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# Financing Projects Islamically

*Shariah Compliant to Shariah Based*

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**MEED – Islamic Project Finance Conference**

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# Back to Basics

**“Islamic economics is the opposite of Western Finance”**

**Islam + Finance = Islamic Finance**

# Objectives of Islamic Finance

- **Economic Justice (Equity)**
- **Wider Distribution of Wealth**
- **Productive Use of Funds**
- **Social Cohesion and Peace**
- **Salvation in Eternal Life**

# The color of money is same!

- **Internal Equity**
- **External Equity**
- **Senior Debt**
- **Subordinated Debt**

# Typical “Islamic” Deals

■ **Sponsor (Internal) Equity** → **10% - 15%**

■ **EBLs**

■ **Private Equity**

**10%- 15%**

■ **Capital Markets**

■ **Conventional Debt** → **50% to 60%**

■ **Islamic Debt** → **10% to 20%**

# Reality Check

## Mega Deals with Islamic Tranches

Deal	Debt Size (MM)	Islamic Debt (MM)	Percentage of Islamic Debt
Shuaibah IWPP	\$1,977.00	\$300.00	15.17%
Marafiq IWPP	\$2,727.00	\$400.00	14.67%
Petro Rabigh	\$5,540.00	\$500.00	9.03%
Shuqaiq IWPP	\$1,390.00	\$140.00	10.07%
Ma'aden Phosphate	\$3,868.00	\$625.00	16.16%

# Towards Shariah Base

- **Pure Equity**
- **Voting / Non – Voting Stocks**
- **Preferred Stock**
- **Convertible Securities**
- **Partially Convertible Securities**
- **Convertible / Redeemable Securities**

# Islamic Alternatives

- *Musharakah Stocks (Sponsors' Equity)*
- *Mudarabah Stocks (Non Voting Stock)*
- *Musharakah Sukuk (Redeemable Bond with Voting Right)*
- *Mudarabah Sukuk (Redeemable Bond without Voting Right)*
- *Redeemable Ijarah Sukuk (Asset backed Redeemable Bond)*

# Towards Shariah Base - contd

- **Real Estate: Yes / No ?**
- **Healthcare / Pharmaceuticals ?**
- **Food Self Reliance ?**
- **Basic Infrastructure ?**
- **Heavy Industry ?**

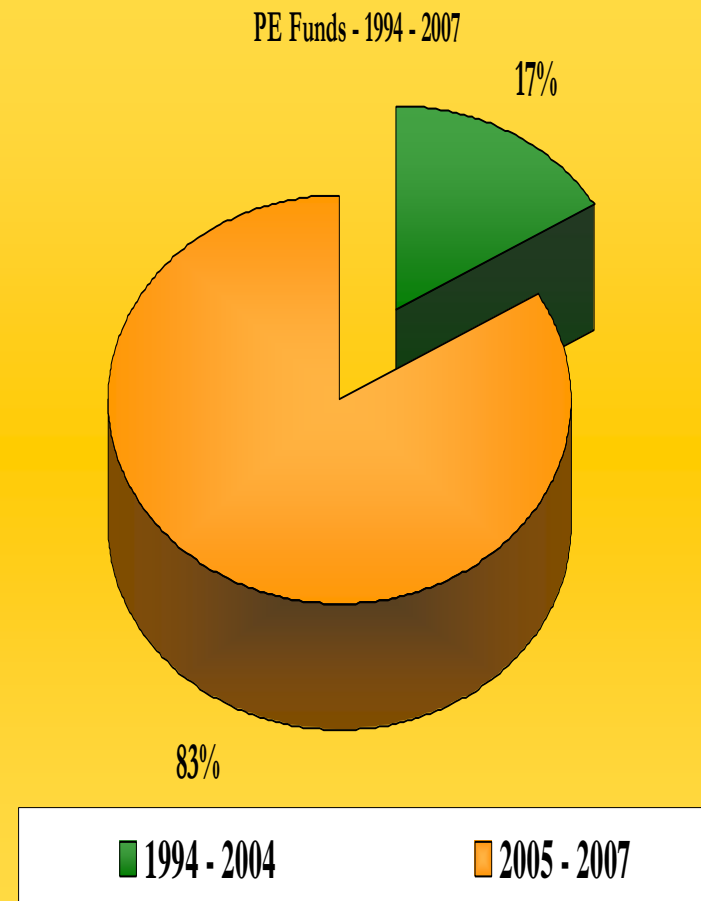
# MENA Private Equity

# PE & Islamic Finance – Bull's-eye !!

- ◆ **Two apparent advantages are diversification of funding and moving towards Shari'ah base.**
- ◆ **Investors participate as partners rather than creditors by bringing in early stage capital with pure equity investment.**
- ◆ **Two Mega trends – Islamic Finance & PE are likely to converge sooner than later. Partnerships are the way forward;**
- ◆ **Both Share the same Idea – Sharing value, Risks & Rewards through partnership;**
- ◆ **Hence, conventionally financed businesses will be restructured to adapt to new Shariah funds as more cost effective route to capital;**

# Picking up Steam – PE in MENA

- A total of US\$ 14.4 Billion of Private equity funds were raised in MENA between 1994 – 2007
- The rapid growth of PE in the region is due to : –
  - 1) Growing Private Sector
  - 2) Predominance of Family owned businesses (Approx 90%).
  - 3) Financing needs of MENA businesses.
  - 4) Excess liquidity.
  - 5) Privatization.
- By 2011 Islamic PE market in the MENA region will reach US\$ 26 Billion.

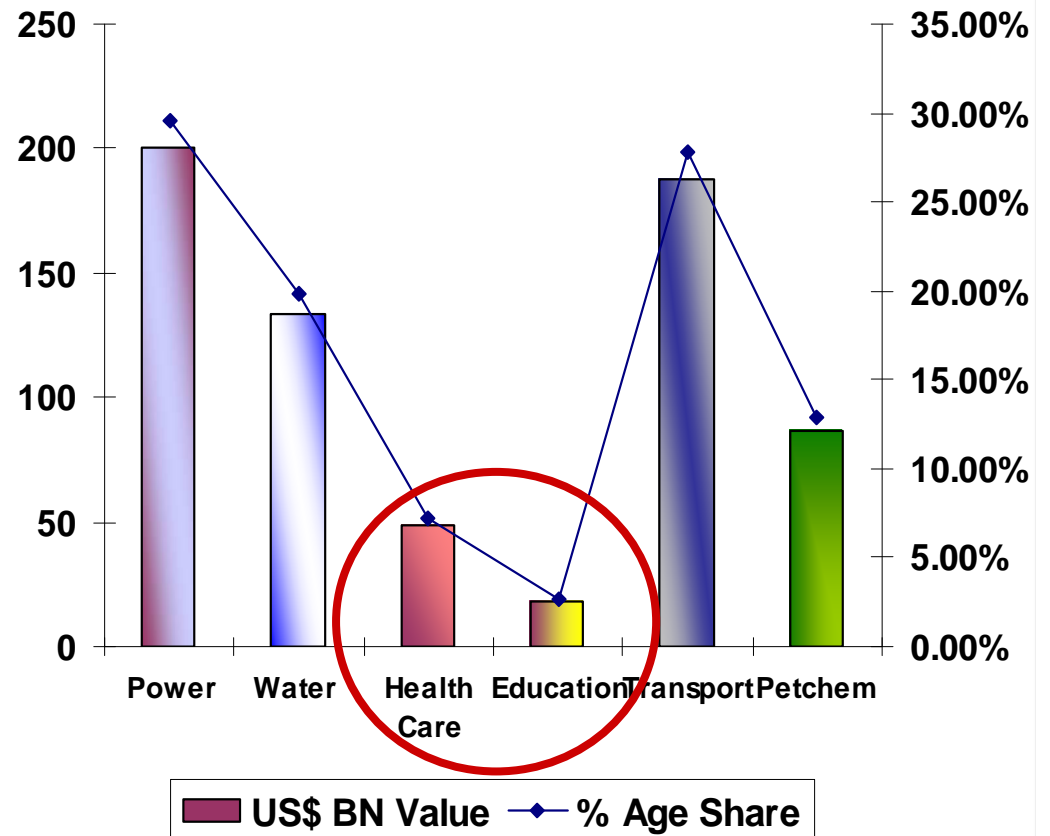


Data Source: ZAWYA / Arab News April, 2008

# For Whom the Bell Tolls: PE Outlook 2008 – 2018

- Middle East PE industry is estimated to reach more than US\$ 676 BN in the next ten years;
- The MENA region is expected to become the 4th centre of global PE activity after US, Europe and Asia;
- PE firms have raised a cumulative of US\$ 22.8 BN between 2002 – 2007 with six firms accounting for 50% of the fund raising activity.

PE Potential Sectors 2008 - 2018



# Regional PE – Why Will it Grow?

- **More than 90% of all commercial activity in the region is controlled by family firms;**
- **131% increase in the value of funds raised in 2007 (US\$ 6 BN) from 2006 (US\$ 2.6 BN)**
- **Numbering over 5000 and holding US\$ 500 BN + in assets, these family firms employ more than 70% of the work force;**
- **G.C.C. GDP is expected to cross US\$ 1 Trillion;**
- **PE funds under management as a percentage of GDP stood at 1.45 percent (US\$ 15 BN ), compared to 6% in the US;**
- **Rewarding through exits – 19 exits in 2007 as against 17 in 2006 and 6 in 2005;**
- **Future exits expected to include Trade Sale, Buy Outs, and Buy Ins.**

# PE → Challenges Ahead

- **Islamic Private Equity is at a nascent stage with very few established models;**
- **Significant dissemination of information needs to be undertaken to educate potential investors/business owners about structures and options;**
- **Fierce competition from existing conventional products;**
- **The present crisis means investors/business owners are unwilling to try untested structures;**
- **Valuation Gap;**
- **Saudi Arabia is viewed with skepticism due to lack of a legal precedent and uncertain tax situation;**
- **Shallow Capital Market i.e. limited exit options.**

# Islamic Project Finance

# Turning a New Leaf: Islamic Project Finance

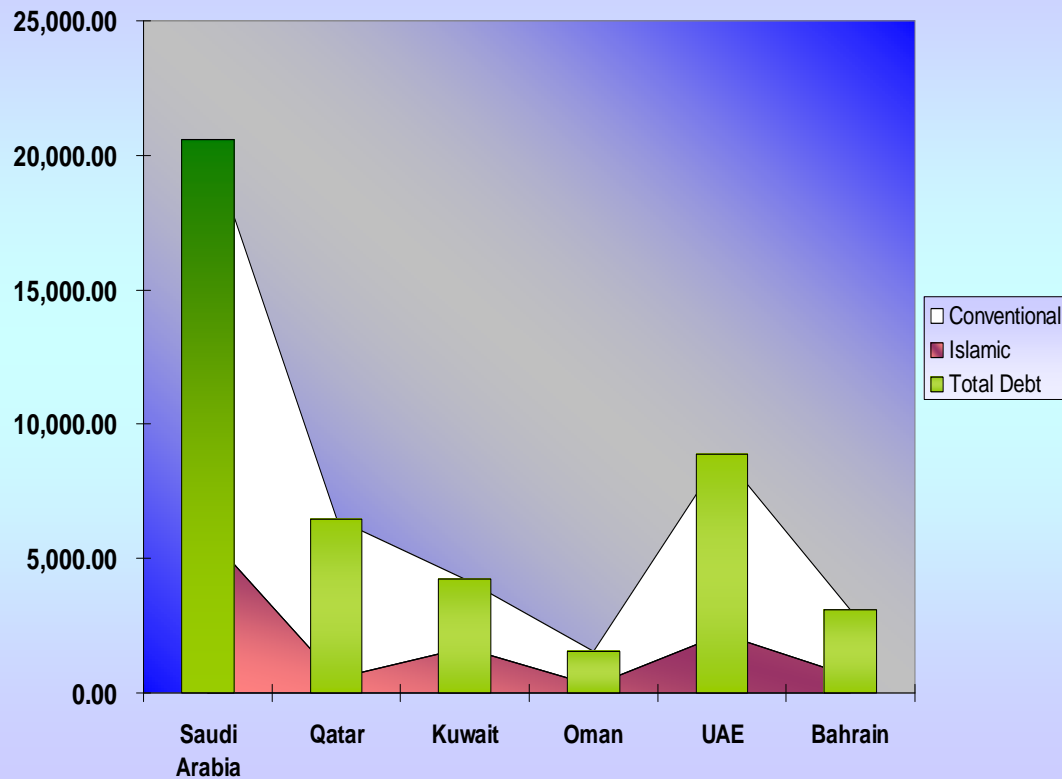
## ■ PAST TREND, CURRENT & FUTURE –

- ✓ It is estimated that private wealth in the hands of G.C.C. citizens is US\$ 1.8 trillion
- ✓ Arab investors hold approximately \$900 billion of assets in European banks, with a trend to invest that money in Islamic products.
- ✓ An Infrastructure boom, a strong urge to diversify and high liquidity from record oil prices increasing this pool.
- ✓ Evolving Products & wrapped financing to address long term financing concerns.
- ✓ According to a recent estimates, the G.C.C. Project Finance market will attract US\$ 118 BN in the next three years.
- ✓ Tangiblizing the intangible - In the largest ever Islamic Tranche, financing was secured on airtime minutes in the US\$ 2.8 Billion Mobily refinancing.

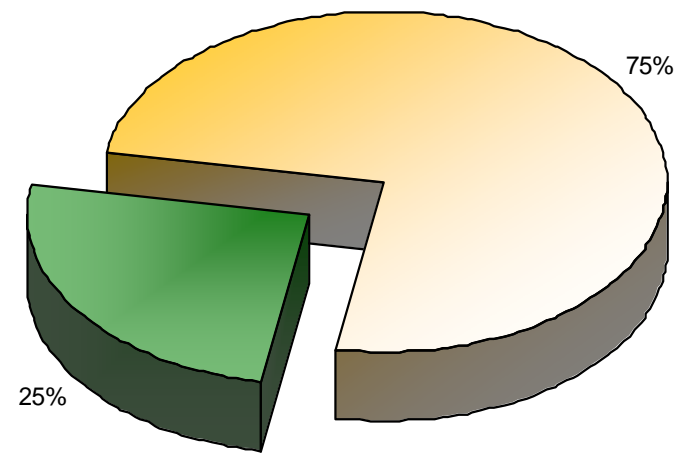
# Blast from the Past – 1996 – 07

Since 1996, 25 deals have seen the involvement of Islamic tranches in the G.C.C. region

Deals With Islamic Tranches 1996 - 2007 (US MM)

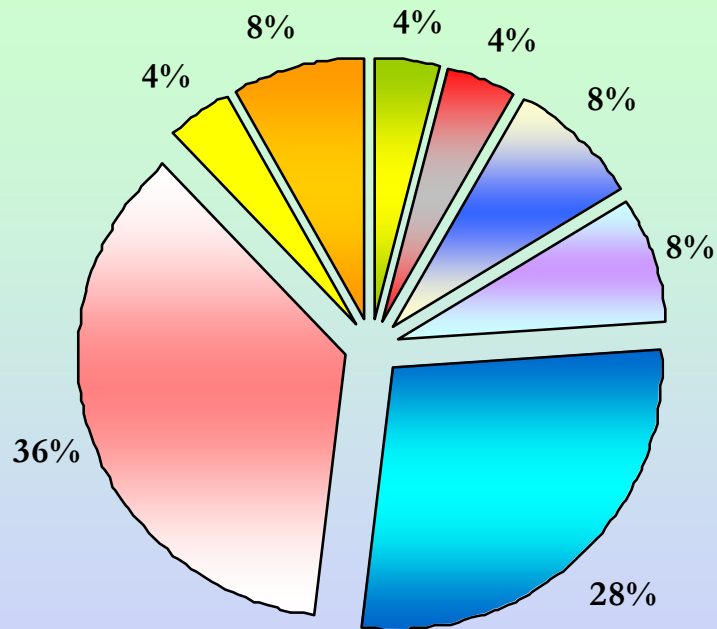


Split Between Conventional / Islamic (96 - 07)



# Existing Foundation for Future Deals

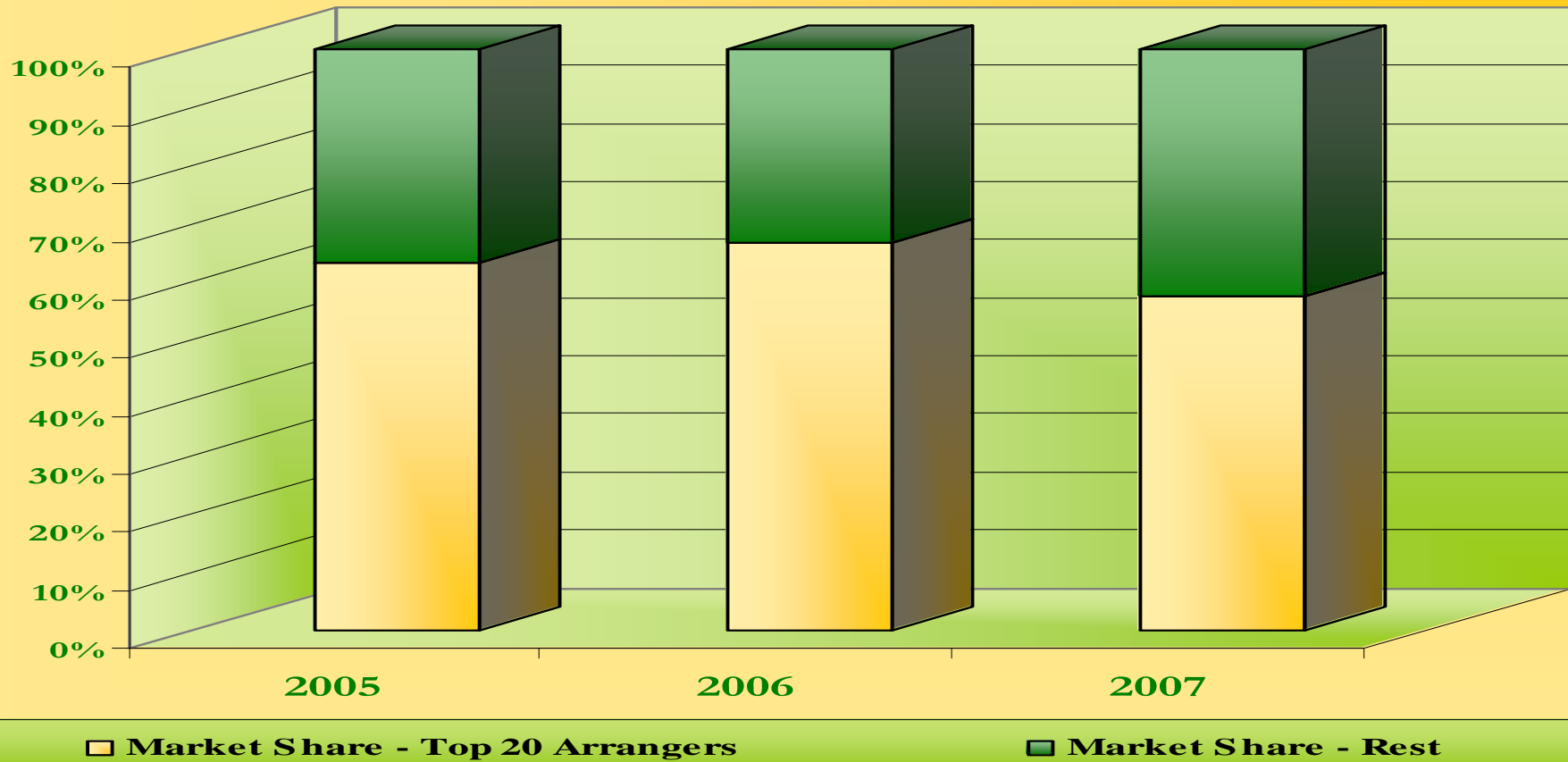
Islamic Deal Types (96 - 07)



**Power & Water +  
Petrochemical deals  
accounted for the bulk  
of transactions (64%)  
that set the trend for  
Islamic Tranches.**

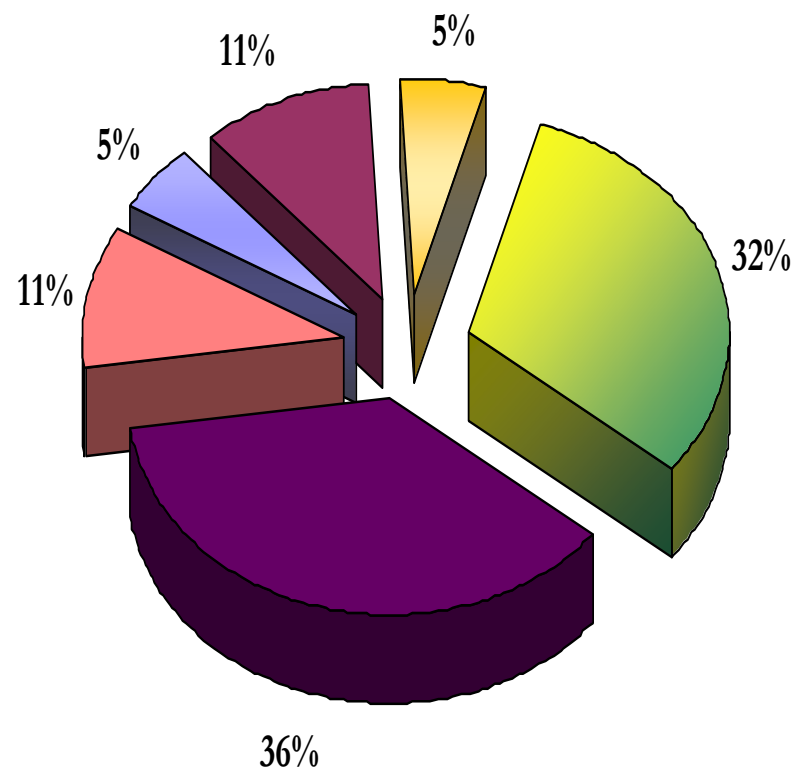
# G.C.C. Power Play – Balance of Power Shift

Market Share Information



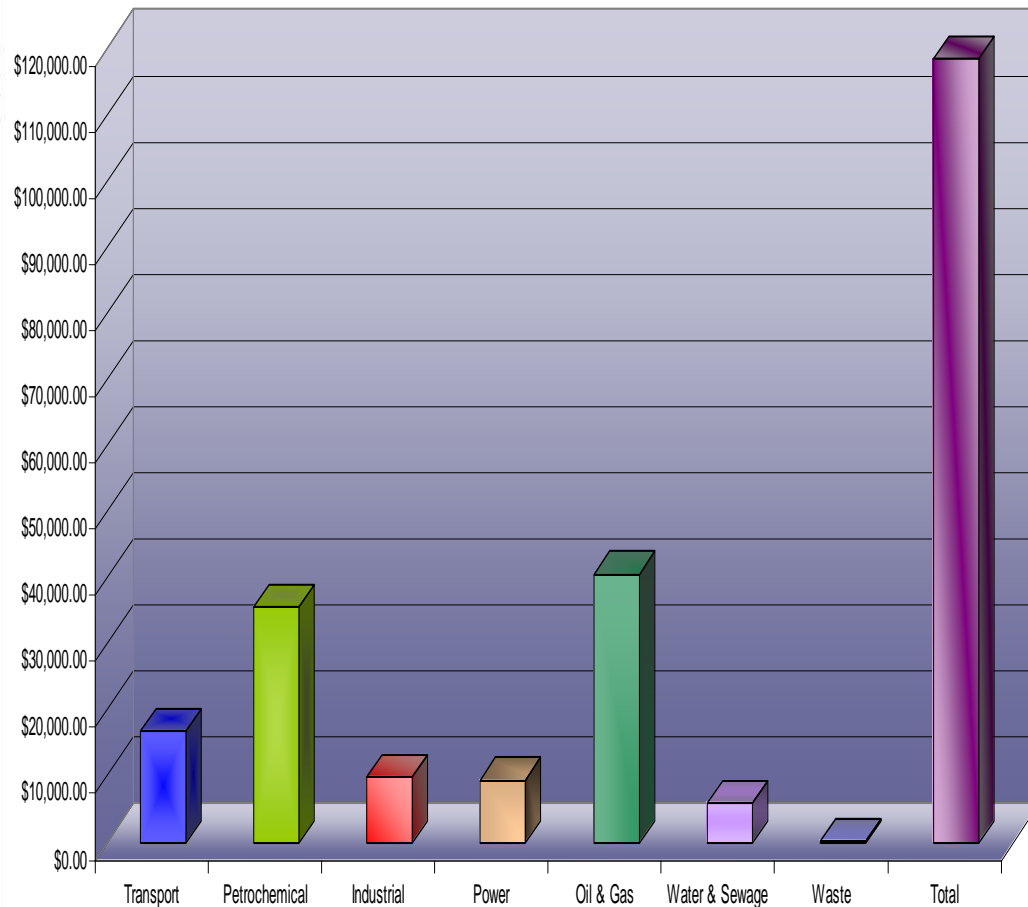
# GCC Project Finance Sectoral Allocation – 2007

GCC Sectoral Allocation - 2007



# Target Sectors – Islamic PF (2008 - 2010)

Sectoral Allocation Pipeline Stages (in US\$ MM)



- **IF past figure is anything to go by, 25-30% of the pipeline to be financed on the principles of Shariah in the next 3 years;**
- **It is hence estimated that Islamic Finance tranches will be worth US\$ 30 BN - US\$ 36 BN in the next three years;**
- **Energy and Energy intensive sectors are expected to attract the bulk of financing, with Islamic Tranches attached.**

# NCB Project Finance Snapshot – 06/07

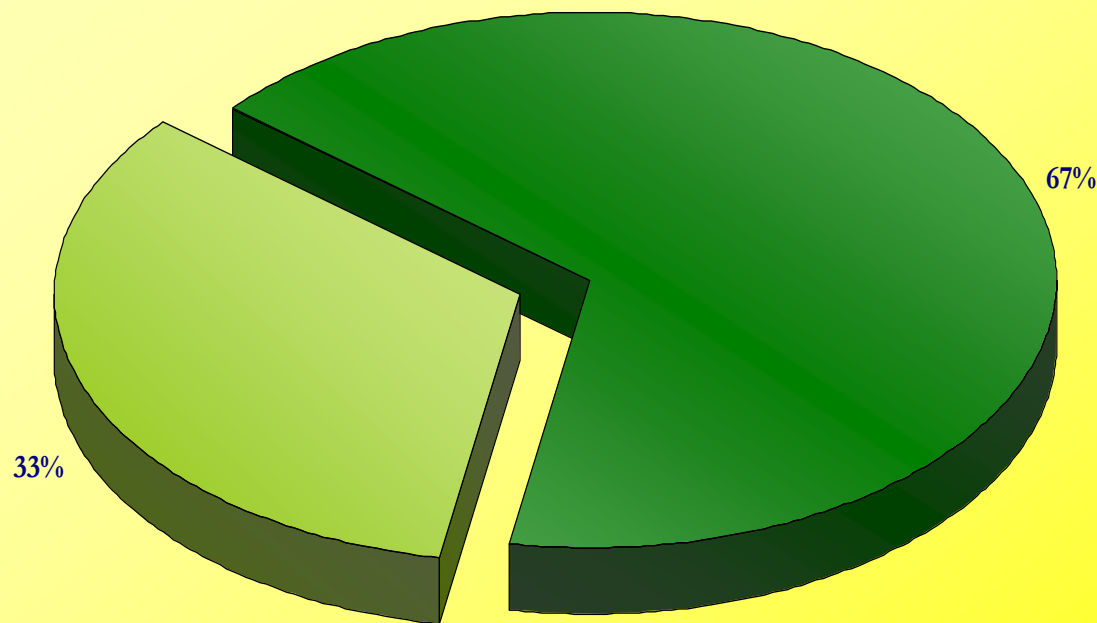
S.No	Deal Name	Sector	Total Size	NCB Tranche	Tenor	Type
1	Al Tuwairqi Group	Steel	SAR 200 MM	SAR 200 MM	4 Years	Conventional
2	Advance Polypropylene	Petchem	USD 464.8 MM	SAR 143	12 Years	Islamic
3	National Petrochemical	Petchem	USD 411 MM	SAR 300 MM	11 Years	Conventional
4	Jubail Chemicals	Petchem	USD 80 MM	SAR 112.5 MM	10.5 Years	Islamic
5	Saudi Formaldehyde	Petchem	SAR 1128 MM	SAR 220 MM	8 Years	Islamic
6	YANSAB	Petchem	USD 1433 MM	USD 50 MM	12 Years	Islamic
7	Shuaibah	Water & Power	USD 300 MM	USD 53.25 MM	20 Years	Islamic
8	Gas	O&G	SAR 1500	SAR 500	9 Years	Islamic
9	Marafiq IWPP	Water & Power	USD 2 BN	USD 200 MM	22 Years	Islamic
10	ISPC	Steel	USD 135	SAR 112.5 MM	6 Years	Conventional
11	IBN ZAHR	Petchem	USD 855 MM	USD 91 MM	10 Years	Islamic
12	NCP	Petchem	USD 1879 MM	USD 160.8 MM	15 Years	Conventional
13	Saudi Kayan	Petchem	USD 1759 MM	USD 125 MM	15 Years	Islamic
<b>24</b>	<b>Total</b>		<b>\$10,071</b>	<b>\$1,042</b>		

# Islamic PF – Challenges Ahead

- **Complex Structure brings forth execution risk**
- **Fierce competition from conventional Capital Providers**
- **Need for underlying asset to back transaction**
- **Additional documentation, costs and timing**
- **Differing Shariah interpretations/opinions**
- **Scarce Human Capital**

# G.C.C. Islamic Debt Issues

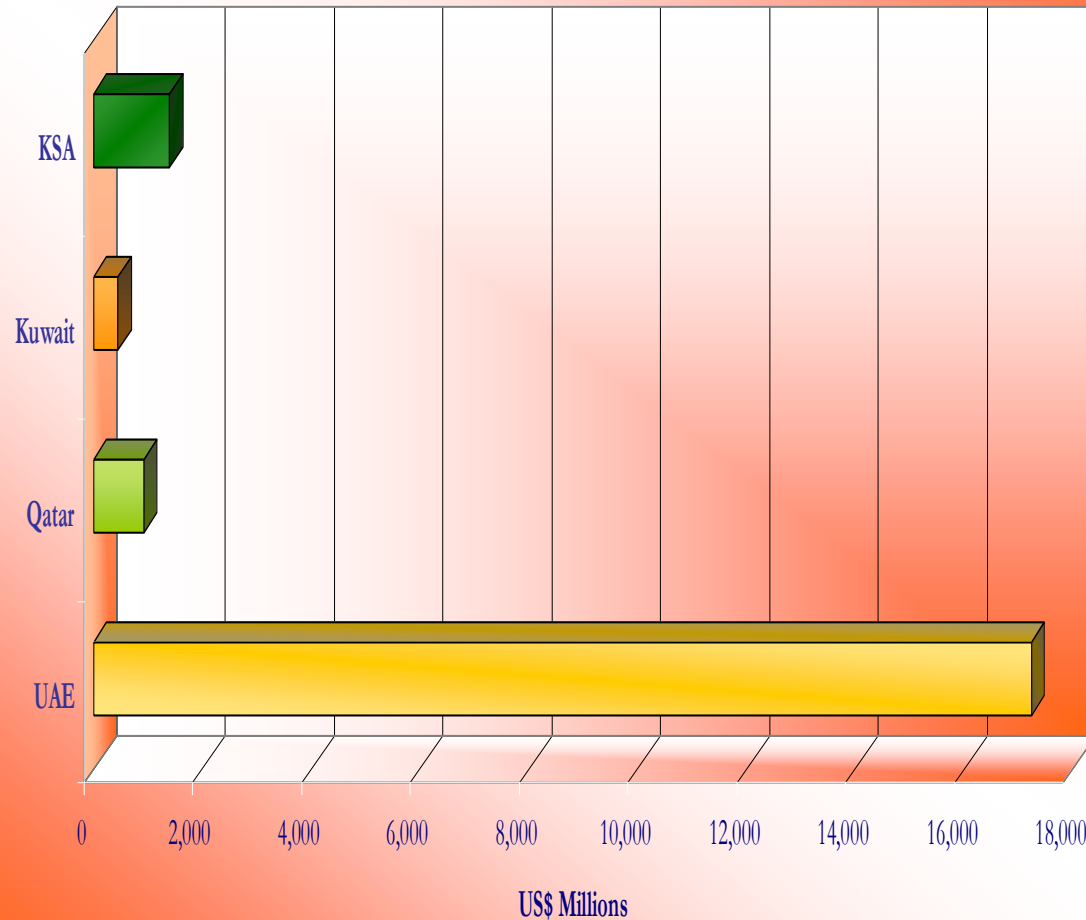
# GCC Sukuk Issuance – 2006 / 07



Country	Conventional	Sukuk
U.A.E.	3	6
Qatar	1	1
Kuwait	1	1
KSA	-	2

# By Value – G.C.C. 2006 / 07

Top Deals by Value - G.C.C. 2006/07



- U.A.E. grabbed the lions share of Corporate bond issues (Islamic + Conventional) accounting for about 86% of the total Value.
- Second ranking Saudi Arabia accounted for just 7% bringing to light the wide disparity in Bond issuances in the G.C.C.

# Sukuk – Challenges Ahead

The Shari'ah Committee of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) February 2008 decisions with regards to issuing sukuk:

- Tradable sukuk must represent ownership for sukuk holders in real assets (tangible, usufructs, or services). The ownership of assets comes with all its rights and obligations including its possession and disposal. The transfer of assets should be reflected in the books of issuer.
- It is not permissible for tradable sukuk to represent either revenue streams or debt except in case of a trading or financial entity that is selling all of its assets.
- It is not permissible for the sukuk manager/issuer to offer loans to sukuk holders when actual earnings are less than expected returns. However, a reserve can be established and be used for any shortfalls on condition that the same is mentioned in the prospectus.
- It is not permissible for the sukuk manager/issuer to purchase the assets from the sukuk holders at their nominal value at the end of the tenors. It is, however, allowed to purchase assets back at their net value or fair market value or a price agreed upon at the time of purchase.
- Shari'ah supervisory boards must review all contracts and documentations related to the actual transaction and oversee the implementation of the process to ensure Shari'ah compliance.

# Conclusion

- As far as project volume is concerned, we will see a steady increase rather than any skyrocketing figures;
- Private Equity is catching up but faces a series of challenges e.g. structuring, monitoring and valuation;
- The proportion of project financings that include an Islamic Tranche will continue to grow but will not in the short term fully replace conventional project finance;
- We will continue to see innovation in the types of assets financed and the way in which they are financed: Istisna Sukuks, Zero Coupon Convertibles, Partially Redeemable Bonds, Mezzanine Islamic Capital etc.;
- 2008-09 is set to witness purely Shari'ah based projects in jurisdictions outside the GCC.

In the Light of the facts & figures discussed in this presentation, it can be concluded that Islamic Finance serves as the next evolving liquidity pool. Once practitioners familiarize & equip themselves with Project Structures that are **based** on the Principles of Shariah, with better regulatory framework, Islamic Finance is geared for increased acceptance and steady growth.