnitude of these sanctions is still too small to have a significant impact on the Iranian economy. However the prospect of being faced with tougher sanctions has made many in the country concerned about the future outlook for the market and the overall economy.

April 2007

The month of April witnessed new developments in macroeconomic decision-making as well as the Iranian nuclear program. On the nuclear issue, the Iranian president made an official announcement during a nationally televised celebration that the country has reached industrial scale uranium enrichment. Following this announcement, Iranian officials stressed their willingness to negotiate with the West over the giving of assurances that Iran's nuclear program is aimed at peaceful energy production. Later in the month Iranian nuclear negotiator Ali Larijani met with the European Union's lead negotiator Javier Solana to discuss a common basis upon which full-scale negotiations between the Western nations and Iran could resume. Both diplomats called the preliminary negotiations positive and constructive and indicated that they will continue with their negotiations when they meet again in a few weeks' time.

On the macroeconomic front, there was some significant news in April. First and foremost, the country's Supreme Credit and Monetary Council (SCMC) decided that interest rates during the current Iranian year will stay untouched and would not be cut as previously planned. This decision was later overruled by President Ahmadinejad who insists on decreasing interest rates on an annual basis claiming that high interest rates are responsible for slowing growth and inflation. The final decision on this matter is yet to be made. However, the country's private sector representatives, the Central Bank and the state and private commercial banks who all have representatives on the SCMC oppose the decision to cut interest rates calling it disastrous since it poses a threat to the survival of the country's banking sector by shifting investments from banks to other sectors while increasing liquidity growth and as a result the inflation rate.

The other significant decision by the parliament which was approved and handed over to the government for execution was the plan to ration gasoline consumption from 21 May 2007. According to this plan, domestically produced gasoline will be distributed equally amongst all vehicles giving them a share of 100 litres per month at the heavily subsidised price of 1,000 Rials (10 US cents) per litre while any consumption above this level requires consumers to pay a price of 3,000 Rials (30 US cents) per litre. This is still significantly lower than global prices but considered high for Iranian consumers. In order to ensure the smooth execution of this plan, smart cards have been issued for each vehicle which keep track of gasoline consumption. It is worth noting that the difficult task of distributing 7 million smart cards for existing vehicles could mean that the plan will take much longer than previous forecasts to be fully implemented. Production of inefficient vehicles domestically as well as heavy subsidies on the price of gasoline in recent years has significantly increased the country's per capita consumption levels putting it amongst the highest in the world. This is while cheap gasoline has caused traffic, air pollution, and gasoline smuggling to reach critical levels. Iran currently consumes 70 million litres of gasoline per day while only producing 40 million litres per day domestically.

In this edition of the Economy section, the Iranian economy during the recently ended Iranian year of 1385 is analysed with emphasis on some particular challenges and problems.

• **Liquidity Growth:** One of the main characteristics of the Iranian economy in 1385 has been the surge in liquidity levels which have seen a 42% rise during the past year to reach 1,200 trillion Rials ($130 billion). The main engine behind the rise in liquidity is the significant rise in Iran's oil income which reached historic levels of over $50 billion. All the oil income, in addition to several billions of dollars of the previous years' savings, was spent in 1385 following the execution of expansionary policies by the President Ahmadinejad's government. According to official statistics, liquidity growth has forced the inflation rate upwards to 14% from the previous 11% level.

• **Imposing Interest Rate Cut:** During the first few weeks of 1385, the government announced a mandatory interest rate cut which forced the state-owned banks to drop their interest rates from 16% to 14% and the private banks from 22% to 17%. This decision was opposed by many experts who believed any government involvement in imposing interest rates would disrupt the balance of the money market and argued that a cut in interest rates would result in a surge in loan applications and a corresponding drop in bank deposit levels. These predictions largely came true as most state-owned banks faced liquidity shortages while a significant amount of money was shifted from bank deposits to other sectors such as the property sector in particular which saw a 20% overall price rise in the second half of the year.

• **Employment and Wage Policies:** Another policy adopted by the government in 1385 was to force employers to raise the minimum wage level of permanent and contract-based employees by different rates giving contract-based employees high enough salaries to encourage companies to switch them to permanent employment. This decision proved disastrous as most employers and entrepreneurs threatened to lay-off large numbers of contract-based employees to curb rising costs. This situation finally forced the government to reverse its decision and adopt similar rates of increase for salaries of both permanent and contract-based employees.

Later in the year, the government focused on financing Small and Medium-size Enterprises (SME) with a plan for the short term return of capital as well as adopting microfinance models to promote employment opportunities for the country's over 4 million unemployed. It is estimated that a total of 500,000 projects were approved by banks for these loans which totalled around 100 trillion Rials ($10.8 billion).

• **Real Estate and Construction:** The prices of cement and steel witnessed a swift rise in the first few months of the year forcing the government to impose a ban on exports while eliminating all import tariffs of these products. It is estimated that a total of $3 billion worth of steel products were imported during the past year.
The rise in the prices of raw materials as well as increased liquidity in the market helped boost housing and property prices in the second half of the year. While in some areas of the country, the prices rose by over 50%, in Tehran the Housing Unit Price Index grew by over 21% in the second half of the year.

• **Auto Production and Gasoline Consumption:** Iran's production of different types of vehicles passed the one million unit mark in 1385. In addition, 30,000 foreign-made cars were imported into the country which mostly consisted of luxury passenger cars. In order to modernise the country's aging fleet of cars, the government introduced a substitution plan based on which loans would be provided to those owning aging cars to exchange their vehicles with a newly produced replacements. This is intended to increase efficiency and reduce gasoline consumption and so far 250,000 people have registered for this program which appears to be behind schedule.

Iran's gasoline consumption is reaching alarming levels of around 72 million litres per day of which only around 40 million is produced domestically. In 1385, Iran imported over $5 billion worth of gasoline which was distributed amongst consumers at heavily subsidised prices. For the current year however, the parliament has directed the government to ration gasoline consumption to curb consumption as well as imports, pollution and the smuggling of gasoline. The plan is expected to be implemented in June 2007.

- **Privatization:** Although the government initially opposed the idea of privatisation , the push by the country's Supreme Leader and other decision-making institutions forced the government to implement privatisation plans according to the decree presenting the new interpretation of the Iranian Constitution. According to this plan, the government's share in the economy should drop to 20% from the current 70-80% within the next 8 to 10 years. By the end of 1385, shares of two of the largest Iranian companies, National Iranian Copper Industries Company (NICIC) and Mobarakeh Steel Complex (MSC), were offered for the first time on the Tehran Stock Exchange.

Another plan of the Ahmadinejad government which was implemented to some extent in 1385 was the introduction of a share distribution model dubbed Justice Shares, based on which the government will offer its shares in state-owned companies to all Iranian families with priority given to poor and underprivileged families. Families then pay back the government from the dividends generated by those shares over a period of 20 years. As a result, in the second half of the year, around $2.5 billion worth of state shares were transferred to underprivileged families totalling 4.6 million people. Each person received around $550 in shares with a maximum of 5 payments for each family.

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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