

THE 2ND ISLAMIC VENTURE CAPITAL & PRIVATE EQUITY CONFERENCE 2009

KUALA LUMPUR CONVENTION CENTRE
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WHY ISLAMIC VC/PE IS NEEDED AND ITS IMPORTANCE



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**Promoting New Asset Class For Institutional Clients As Well As
High Net Worth Individuals For Both Muslim & Non-Muslim
Investors;**

**Issues And Challenges -
Turning Conventional Practices Into Shariah Compliance
Mechanism.**

The roots of Islamic Finance & Investment

Islam

“This day I have completed your religion for you, completed My Favor upon you and have selected for your Way of Life, Al-Islam.” [Holy Quran, Chapter Al-Maidah: Verse 3]

A Jewish man, once, said to Umar ibn Al-Khattab, *radiallahuanhu*, regarding the above Quranic verse. “If this verse [above] had been revealed to us, we would have taken the day it was revealed as an Eid (a day of celebration).”

Umar ibn Al-Khattab, *radialluhanhu* said,

“I know the day when this verse was revealed; it was revealed on the day of Arafah [standing on Mount Arafah on the Day of Hajj [pilgrimage] on a Friday.” (Sahih Al-Bukhari)

A known scholar, Imam Ibn Hajar said,

“We would have taken the day it was revealed as an Eid” means that we would have honored this day and celebrated it every year, because the occurrence of the completion of the religion is tremendously great.

As a complete religion & way of life, Islam teaches mankind how to attain success in the most perfect way.

The roots of Islamic Finance & Investment

Derivation of Islamic Rulings

The first thing which distinguishes the Ahl us-Sunnah wal- Jamaa'ah (the Sunni) is the methodology with which they acquire their sciences of the Religion and the source of the Truth from which they derive their beliefs, concepts, actions of worship, dealings (with the people), their mode of conduct and their manners.

For the Ahl us-Sunnah, the source of Islamic Knowledge in all its various branches is from:

i) Quran (the Book of Allaah)

ii) The Sunnah (the Practice, Actions & Approvals) of His Messenger Muhammad (Sallallaahu 'alayhi Wasallam); then

iii) The Ijmaa' (Understanding & Consensus) of the Companions of the Messenger, the Salaf us-Saalih (the Pious Predecessors), and then

iv) Ijtihad after having referred it to the Quran, the Authentic Sunnah and the Ijmaa' of the Salaf us-Saalih.

Foundation of an Action

(Sincere) Intention

عَنْ أَمِيرِ الْمُؤْمِنِينَ أَبِي حَفْصِ عُمَرَ ابْنِ الْخَطَّابِ
رَضِيَ اللَّهُ عَنْهُ قَالَ، سَمِعْتُ رَسُولَ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ
وَسَلَّمَ يَقُولُ: إِنَّمَا الْأَعْمَالُ بِالنِّيَّاتِ وَإِنَّمَا لِكُلِّ امْرِئٍ
مَا نَوَى فَمَنْ كَانَتْ هِجْرَتُهُ إِلَى اللَّهِ وَرَسُولِهِ فَهَجْرَتُهُ إِلَى
اللَّهِ وَرَسُولِهِ وَمَنْ كَانَتْ هِجْرَتُهُ لِدُنْيَا يُصِيبُهَا أَوْ امْرَأَةٍ
يَنْكِحُهَا فَهَجْرَتُهُ إِلَى مَا هَاجَرَ إِلَيْهِ. رَوَاهُ إِمَامَا الْمُحَدِّثِينَ
أَبُو عَبْدِ اللَّهِ مُحَمَّدُ بْنُ إِسْمَاعِيلَ بْنِ إِبْرَاهِيمَ بْنِ الْمُغِيرَةَ ابْنِ
بَرْدِزْبَةَ الْبُخَارِيُّ وَأَبُو الْحُسَيْنِ مُسْلِمُ بْنُ الْحَجَّاجِ بْنِ
مُسْلِمِ الْقَشِيرِيُّ النَّسَائُبُورِيُّ فِي صَحِيحَيْهِمَا اللَّذَيْنِ هُمَا
أَصْحَحُ الْكُتُبِ الْمُصَنَّفَةِ.

It is narrated on the authority of Umar ibn al-Khattab, *radiyallahuanhu*, who said:

'I heard the Messenger of Allaah, Muhammad (Sallallaahu 'alayhi Wasallam), saying, "Verily actions are by intentions, and for every person is what he intended. So the one whose hijrah (migration) was to Allaah and His Messenger, then his hijrah was to Allaah and His Messenger. And the one whose hijrah was for the world to gain from it, or a woman to marry her, then his hijrah was to what he made hijrah for.'

[Related by Al-Bukhari & Muslim]

Imaam Ahmad said, "the foundations of Islam are upon three ahaadeeth:

1. The hadeeth of Umar, '*verily actions are by intention*'
2. The hadeeth of Aa'ishah, '*whosever introduces into this affair of ours that which is not part it, then it is rejected.*'
3. The hadeeth of Nu`maan bin Bashir, '*the halaal is clear and the haraam is clear.*'"

Guidance on an Action

Avoiding Doubtful Matters

عَنْ أَبِي عَبْدِ اللَّهِ النُّعْمَانِ بْنِ بَشِيرٍ رَضِيَ اللَّهُ عَنْهُمَا
قَالَ: سَمِعْتُ رَسُولَ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ يَقُولُ: إِنَّ
الْحَلَالَ بَيْنَ وَإِنَّ الْحَرَامَ بَيْنَ وَبَيْنَهُمَا أُمُورٌ مُشْتَبِهَاتٌ
لَا يَعْلَمُهُنَّ كَثِيرٌ مِنَ النَّاسِ فَمَنْ اتَّقَى الشُّبُهَاتِ فَقَدْ
اسْتَبْرَأَ لِدِينِهِ وَعِرْضِهِ وَمَنْ وَقَعَ فِي الشُّبُهَاتِ وَقَعَ فِي
الْحَرَامِ كَالرَّاعِي يَرعى حَوْلَ الْحِمَى يُوشِكُ أَنْ يَرْتَعَ فِيهِ
أَلَا وَإِنَّ لِكُلِّ مَلِكٍ حِمَى أَلَا وَإِنَّ حِمَى اللَّهِ مُحَارِمُهُ أَلَا وَإِنَّ
فِي الْجَسَدِ مُضْغَةً إِذَا صَلَحَتْ صَلَحَ الْجَسَدُ كُلُّهُ وَإِذَا
فَسَدَتْ فَسَدَ الْجَسَدُ كُلُّهُ أَلَا وَهِيَ الْقَلْبُ - رَوَاهُ
الْبُخَارِيُّ وَمُسْلِمٌ.

On the authority of Abu 'Abdullah al-Nu'man bin Bashir, *radiyallahuanhu*, who said:

I heard the Messenger of Allah, Muhammad (Sallallaahu 'alayhi Wasallam), saying, "Truly, what is lawful is evident, and what is unlawful is evident, and in between the two are matters which are doubtful which many people do not know. He who guards against doubtful things keeps his religion and honour blameless, and he who indulges in doubtful things indulges in fact in unlawful things, just as a shepherd who pastures his flock round a preserve will soon pasture them in it. Beware, every king has a preserve, and the things Allah has declared unlawful are His preserves. Beware, in the body there is a flesh; if it is sound, the whole body is sound, and if it is corrupt, the whole body is corrupt, and behold, it is the heart."

[Related by Al-Bukhari & Muslim]



Islamic Finance & Investment promotes...

Just, Equitable & Fair Dealing.

Ethical activities. If something is immoral (e.g. alcohol, tobacco), one cannot profit from it.

In sharing reward, one must also share risk.

Clear distinction between Equity and Debt.

Islamic private equity investing actually seeks "Real Economy" impact, rather than merely a "Financial re-Engineering" exercise.



Promoting New Asset Class For Institutional Clients As Well As High Net Worth Individuals For Both Muslim & Non-Muslim Investors

Islamic Private Equity fits for all...

Private equity and Islamic investment share a lot of common principles: both of them are based on investment in the real economy, and on the principle of sharing risks and rewards through partnership. Private equity takes a relatively long-term view on investments and aligns the interests of stakeholders, which are also among the key principles of Islamic investment.

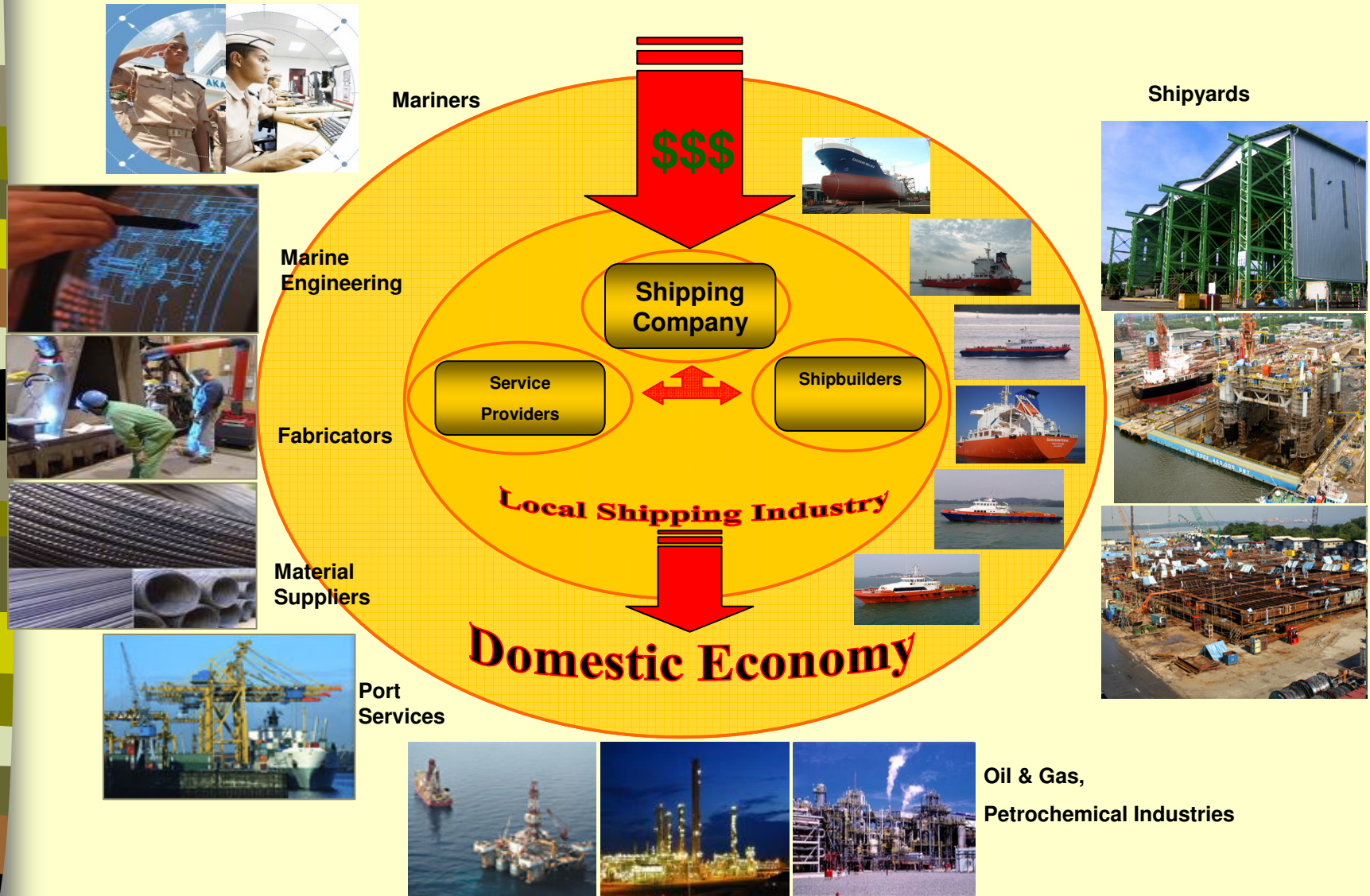
Private Equity is a natural fit for Islamic investors since at the core of Shariah principles money should be directed to the real economy through investing in businesses that offer ethically acceptable products and services. This means that returns should be earned through active involvement and participation in the business risk in Shariah compliant investments.

Private equity model represents classic Mudarabah and/or Musyarakah with the GP / LP structure being a strikingly pure example of what they are envisioned to be.

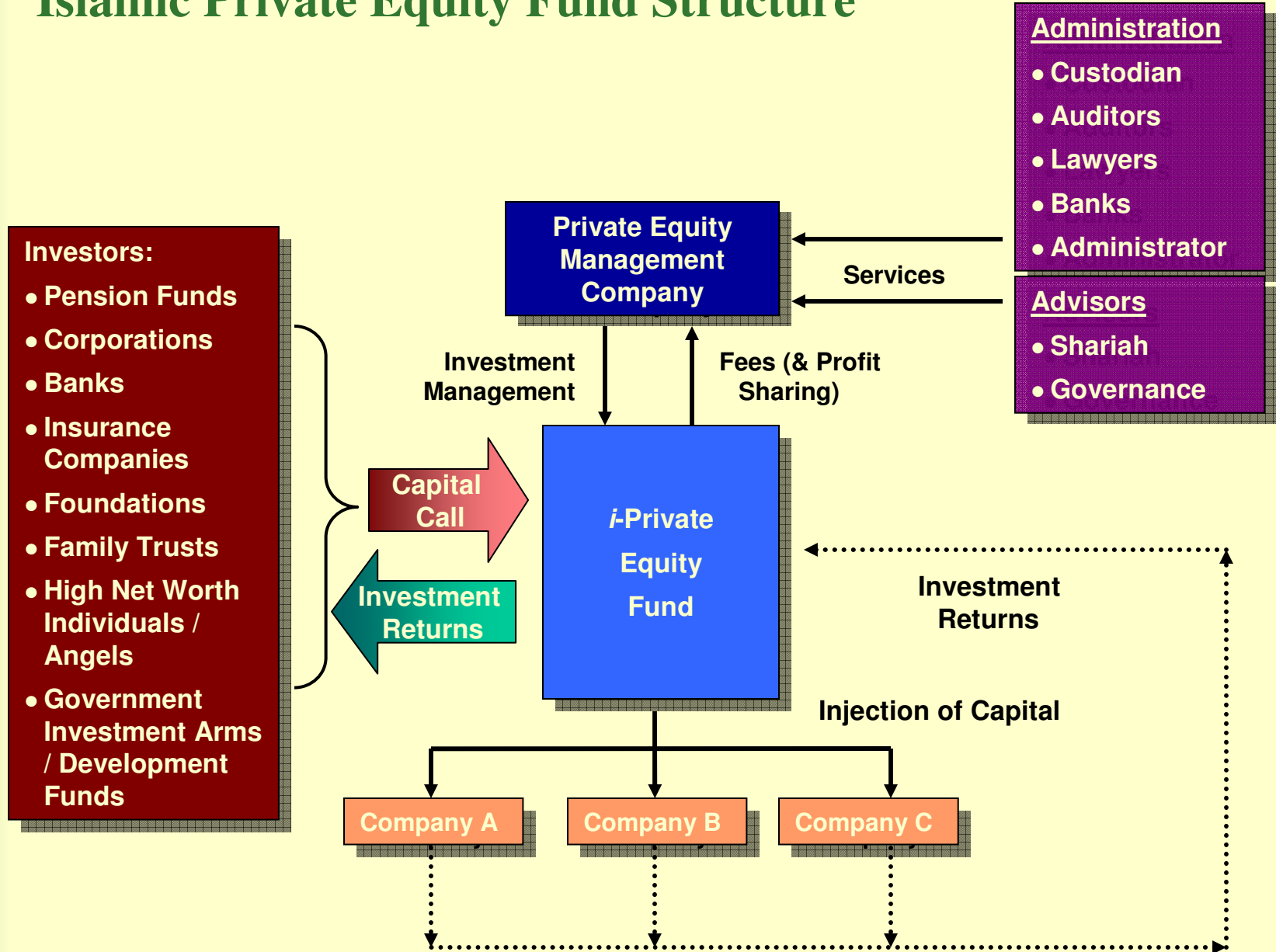
Since Islamic investment adheres to high ethical standards, it should be attracting a growing number of non-Muslim investors, in addition to the 1.3 billion Muslims worldwide, thereby targeting a substantially larger investor base than conventional private equity.

Multiplier Effect into the Real Economy, Exemplified

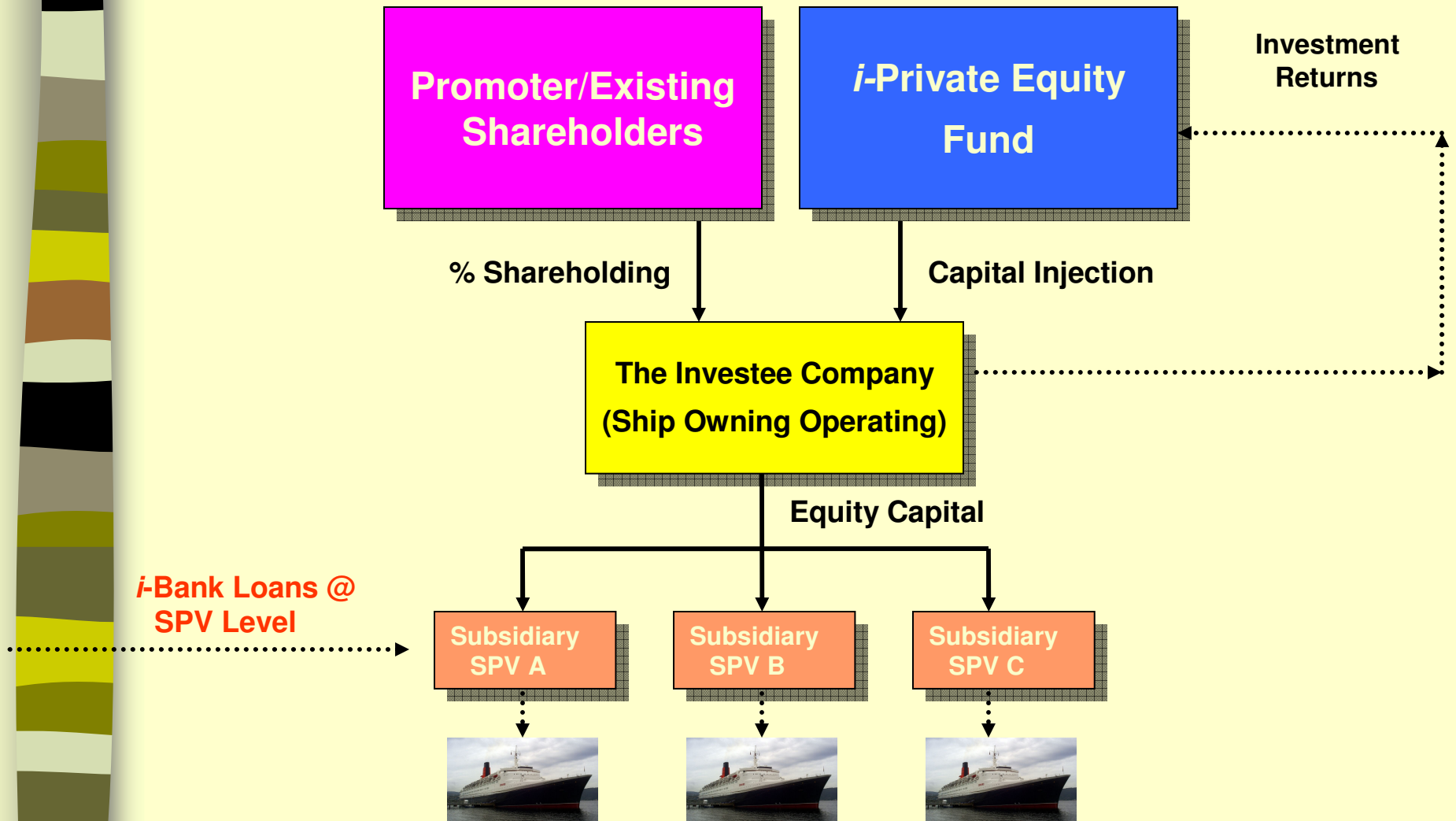
Capital from *i*-PE Fund



Islamic Private Equity Fund Structure



Structure - Private Equity Investment (example)





Features of Islamic Private Equity Investing In a Nutshell

The Fund Company can only invest in syariah compliant activities.

For equity, there is no differentiation between class of shares, vis-a-vis, i) profit distribution priority; ii) liquidation priority in winding-up cases.

Losses incurred by the Fund Company must be shared on a pro-rata basis depending on capital contributed, but profits are allowed to be distributed not in the same pro-rata manner.

Redemption of shares by the investee company is allowed as long as the redemption price is not fixed in a pre-determined price formulation that provides capital return certainty. The redemption price should be reflective of its market value & the company performance or based on willing buyer willing seller at the point of redemption. Similarly Put & Call Option Exercise Price.

In return for the management services rendered, the PE Fund Management Company (the Fund Manager) can be paid: i) annual fixed fees based on certain pre-agreed % formulation; ii) incentive fee (“carry”), as a reward only if the Manager performed and achieve above & beyond certain pre-determined profitability threshold, also based on pre-agreed formulation.

As is well known, Islamic principles also impact how businesses finance and operate themselves. In its strictest form, so long as the Islamic PE Fund held equity in the Investee Company, any future financial transactions undertaken by that Company had to be compliant with Islamic law. Not only did this mean that interest-bearing borrowings would be prohibited, but also that future issuances of conventional preferred stock in the company would be prohibited as well.

Highly geared companies best avoided. The application of Financial Ratios, where target investee companies must meet them. Target companies that straightaway meet the Financial Ratios, on fast track approval.

Companies whose activities are syariah compliant, but do not entirely meet the Financial Ratio, may still be eligible subject to further review and approval may eventually be obtained subject to them achieving further milestones vis a vis compliance over given period of time.



Issues And Challenges - Turning Conventional Practices Into Shariah Compliance Mechanism

Expectations of Investors of the Fund / the Fund Company...

Risks vs. Rewards.

Debt vs. Equity.

Security vs. Entrepreneurial Risks.

Short Fund Life Duration vs. Longer Gestation for Real Impact of Injected Capital.

On the Deals...

Scarcity of readily available Syariah-compliant target companies. Full compliance in its strictest sense may not be attainable every time.

The lengthy process of informational dialogue with the target company and its other existing investors, if any) on Islamic finance, its philosophy & practice.

Reciprocity of commitment to the Investee Company and commitment to Islamic finance.

Absence of liquidation preference provisions calls for a much cautious due diligence approach (including behavioural assessment) on the target & its promoters.

In structuring, innovation can only stretch to a certain limit within the boundary of permissible Islamic principles.

Reputation and Performance – key attributes of the winning Fund Managers

Thank You



CMS Opus Private Equity Sdn Bhd



Adi Arman Abu Osman

Senior Vice President, CMS OPUS Private Equity Sdn Bhd

- **With over 8 years of direct experience in the private equity industry, he was previously attached to a bank-backed VC, and subsequently with the Private Equity Division of EPF prior to joining COPE;**
- **Experience in managing private equity investments through out its life cycle process from origination of deals up until exit/divestment stage;**
- **Industry domain exposure includes oil & gas, maritime & logistics, manufacturing, financial services, ICT;**
- **Graduated with Honours from the London School of Economics & Political Science (LSE), in Accounting and Finance;**
- **He spent 2 years in Islamic University of Madinah, Kingdom of Saudi Arabia studying Arabic.**