

The East Cameron Gas SUKUK



Ibrahim Mardam-Bey, April 25th , 2007

The Main Characters

- BSEC , driven by an ambitious team of knowledgeable structured finance bankers
- ECP , A father and Son wildcat team that had been through the boom and bust cycles of the U.S oil & Gas industry
- The assets, two gas properties located in the shallow waters offshore the State of Louisiana
- The bank, Macquarie Bank, lien holder of ECP assts
- V & E , the lawyers based in Dubai and Houston
- Various other players such as S&P , Merrill Lynch etc..

The Plot

- ECP , an independent Oil & Gas company was looking for a radical solution to a problem
- In order to develop the fields, ECP had borrowed \$45M from Macquarie at 15% per annum plus 50% upside in the form of a working interest.
- ECP had repaid the loan and was now stuck with a non-operating partner unwilling to fund further development and looking to monetize their 50% equity.
- ECP had exhausted all forms of prospective finance, and realized that it had little choice other than a combination of Commercial debt, Mezz and equity funding
- ECP was driven by the need to own 100% of the asset and master its own destiny

The Pitch

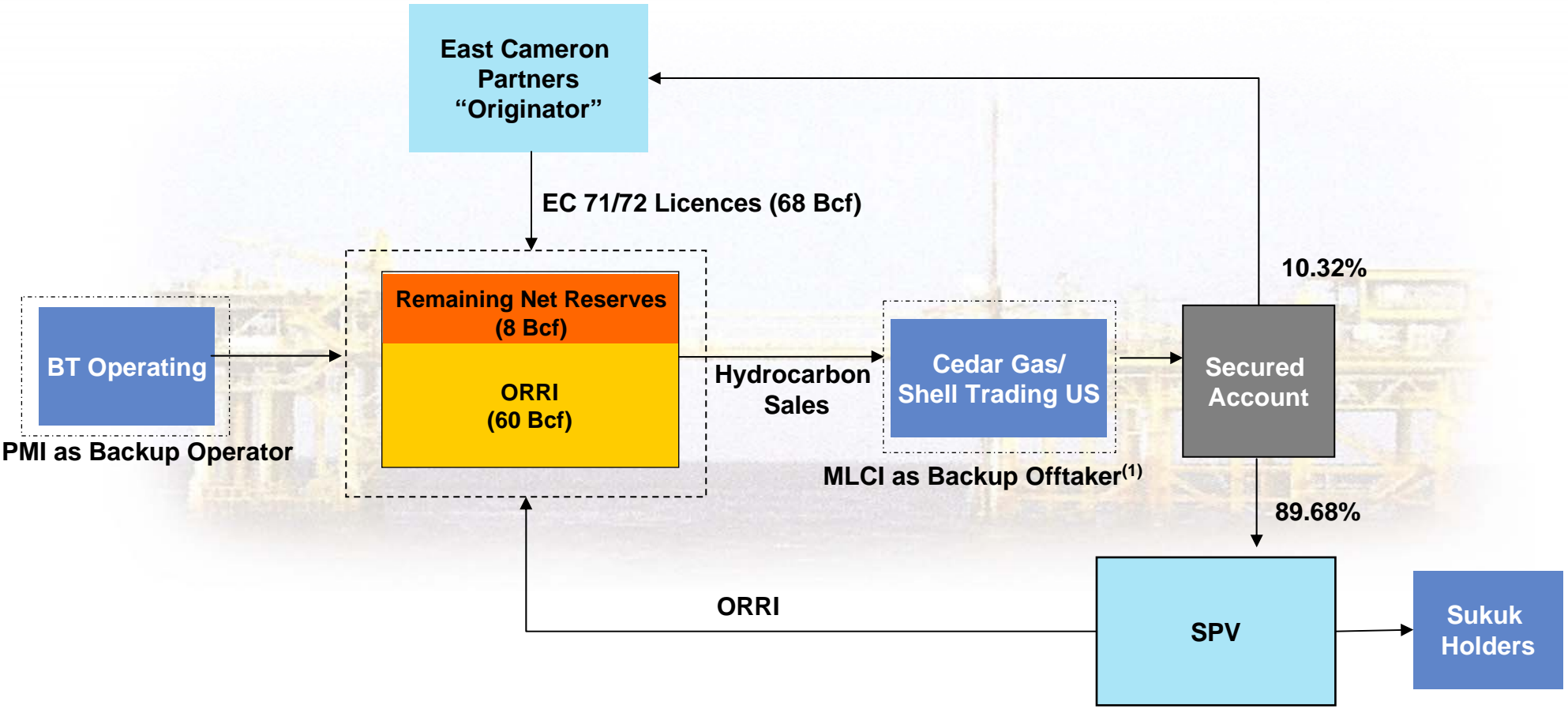
- I met Campbell Evans the ECP managing director in Houston on a whim that ECP needed a structured finance solution
- After multiple meetings and hours of discussions I convinced the father and son owners of ECP that their best plan would be a Sukuk that securitised their asset in return for funding that would look like debt to them.
- They could purchase back the equity they had given up to Macquarie and raise additional development funding without further equity dilution
- The cost of funding would end up being priced by the market but the road would be hard and with no guarantees
- The SUKUK and the Islamic finance structure was a tool and had no impact of the asset nor the operator.

Transaction Background

- East Cameron Partners, LP (“ECP” or the “Originator”) is an independent oil and gas exploration and production company, based in Houston Texas whose producing assets consist of two gas properties located in the shallow waters offshore the State of Louisiana
- The properties consist mainly of natural gas and have net proved reserves of approximately 68 Bcfe net to originator with an estimated remaining production life of 14.5 years
- The Originator has raised US\$165.67mm through an issuance of Investment Trust Certificates (“Sukuk”) mainly to finance the acquisition of a 50% net profit interest in the properties that were held by a 3rd party as well as to fund further development
- The Sukuk will be repaid from proceeds of the sale of hydrocarbons to offtakers (Merrill Lynch will backstop natural gas offtake) pursuant to an Overriding Royalty Interest (ORRI) to be obtained from the Originator in the designated properties
- The legal final maturity of the Sukuk is 13 years with an expected final and weighted average maturity of 5.5 yrs and 3.5 yrs respectively
- The Sukuk are secured by a 1st mortgage on the assets of the Issuer, which include the ORRI and secured accounts

Transaction Overview

The Transaction Fundamentally Involves the “Securitization” of Hydrocarbon Sales From the EC71/72 Fields



(1) Merrill Lynch Commodities, Inc. (MLCI) will backstop the Cedar Gas natural gas offtake contract only

Terms And Conditions

<u>Issuer</u>	: East Cameron Gas Co.
<u>Amount</u>	: Up to \$165.67mm
<u>Certificates</u>	: Amortizing Investment Trust Certificates (“Sukuk”)
<u>Security</u>	: Right to Oil & Gas ORRI
<u>WAL (Base Case)</u>	: 3.5 years
<u>Closing Date</u>	: July 2006
<u>Legal Final Maturity</u>	: 13 years from closing
<u>Ratings</u>	: “CCC+”
<u>Repayment</u>	: Quarterly based on volume produced
<u>Return</u>	: 11.25%
<u>Distribution</u>	: Reg S / Reg D
<u>Governing Law</u>	: US

Sharia'ah Compliance Aspects of the Transaction

- The **underlying asset** (oil and gas hydrocarbons) is lawful and compliant
- The transaction is based on **acquisition of a physical asset** : Purchaser SPV is purchasing on a true sale basis a physical asset which is opined on as being a Real Property (and registered in an official public registry with the MMS)
- The Sukuk qualified as **Sukuk al-Musharaka** are as defined by industry standards established by the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), paragraph 3/6, under the heading, *Musharaka Certificates*; The venturing parties being ECP and Issuer SPV
- The **Funding Agreement** (linking the Issuer SPV to the Purchaser SPV) is a Shari'a compliant instrument aiming at (i) materializing the contribution of the Issuer SPV (as a *Musharek*) and (ii) conveying to Issuer SPV a certain risk and reward profile which is passed on to the Sukuk holders
- The **Hedge is essentially an obligation or, in Shari`ah terms, iltizam** which is lawful because of true commercial value (it should not be viewed as a mere speculation). In the customary practice of modern finance such a sale is commonplace and there are well-established mechanisms for its pricing. It is clear that such a sale has commercial value and, therefore, may be considered lawful in Shari`ah law
- A Fatwa by Sheikh Youssef Delorenzo and by Sheikh Nizam Yacoubi has been obtained

Key Investment Considerations

- **Strong transaction structure substantially mitigates Originator risk**
 - Legal claim on reserves through true and registered ownership of ORRI
 - Backup Operator
 - Reserve Accounts

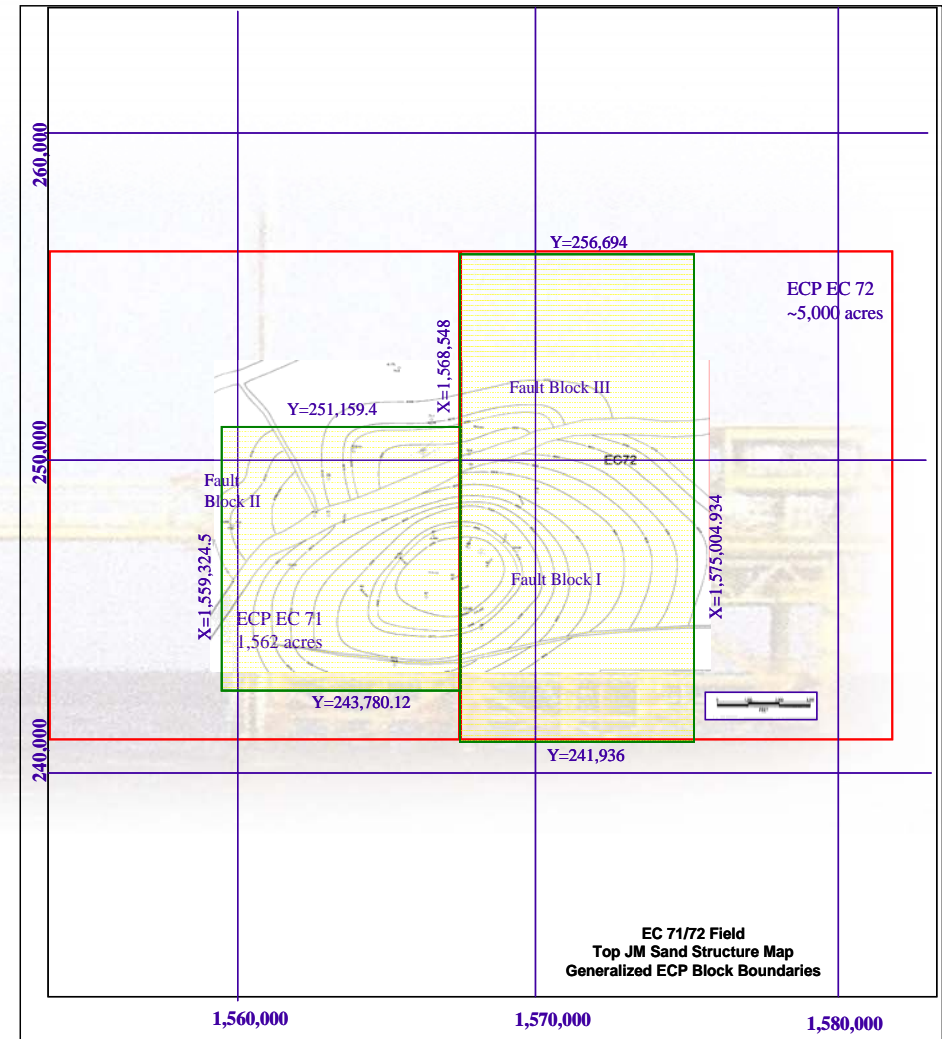
- **Conservative approach to sizing the Sukuk**
 - Conservative hydrocarbon price projections used
 - Commodity price hedges in place to mitigate downside price risk
 - Proved reserves only relied upon for repayment (of which 61% are proved developed)
 - 100% Pre-funded capex account to ensure production and delivery of the 39% proved undeveloped reserves

- **Adequate and realizable collateral package**
 - ORRI volume provides over collateralization
 - ORRI is a marketable interest and can be sold in case an enforcement event occurs
 - The implied value of the properties based on current comparable transactions in the Gulf of Mexico is well in excess of the pro forma net financing

- **Attractive yield and weighted average maturity**

Properties & Leases

- The Originator, holds a 100% record title interest in Lease EC 72 and a 100% operating rights interests in a portion of EC 71. The Originator holds a 100% working interest in both Leases
- ECP's interest in the leases enable the Originator to exploit all hydrocarbon reserves found within these properties for as long as the Properties are producing and MMS approved field development is carried out
- Both leases are administered by the Minerals Management Service as part of the US Department of the Interior



Platforms and the Production Facilities

A & C Platforms



The production facilities for the fields are comprised of:

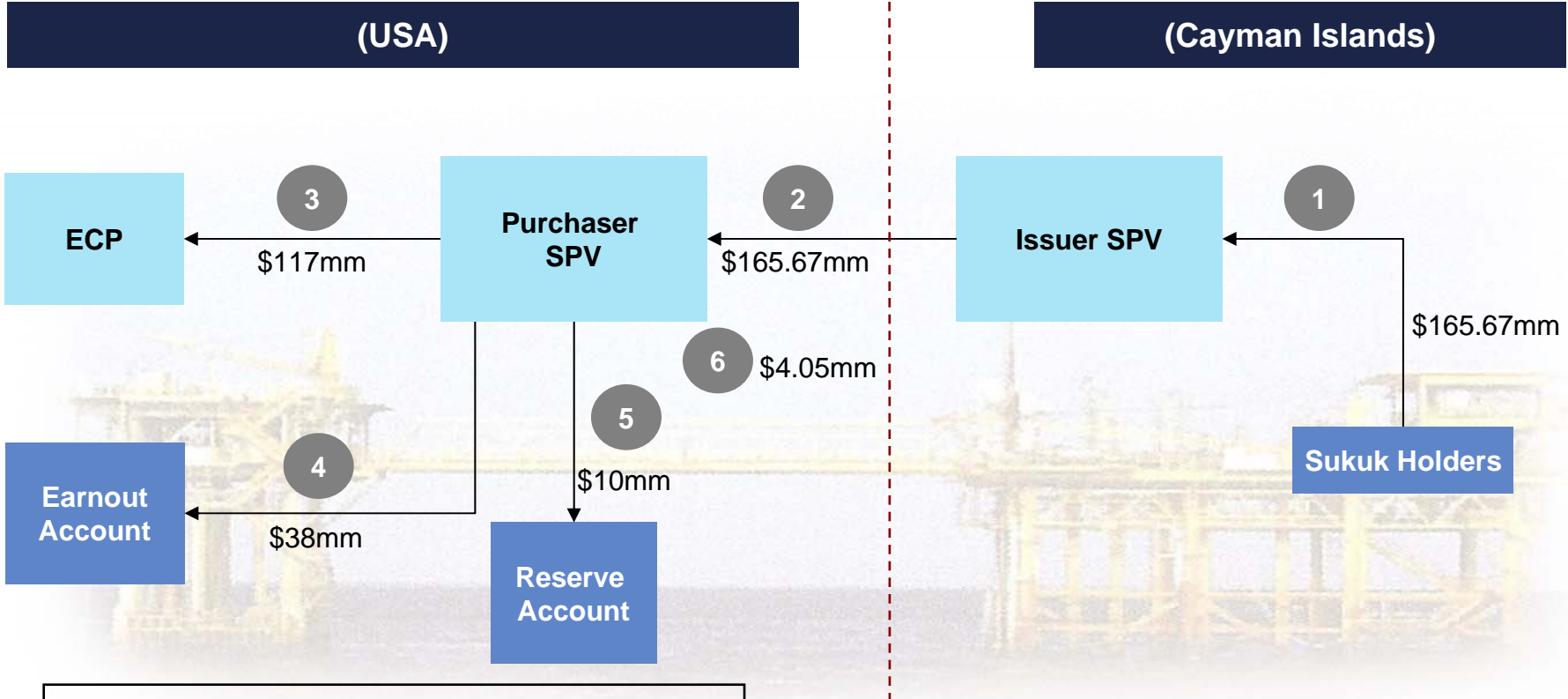
- two platforms (EC 71 A and EC 71 C)
- two free-standing, single-well caissons (OCS-G 13576 #8 (71-8) and OCS 0184 #4 (72-4))

The Properties currently include 7 producing wells with an additional 5 to be producing through re-completion, 4 following drilling during the development plan, and 1 following re-entry

Production equipment on platform has following capacity:

- 120 MMCFD of natural gas
- 3,500 BPD of condensates
- 6,000 BPD of water

Transaction Schematic



- 1 – Sukuk Subscription
- 2 – Funding
- 3 – Purchase of ORRI
- 4 – Funding of Earnout Account
- 5 – Funding of the Reserve Account
- 6 – Purchase of Additional Puts

Reserve Account Structure

- **Reserve Account** - Prefunded at \$9.5m on closing date:
 - Provides 6 months of cash reserve to cover senior expenses and Sukuk return
 - Reserve Account to be topped up before making any Sukuk Redemption or distributions to originator
- **Opex Account** - Prefunded at \$5mm on closing date:
 - Provides sufficient liquidity to originator to meet with planned opex and repairs and maintenance expenditure. Opex Account to be topped to \$5mm before any distribution to originators
- **Earnout Account** - Prefunded at \$38.3mm on closing date:
 - All required capex as per the GCA Development Plan is prefunded via the Contingent Purchase Price Account. With an average 15% contingency incorporated , it provides sufficient cash to the originator/operator to develop properties to their potential

Summary Risks and Mitigants

Commodity Price Risk



- Sukuk sized using conservative commodity price projections
- Long term natural gas price of \$4.00/MMBtu used in Base Case vs. 5 year historical average of \$5.61/MMBtu
- Hedging Programme will be in place to further support purchaser SPV and ECP production

Reserve/Development Risk



- Sukuk offerings based only on proved reserves as validated by GCA; 61% of reserves classified as proved developed
- Structure benefits from substantial reserve over collateralisation and can withstand reductions in reserves
- Structure protects Sukuk holders from substantial reserve degradation as monitored by reserve audit every six months

Offtake Risk



- Merrill Lynch Commodities, Inc will provide backstop offtake agreement for full volumes of natural gas over life of transaction
- Condensates sold to Shell Trading (US) represent only small portion of total hydrocarbons; readily accessible buyers at condensates delivery point

Operator Risk



- Simple operations (low technology in shall water area)
- Backup operator contract with PMI
- ECP will hedge gas to ensure minimum cash flow to pay ongoing operating expenses
- \$5.0 million Opex Account pre funded at closing (equal to approx 12 months of opex) to provide additional liquidity
- Insurance package to cover unforeseen equipment or repair costs

Summary Risks and Mitigants

Production/Development

- BT Operating are qualified operators with significant track record with and understanding of the Properties
- The properties are currently operating
- Development plan involves no unusual technical risks
- Reserve accounts mitigate short term production stoppage risks
- Delays in the Development Plan can be with stood by structure

Event Risk

- The Platform and facilities have repeatedly demonstrated the ability to withstand hurricanes
- Rita was the first hurricane since 1992 to cause damage; production was back on line after only 10 weeks
- ECP has insurance package available to cover physical damage to platform and equipment of up to \$7.5 million
- Replacement cost of the platform and equipment estimated to cost less than \$10.0 million - majority of collateral value is in reserves
- Transaction structure includes cash reserves to provide liquidity for ongoing costs in hurricane shutdown scenario (opex up to 12 months; return 6 months and Hedge collateral up to approximately 10 months)
- Legal final maturity of 10 years allows for periodic stoppages or delays in production with no adverse effect

Legal Risk

- True Sale opinion regarding the ORRI
- Performance obligations of Originator backed by mortgage over Licences

Selling the Transaction

- A significant challenge for a small Beirut based investment bank, selling an innovative Sukuk structure based on US Oil & Gas assets.
- Initial pre-sales efforts were not encouraging.
- BSEC decided to bring in a tier 1 book runner “Merrill Lynch” late in the transaction cycle and at significant time and \$ cost.
- BSEC also decided to rate the transaction which required lengthy discussions with rating agencies
- The result was unexpected. A significant take up by non-GCC Islamic institutions.
- New York Hedge Funds had found “SUKUKS” !

Awards

- “Most Innovative Islamic Finance Deal of the Year” by Euromoney, UK,
- "Best Structured Finance Deal of the Year by Islamic Finance News Malaysia.
- "USA Best Deal of the Year" by Islamic Finance News Malaysia.