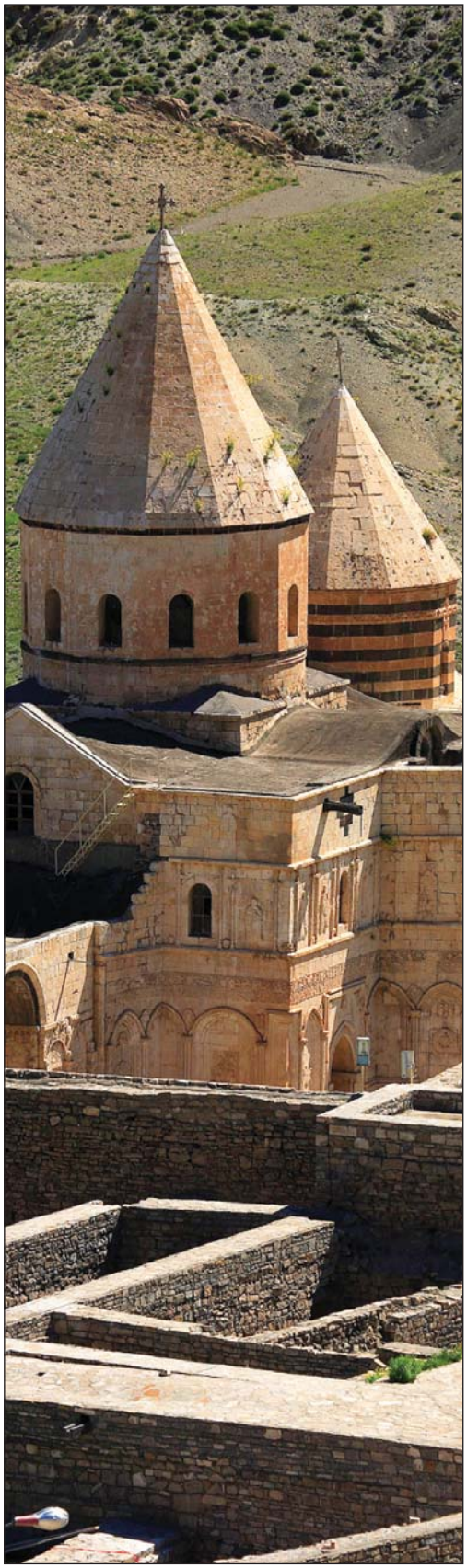
Iran Investment Monthly

December 2010
Volume 5, No 51

TURQUOISE PARTNERS



St. Thaddeus Monastery, Western Azerbaijan Province , North Western Iran

THIS MONTH

Market Overview 2

Following a month of price declines, the Tehran Stock Exchange (TSE) stabilised in November. Investor sentiment remained cautious due to the approaching implementation of the plan for the removal of subsidies. The fixed income market had an exceptionally active month.

Privatisation & IPO's 4

In November, shares of Post Bank of Iran, Tabriz Refinery and Parsian Insurance were listed on the TSE.

Turquoise Iran Equity Investments 5

This section provides data and charts on the performance of Turquoise Iran Equity Investments Class A for the month of November.

Country Overview 6

The fifth socio-economic development plan and the latest developments in Iran's nuclear programme will be discussed in this section.

Economy 8

Iran's pharmaceutical industry, a new galvanised sheet plant, the Iran – Turkmenistan gas pipeline, and the inflation and unemployment rates will be covered in this section.

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, Sanam Mahoozi, Emilia Tebyanian

Turquoise Partners, No. 17 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.

Following a month of steep price declines, the Tehran Stock Exchange (TSE) stabilised somewhat in November. Market traders continued to be cautious due to the uncertainties surrounding the governmental plan for the removal of subsidies. This plan is expected to commence towards the end of December. Investors in general have taken a defensive stance and are waiting for further clarification on the subsidies plan. Under the law approved by the parliament, the government is expected to provide compensation and assistance to industrial companies due to the increased production costs resulting from the partial removal of subsidies on energy. However, it is still unclear how much prices will increase, as well as to what extent and in what form the government is planning to compensate for the increased costs.

Analysts expect the market to remain flat and investors to remain cautious until the subsidies plan has commenced.

In November, shares of Post Bank of Iran, Tabriz Refinery and Parsian Insurance were listed on the TSE. Please see the Privatisation & IPO's section for the details.

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

Telecommunications

In November, the Telecommunications Company of Iran (TCI), which is the largest listed company on the TSE and accounts for 13% of the market main index, single-handedly turned the market index positive. In the final week of November, the Mobile Communications of Iran Co. (MCI), which is the mobile phone operating arm of TCI, was accepted by the exchange regulator to be listed on the Iranian over-the-counter (OTC) market. This led to significant buying demand for TCI. Shares of TCI ended the month 15% higher.

MCI accounts for more than 70% of TCI's profits. Analysts expect the IPO to take place at a market capitalisation in the region of $7 - 8 billion. This could potentially lead to a 30% increase in TCI's net earnings for the year. The IPO of MCI is expected to take place in late December.

Oil and Gas Extraction

In November, the government offered a 50% plus one share block of Haffari Shomal (North Drilling Co.) on the TSE at a base price of $450 million. Despite the attractive payment terms of 20% cash upfront and the remainder in instalments, the offering failed to attract any buyers. This disappointed some investors and the shares lost 5% of their value.

Haffari Shomal's key business is the management and leasing of oil and gas extraction platforms in the Caspian Sea, to both Iranian and also to foreign customers. It was listed on the TSE in July 2009, as part of the ongoing privatisation programme. Analysts predict that Haffari Shomal's net profit will reach $100 million this year, 25% above its initial budget and 37% higher than the previous year.

Iron Ore

On 15th November, the government unexpectedly introduced a massive export tariff for iron ore. Tariffs for the export of iron ore concentrate and pellet have been set at 50% and 35% respectively. The government plans to increase Iran's steel production capacity from the existing 12 million tonnes per annum to 20 million tonnes by the end of next year. Accordingly, the new tariffs have been introduced in order to support the domestic demand for iron ore. However, analysts argue that if the steel production capacity target is not met, iron ore producers could potentially face excess production capacity of up to 10 million tonnes next year. Among the producers, Gol Gohar, the second largest listed iron ore producer, will suffer the most. This

is because it has budgeted for 50% of its existing year's revenues to come from exports.

Stocks of iron ore producers and related companies experienced significant selling pressure after this announcement. The mining sector index lost 6.5% of its value in November.

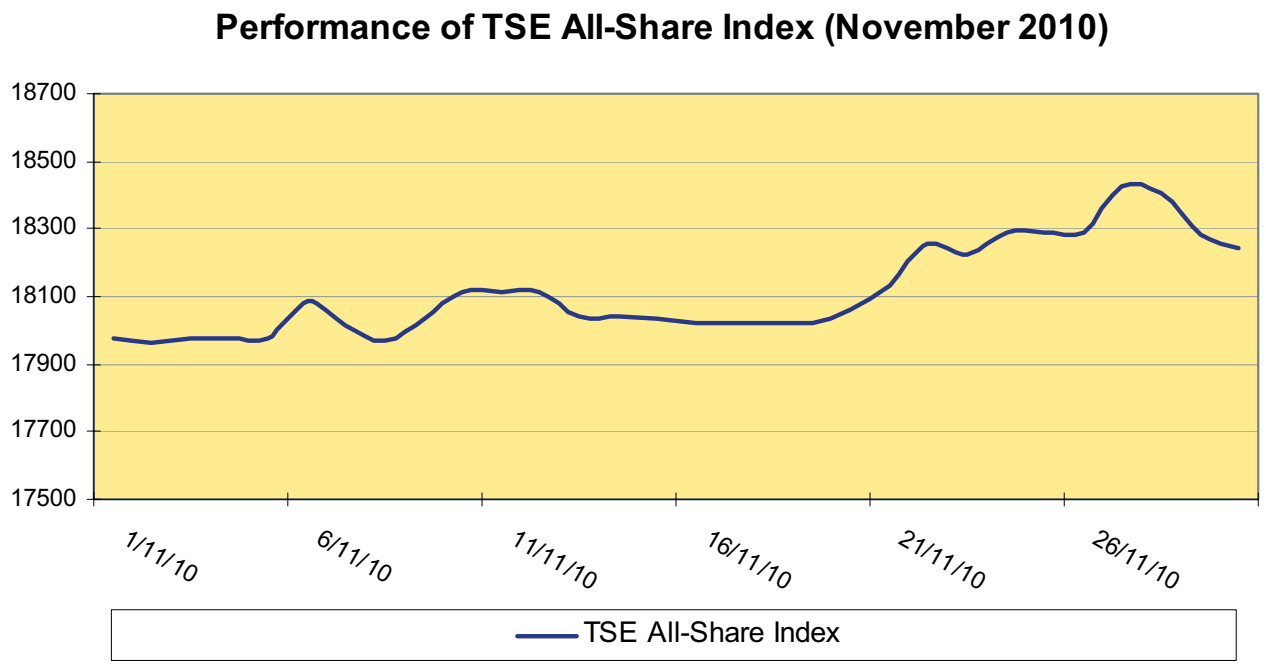
Fixed Income Market

This year, participants in the Iranian capital market have witnessed exceptional growth in the fixed income market. Since the beginning of the Iranian calendar year (which began on 21st March), over $5 billion of fixed income instruments have been issued.

In November, the largest ever single issuance of Participation Papers (an Islamic form of a bond) took place. Pars Oil & Gas Co (POGC) successfully sold $2.3 billion of papers to fund the development of the South Pars gas field. Previously, POGC had sold $1.5 billion worth of papers for the same purpose. These papers pay a coupon of 16% per annum and have a tenure of 4 years.

On 9th November, Keshavarzi Bank listed $100 million of one-year tradable Certificates of Deposit (CD's) with an annual interest rate of 15%, on the Iranian OTC market. However, this issuance did not enjoy the success of POGC's papers, due to its lower coupon rate. Only 20% of the CD's were sold on the first day and the remaining 80% was taken up by the underwriter.

Overall, the TSE had a stable month, with the All-Share Index gaining 1.3% in Rial terms. Trade volumes stood at $1.53 billion, a slight decline of 7% from the previous month.



Post Bank of Iran

On 1st of November, a 5% stake in Post Bank of Iran was offered on the TSE, as part of the ongoing privatisation programme. Post Bank was listed at a market capitalisation of $129 million and a price to earnings ratio of 7. Given the small size of the stake offered on the market ($6.5 million), the entire offering was bought within seconds. The stock experienced significant buying pressure for the remainder of the month and gained 35% in value by the end of November.

Post Bank of Iran was founded in 1997 and currently has 400 branches across the country. With a deposit base of $1.3 billion, Post Bank is Iran's smallest state-owned bank. Its net profit for the current Iranian calendar year (which ends on 20th March) is forecasted at $18.5 million. Initially, the government was planning to sell 50% plus one share of the bank by the end of the year. However, this has been met with strong resistance by the management of the bank and the sale is unlikely to take place this year.

Tabriz Refinery

Tabriz Refinery was the second privatisation in November. On 22nd November, a 5% stake in Tabriz refinery was successfully sold on the TSE. This was the second refinery to be listed on the TSE. Tabriz Refinery was floated at a market capitalisation of $272 million and a price to earnings ratio of 9.3. Shares of Tabriz Refinery were in demand for the rest of the month and gained 6% in value between the IPO date and the end of the month.

Tabriz Refinery became operational in 1998 and is regarded as one of the more efficient refineries in Iran. Its key products include gasoil, petrol and furnace oil. In the latest forecast, net profit for the existing year is expected to reach $29.3 million.

Parsian Insurance

Parsian Insurance was the second privately owned insurance company to undergo flotation. Last year, Day Insurance was listed on the Iranian OTC. On 14th November, a 5% stake in Parsian Insurance was offered on the TSE. The IPO took place at a market capitalisation of $335 million and a price to earnings ratio of 8.3. As a result, Parsian became the largest listed insurance company. The offering attracted considerable investor interest, and the stock ended the month 14% higher than its IPO price.

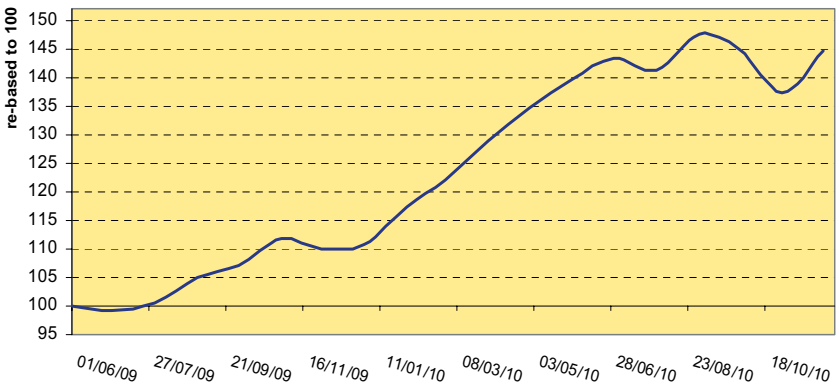
With a 7% market share, Parsian is the third largest insurance provider in Iran. Parsian is jointly owned and controlled by Iran Khodro and Parsian Bank. Its net profit for the existing year is estimated to reach $44 million. Its key business line is car insurance.

Investment Objective – The Turquoise Equity Investments 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.

Class A — *NAV = 144.6*

Vehicle Domicile	Management Fee	Currency
British Virgin Islands	2.0% p.a	Euro (€)
Launch Date	**Carried Interest**	**Minimum Investment**
01 June 2009	20% (High Water Mark Applies)	€100,000

Class A Performance (Euro) - As at 30th November 2010



Period	Portfolio Return
Last Month	**5.4 %**
Last 3 Months	**- 2.0 %**
Last 6 Months	**3.6 %**
Last 12 Months	**31.3 %**
Since Inception (01 June 09)	**44.6 %**

For subscription and further information on our investment products please contact Eddie Kerman on (+44) 20 74 93 04 12 or email eddie.kerman@turquoisepartners.com. For more information about Turquoise Partners please visit our website at: www.turquoisepartners.com

The fifth socio-economic development plan and the latest developments on Iran's nuclear programme will be discussed in this edition of Country Overview.

In November, the parliament approved the fifth 5 year socio-economic development plan. This plan represents the strategic guidelines for Iran's economic expansion and growth for the next five years. Iran's first 5 year development plan began in 1990, after the Iran-Iraq war. Its key aim was the reconstruction and development of Iran's economy and industrial base, with an emphasis on becoming self-sufficient in producing strategic industrial and agricultural goods. Subsequent plans also focused upon further economic growth, the improvement of living conditions and social development.

The fifth development plan is based on a major governmental scheme known as the economic reform plan. It takes into consideration several aspects of the economy such as the banking system, taxation, currency, customs and subsidies reform. It also aims to improve productivity and social justice. It has a number of quantitative and qualitative targets, which are to be met by the end of the plan.

The plan sets the target for economic growth at an average of 8% per annum and the average inflation target at 12% per annum. The same economic growth target was set for the fourth development plan, but it was not achieved. Given the slowdown in economic growth over the past 2 years, experts are sceptical of the government's ability to meet this target. Last year, the government introduced a Value Added Tax (VAT) of 3% for the first time, as part of the taxation reforms. The fifth development plan stipulates that VAT is to be increased by 1% each year, in order that it reaches 8% by the end of the plan. Several segments of the economy responded to the introduction of VAT with significant resistance and discontent. The Bazaar, which is viewed as the key hub for the distribution of most consumer goods, was particularly unhappy.

There is particular emphasis in the plan on the expansion of the role of the private sector within the economy, through further privatisation and liberalisation. Diversification of exports is another key element of the plan. Non-oil exports are to reach $110 billion by the end of the plan. The plan also intends for an average of 1 million jobs to be created each year. This would reduce the unemployment rate down to 7% by the end of the fifth year. The plan also stresses on reducing the dependency of the state budget on oil revenues and expanding international trade. The programme for the removal of subsidies is undoubtedly the most important and most challenging aspect of the plan. The first phase of the so-called targeted subsidies plan is expected to start shortly.

The fifth development plan will commence from the beginning of next Iranian calendar year (which begins on 21st March). It was initially supposed to start in the current year. However, due to the government's delay in submitting the plan's draft to the parliament, the fourth plan was extended for another year.

On 7th December, Iran and the so-called 5+1 Group held a two-day meeting in Geneva to discuss Iran's nuclear programme. The meetings took place behind closed doors. The last round of talks between the parties, which happened in October 2009, failed to resolve the tensions. Following the previous talks, the UN Security Council and several Western states imposed further sanctions on Iran.

A week before the meeting, two bomb blasts in Tehran killed a senior Iranian nuclear scientist and injured another. At the beginning of the meeting, Saeed Jalili, Iran's Chief nuclear negotiator, strongly criticised the West for not condemning the attacks on its nuclear scientists. The Iranian government has accused the US and Israel of responsibility for both the recent attacks and also a similar attack on a nuclear scientist in January 2010.

Despite this confrontational start to the talks, both sides deemed them to be constructive. The two sides agreed to meet again in January 2011 in Istanbul in order to continue the negotiations. Experts are unsure

as to whether the next round of talks will yield the desired results. The two sides appear to be following substantially different agendas for the talks. The West seems to be aiming for a suspension of uranium enrichment by Iran, through offering various incentives such as ending the sanctions against Iran and providing various economic and trade incentives. However, Iran has stressed that its nuclear programme is not open for negotiation and that its focus is on discussing cooperation on various international issues. It seems obvious that a change of stance from both sides is necessary if the Istanbul talks are to have a positive outcome.

Iran's Pharmaceutical Industry

The practice of medical sciences in Iran dates back to over 2,600 years ago. Throughout the centuries, Iranian scientists such as Avicenna and institutions such as Jondi Shapour University & Hospital have made significant contributions to the development of medical science. The pharmaceutical industry in Iran began in its modern form in 1920 when the Pastor Institute was founded. There are currently 92 companies in Iran that are active in the pharmaceutical industry.

In 2009, approximately $3.1 billion worth of drugs and medical products were consumed in Iran. This shows an 80% increase from 3 years ago. Total consumption is estimated to reach $3.5 billion in 2010. Iran has one of the world's highest per capita consumption of medicines in terms of quantity. However, in monetary terms, Iran's per capita consumption is $21, as opposed to the global average of $94. This is due to the fact that the vast majority of generic drugs and also a number of specialist drugs are heavily subsidised by the government. In exchange for generous subsidies on raw materials that are paid by the government to the manufacturers, the government has implemented a very strict pricing policy for products. This means that Iranian-made generic drugs such as antibiotics and vitamins are substantially cheaper than imported drugs. The price differential has widened even further due to a 90% tariff imposed by the government on the import of drugs. In 2009, 1.8 million units of pharmaceutical products worth $1.2 billion were imported into Iran. Imported drugs comprise only 5% of total consumption in quantity terms, but make up 38% of the total in monetary terms.

Over the years and in line with the consumption boom, there has also been tremendous growth in production. In 2009, 29.5 million units of pharmaceutical products worth $1.9 billion were produced in Iran. Exports have also grown by an average of 15% per annum over the past decade. In 2009, Iran exported $74 million worth of medical products to countries such as Iraq, Afghanistan and Russia. With a 33% average gross margin, Iran has one of the most profitable pharmaceutical sectors in the world. The global average gross margin for the pharmaceutical industry is estimated to be 20%.

Iran's pharmaceutical industry is facing a number of challenges. Within the generic drugs sector, the government's strict pricing policies means that companies cannot compete effectively in order to gain market share. The market for a number of drugs, such as antibiotics and generic pain killers, is very saturated and there is little room for growth. The specialist drugs sector, where there is no governmental pricing mechanism and margins are higher, is very much dominated by state-owned companies. Only a handful of private companies have been able to gain access to the new technology and the raw materials required. Experts believe that Iran's pharmaceutical industry is very much in need of liberalisation and also consolidation within the industry.

New Galvanised Sheet Plant in Iran

In a ceremony attended by President Ahmadinejad in November, Iran's first plant for the production of galvanised sheets for the automotive industry was inaugurated. The plant is located in the city of Shahre Kord, in the Charmahal & Bakhtiari Province in western Iran. It has an annual production capacity of 400,000 tonnes of high resistance galvanised sheets, specifically used in the production of cars. According to official sources, this plant is the largest of its kind in the Middle East.

Construction costs of this plant are estimated to be $210 million and the vast majority of the investment has come from Iran Khodro and Saipa, Iran's two largest car manufacturers. Previously, Iran imported these sheets from Europe and South Korea. It is expected that Iran will become self sufficient once the production plant reaches its capacity. The new plant is estimated to have created 200 new jobs in one of the most deprived regions of the country.

Iran – Turkmenistan Gas Pipeline

In a ceremony in November attended by the presidents of Iran and Turkmenistan, the second phase of a gas pipeline between the two countries was started. The first phase had been completed in January 2010. The second phase of the pipeline is 500 kilometres long and has the capacity to transfer 58 million cubic meters of gas per day. The pipeline is expected to become fully operational in January 2011. Following the completion of this project, Turkmenistan's gas exports to Iran will amount to 20 billion cubic metres per annum. The estimated cost for the completion of this second phase is $550 million and the overall cost of the project is said to have been $1.2 billion.

Despite its vast natural gas reserves, Iran has faced shortages during the winter over the past few years. To overcome this, Iran has entered a number of energy swap agreements with neighbouring countries including Turkmenistan, Armenia and Turkey. This will also allow Iran to become a regional gas hub and increase the exports of its own gas.

Inflation and Unemployment

According to the latest statistics published by the Central Bank of Iran, the year-on-year inflation rate in November stood at 12.5%. Also, the Consumer Price Index (CPI) increased by 1.1% in November, in comparison to the previous month. The annual inflation rate bottomed out at 8.3% in June. Experts predict that the inflation rate will reach 15% by the end of the existing Iranian calendar year (excluding the impact of the removal of subsidies).

The latest data from the Statistical Centre of Iran puts the unemployment rate at 14.6%.

About Turquoise

Turquoise is a boutique investment firm 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.