





Sukuk

(Islamic Bond)

(Training Workshop on Sukuk)

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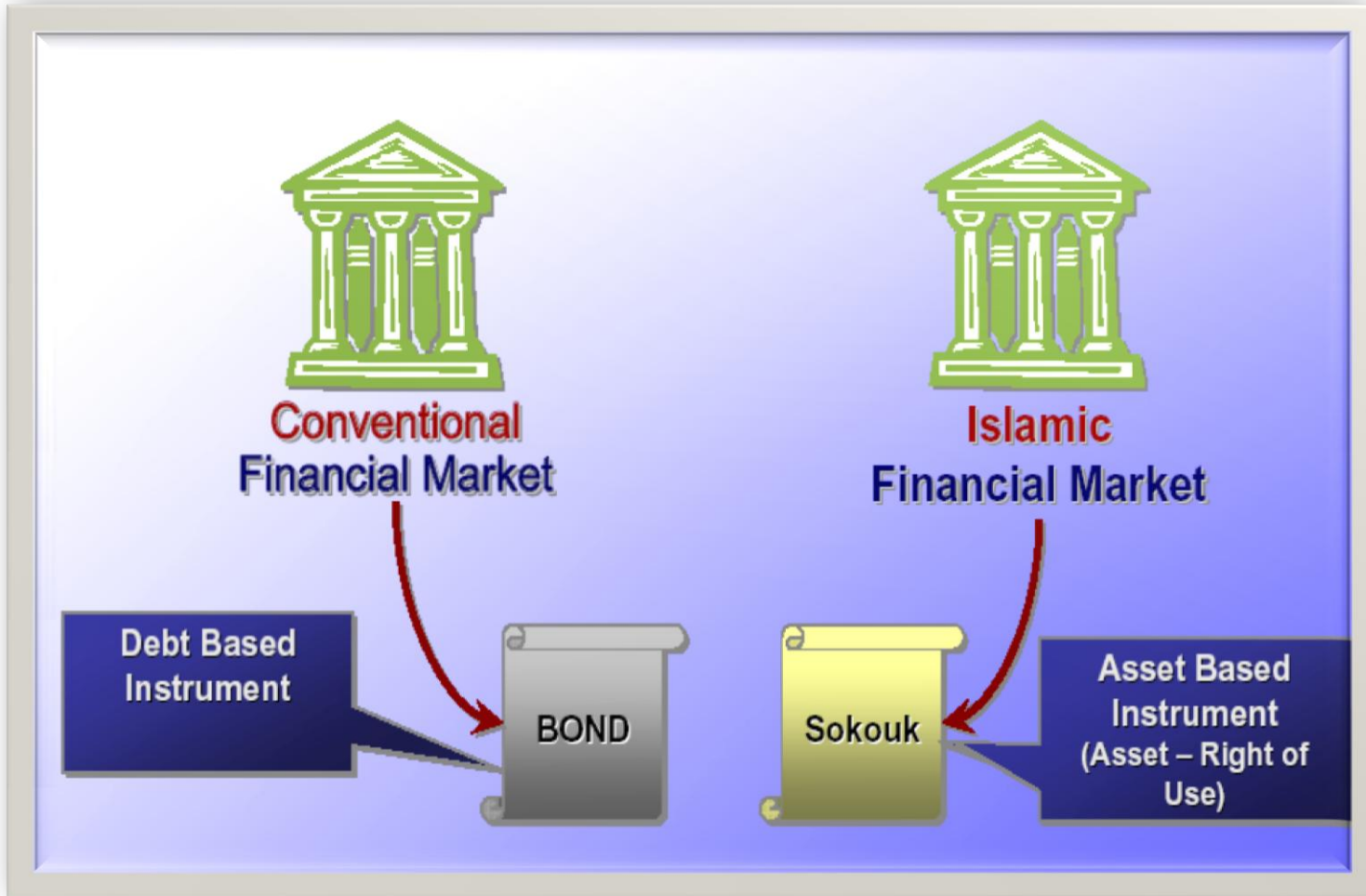
Defination

Sukuk is the Arabic name for a financial certificate, Islamic alternative to conventional bonds, Sukuk is a Trust certificate in which investor returns are derived from legal or beneficial ownership of assets.

Certificates of equal value representing proportionate ownership of tangible assets or usufructs or services or (of) the assets of a project or in an investment activity. (AAOIFI)

This ownership comes in effect after the completion of subscription and with the investment of received funds.

Introduction



A Sukuk represents:



An undivided proportionate ownership interest in an asset

- ✓ The corresponding right to the Islamically acceptable income streams generated by the asset.
- ✓ These current income streams are established and translated into tradable securities
- ▶▶ Trust Notes or Certificates similar to Equipment Trust Certificates (ETCs) and Unit Trusts
- ▶▶ Issuer creates a trust over the leased Assets
- ▶▶ Trustee issues Sukuk to the Primary Subscribers (the beneficiaries under the trust) in the Primary Market

A Sukuk represents: Contd..



- ▶▶ Sukuk Holders have pro-rata undivided beneficial ownership of the leased Assets / Portfolio held in trust - As beneficial owners the Sukuk Holders are entitled to the income streams from the Leased Assets / Portfolio
- ▶▶ The Primary Subscribers can resell the Sukuk in the Secondary Market
- ▶▶ The Secondary Buyer will be the new pro-rata beneficial owner of the Leased Assets held in trust

Growth in Sukuks



- ▶ Liquidity Management of Islamic Financial Institutions.
- ▶ Islamic financial institutions are seeking to diversify their portfolio and increase their portfolio size of tradable instruments with fixed income profile
- ▶ The industry requires Sukuk funds for retail distribution.
- ▶ Islamic Inter-Bank or Short term Islamic Finance market can be developed through sukuk.
- ▶ The underlying assets are purely used as a means of transacting and do not constitute a Transaction specific pool of security

Growth in Sukuks



- ▶ Sukuks are usually issued through special purpose vehicle ('SPV')
- ▶ In Pakistan a Limited Liability Company has acted as the issuer and is registered with and regulated by SECP
- ▶ Short and long term 5 – 10 Years Tenor
- ▶ There were record number of Sukuk Issues in 2007 Worldwide with a Total volume of US\$32.65 Billion
- ▶ 119 New Issues of Sukuk in 2007 – 26% Sovereign and 74% Corporate (31: 88) with an average deal size of US\$269.8 Million in 07 from US\$175 Million in 06

Growth in Sukuks



▶ In GCC– Gulf Co–operation Council UAE Leads in 2007 Sukuks

- ▶ UAE 58 %
- ▶ Saudi Arabia 30 %
- ▶ Bahrain 06 %
- ▶ Kuwait 04 %
- ▶ Qatar 02 % *Bloomberg , Zavya.com & Moody's*

Qatar in Planning to Issue **US\$ 15 billion** Sukuks in 08

Musharika Sukuks remained popular in 2007 in Amount but Ijarah Sukuks in Global Issues Number of Issues

In Asia Pecific, *Malaysia* is dominating *with 95% share* Pakistan stands second with only 3% Sukuks in Value

30–35% Growth expected for next three years 2008–10

Advantages to Sukuk Issuar



- ▶ Diversification of funding sources
- ▶ Creating and enhancing profile in international markets
- ▶ Secondary liquidity
- ▶ Sizeable financing.
- ▶ Ease of clearing and settlement

Advantage of Sukuk Investor



- ▶ Diversification in Investment
- ▶ Provides Leveraging Capabilities
- ▶ Secondary Market Liquidity
- ▶ Ease of clearing and Settlement
- ▶ Investment available to Institutional and Retail investors
- ▶ Allows for many computation of Risk – Credit /Mkt. /Duration etc

Issuance of Sukuk – Factors to be considered



- ▶ Identify the investors
- ▶ Rating – by a Credit Rating Agency
- ▶ Underlying Assets
- ▶ Secondary Market Considerations
- ▶ Applicable laws – SECP rules
- ▶ Costs to the Issuers
- ▶ Drafting of Legal Documents
- ▶ Regularity Framework



Parties Involved

- ▶ Originator : Initial Owner
- ▶ SPV : Set up for the Issue
- ▶ Investors: Subscribers.
- ▶ Servicer: Servicer to the assets.
- ▶ Collection and Paying Agent : Banks
- ▶ Credit Enhancement provider : hedges, Guarantees, Takaful etc Need to be Explored



Parties Involved

- ▶ Merchant Banker (s) :
- ▶ Credit Rating Agency:
- ▶ Legal & Tax Counsel: a Challenging Role
- ▶ Auditors

Challenges for the Market



- ▶ Limited number of issues that constrains active trading of these instruments in the secondary market
- ▶ Buy and Hold Strategy by major investors of Sukuks
- ▶ Limited quality of assets available for Ijarah securitization
- ▶ Limited Corporate Focus – Changing



Ideal models for structuring of Sukuks

Sukuk Structure



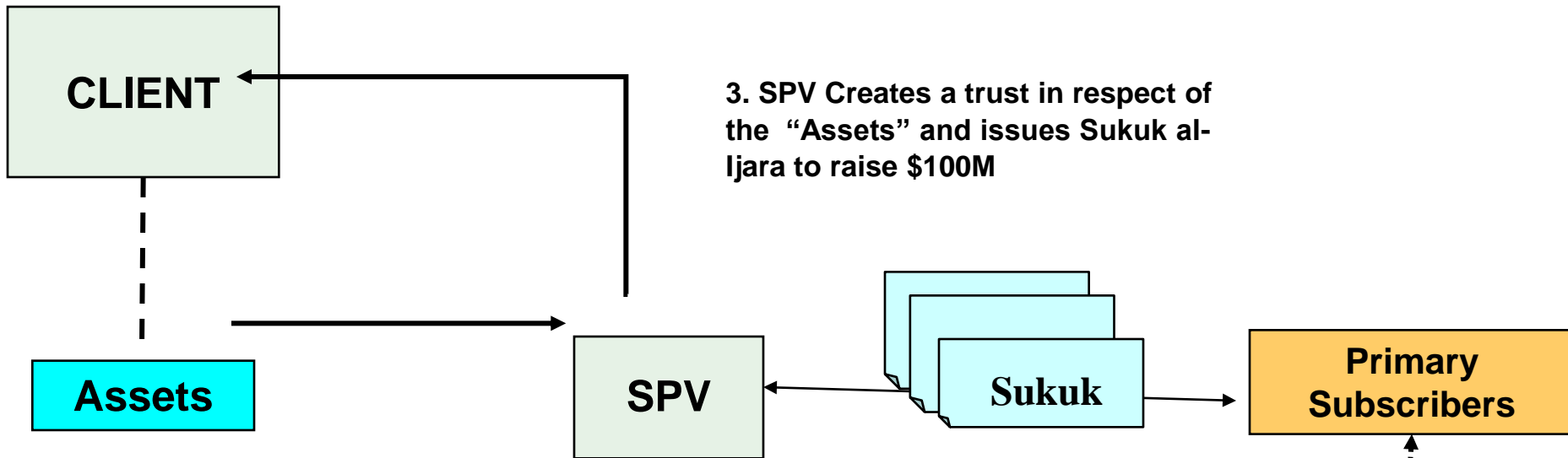
Sukuk Structuring may based on following modes

- ▶ Mudarabah (*Trust Financing/Trust Investment*)
- ▶ Murabahah (*Sale and Purchase*)
- ▶ Musharaka (*Partnership, Project Finance Participation*)
- ▶ Istishna (*Purchase by Order or to Manufacture*)
- ▶ Salam (*Upfront Payment Sale*)
- ▶ Ijarah (*Operating Lease Concept*)



Typical Sukuk Structure for Sale and Leaseback

2. SPV Leases back the Assets



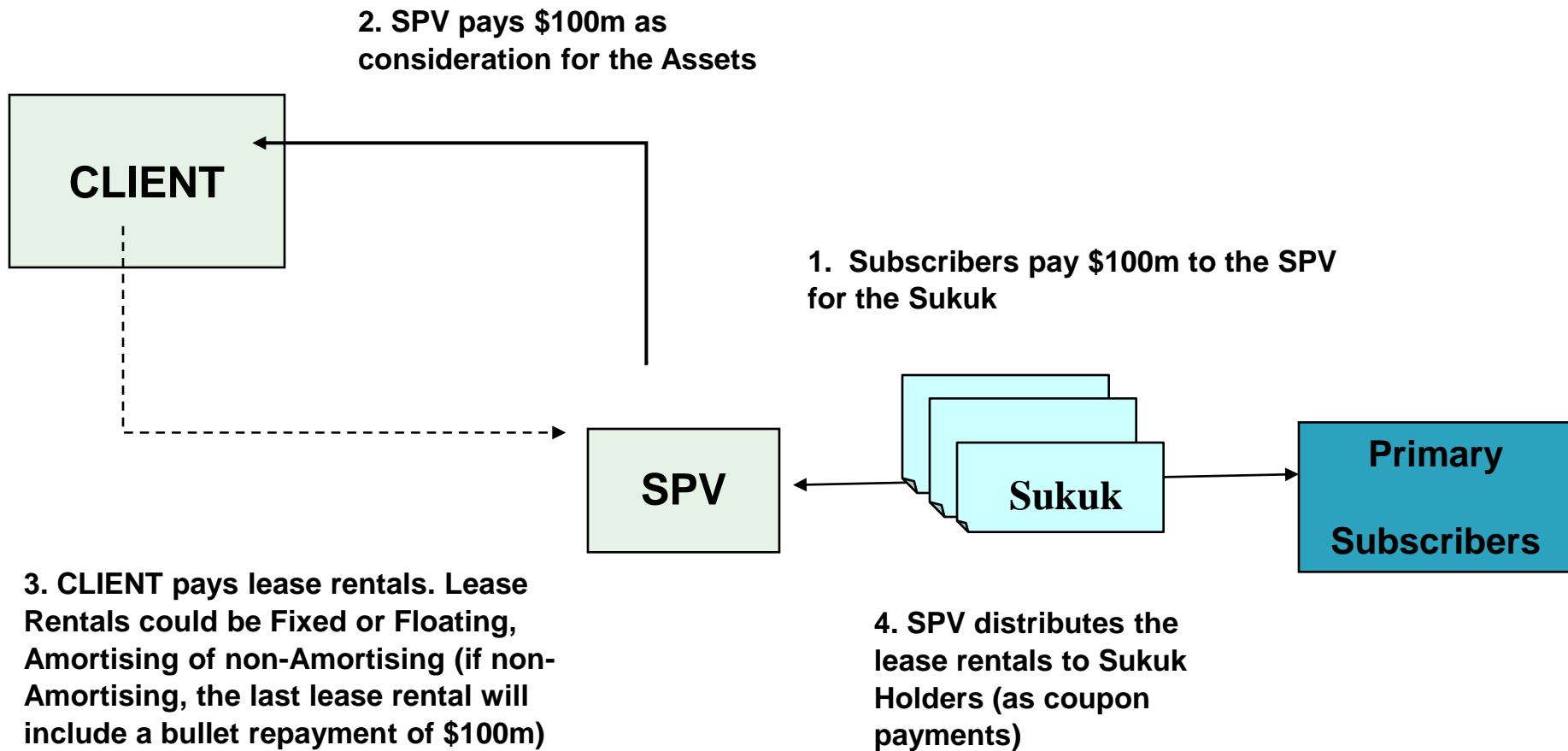
3. SPV Creates a trust in respect of the "Assets" and issues Sukuk al-Ijara to raise \$100M

1. CLIENT sells certain assets that it owns ("Assets") for \$100M. Type of Assets: Real Property, Moveable Property, Equipment, and other tangible assets.

Secondary Market



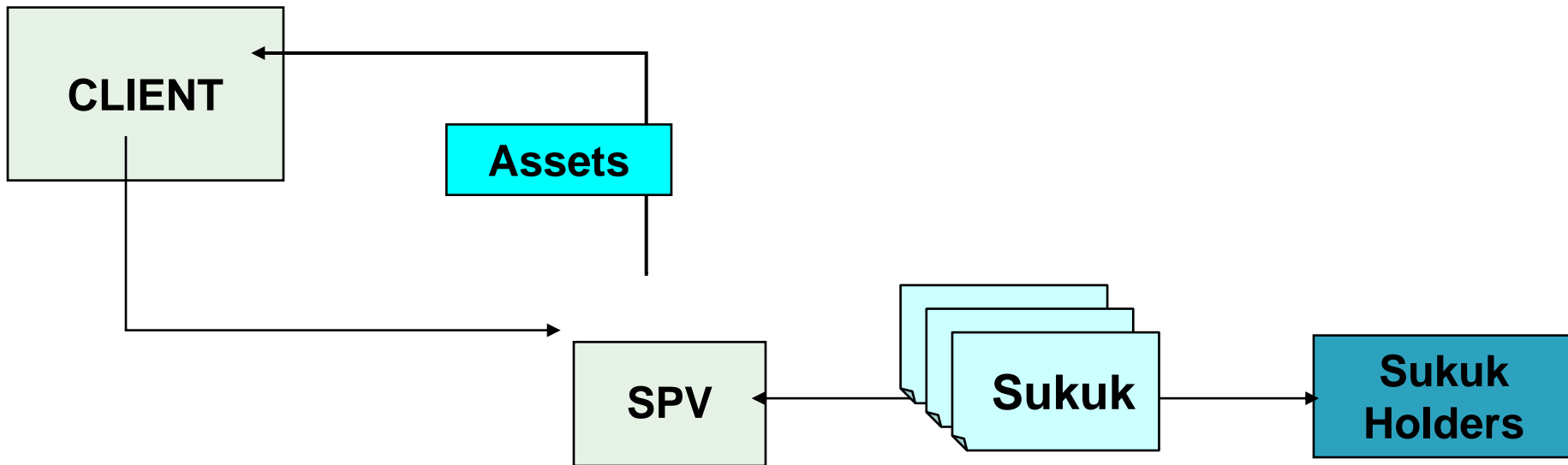
Flow of Funds - Acquisition & Rentals



Flow of Funds - Repayment & Maturity



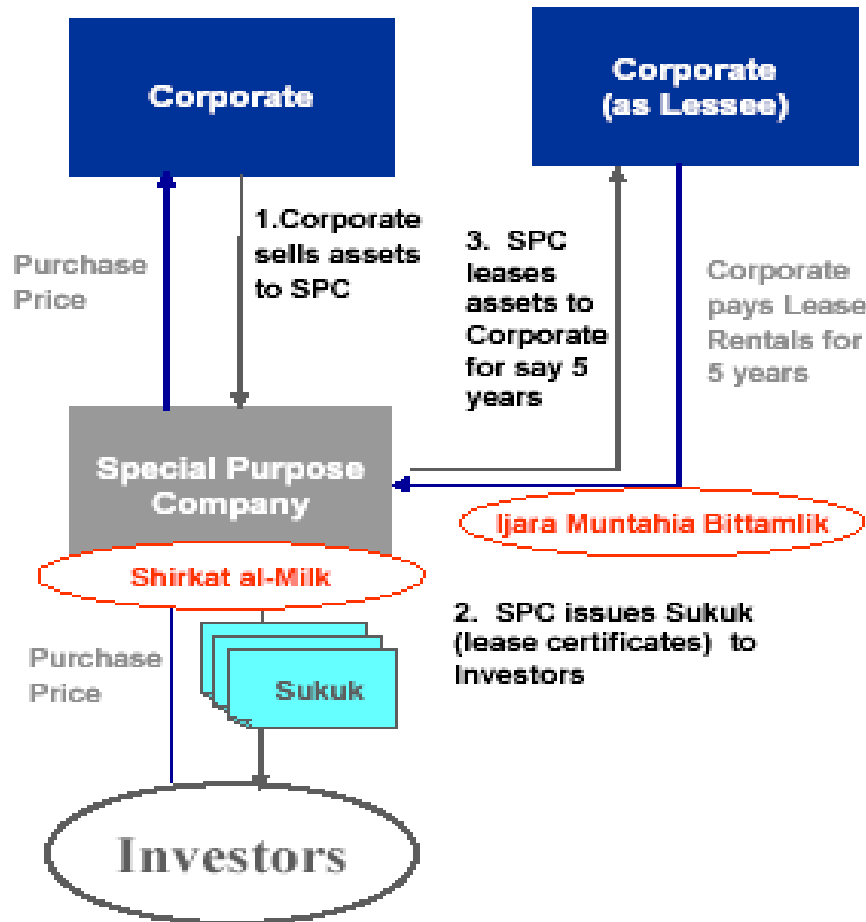
1. SPV will "Put" the Assets to CLIENT



2. CLIENT will pay a nominal amount.
Result: ownership of Assets revert back to CLIENT



Sukuk Al-Ijara based Model

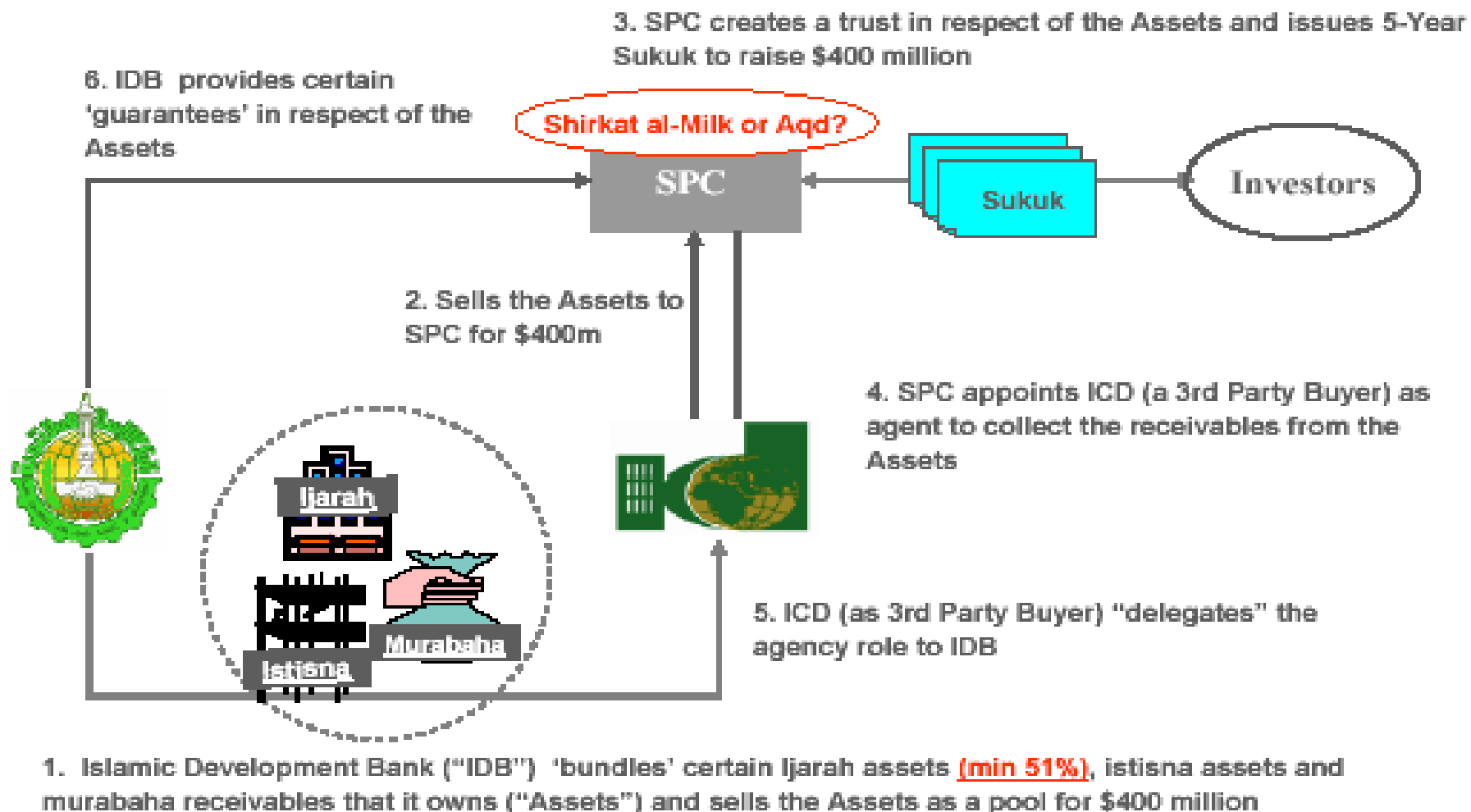


Steps:

- SPC will buy the assets from Corporate at say USD500m.
- SPC will lease the assets back to Corporate for, say, 5 years.
- Lease Rentals will be payable 6-monthly in arrears and will be benchmarked on USD Libor plus a credit spread.
- To raise USD500m, SPC will issue Sukuk at par value of USD500m.
- Investors will subscribe to the Sukuk as primary subscribers (similar to the primary subscription in a bond issue).
- SPC will collect the Lease Rentals and distribute pro rata to the Sukuk holders.
- The Sukuk can be listed, rated, cleared through Euroclear / Clearstream and traded in the secondary market.
- The Kingdom of Bahrain Sukuk issues, the Federation of Malaysia, the State of Qatar and the Republic of Pakistan Sukuk issues were structured based on this concept.

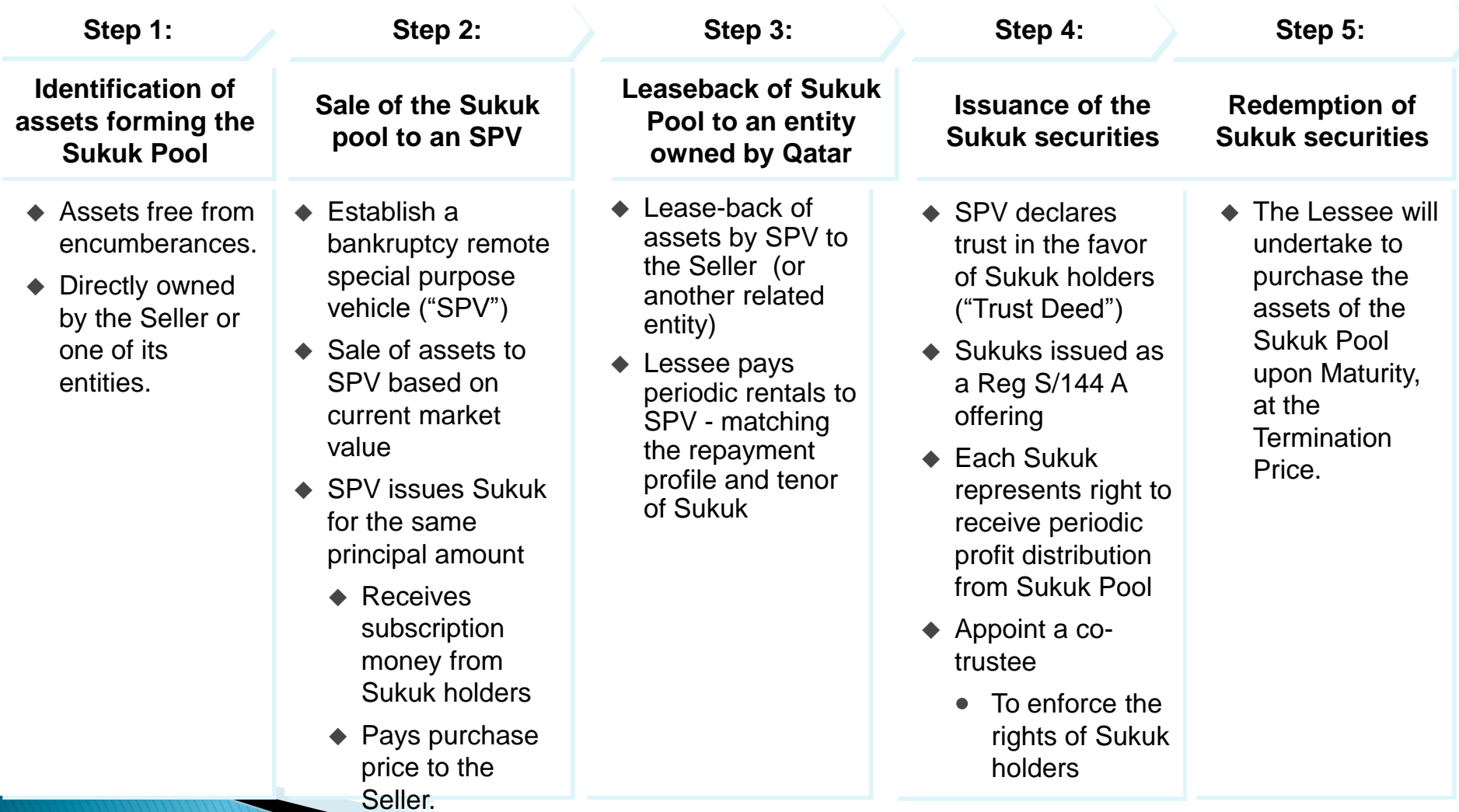


Sukuk al Istismar (51% Ijarah structuring)





Typical International Sukuk Mechanism – Step by step



CASE STUDIES



Case studies on Sukuks

- ▶ WAPDA First Sukuk Issue for Mangla Dam Raising Project – Jan 2006
- ▶ WAPDA Second Sukuk Issue – July 2007
- ▶ Motorway Sukuk – Jan 2005

WAPDA Sukuk

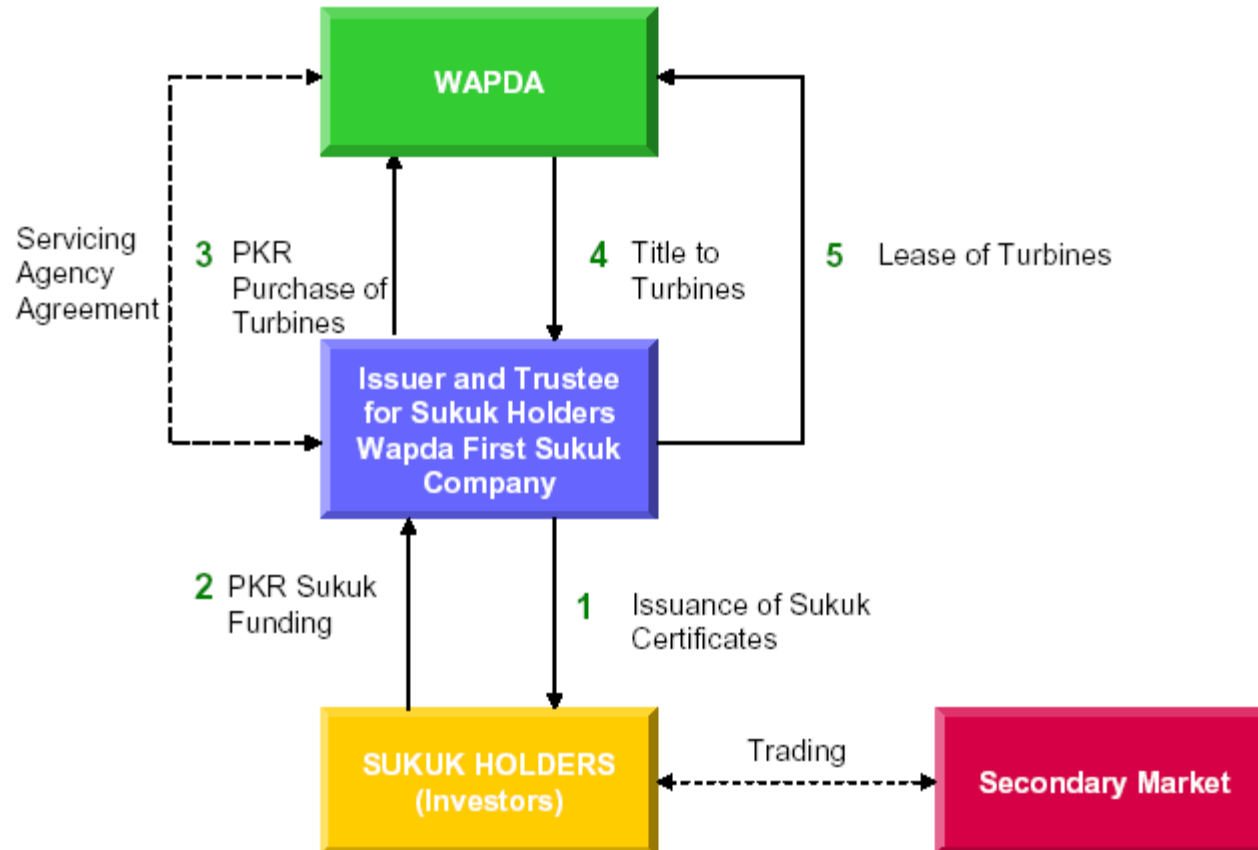


- ▶ WAPDA's financing requirement: PKR 8,000 million to (partially) fund the Mangla Dam Raising Project

Key objectives for WAPDA were:

- ▶ To raise financing in a
- ▶ cost efficient manner
- ▶ Strengthen its presence in the local financial markets
- ▶ Diversify and cultivate WAPDA's investor base
- ▶ Undertake a landmark transaction which will catalyze the promotion of Islamic Financial instruments and lead the way for other public sector entities

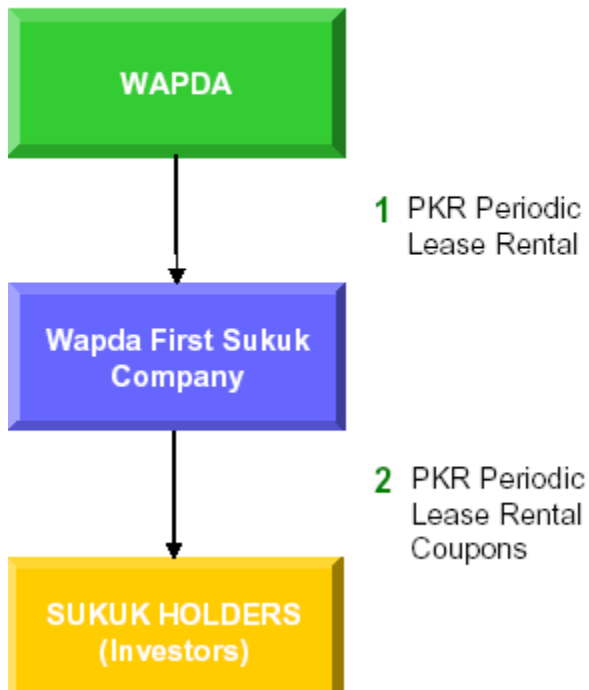
Transaction Structure



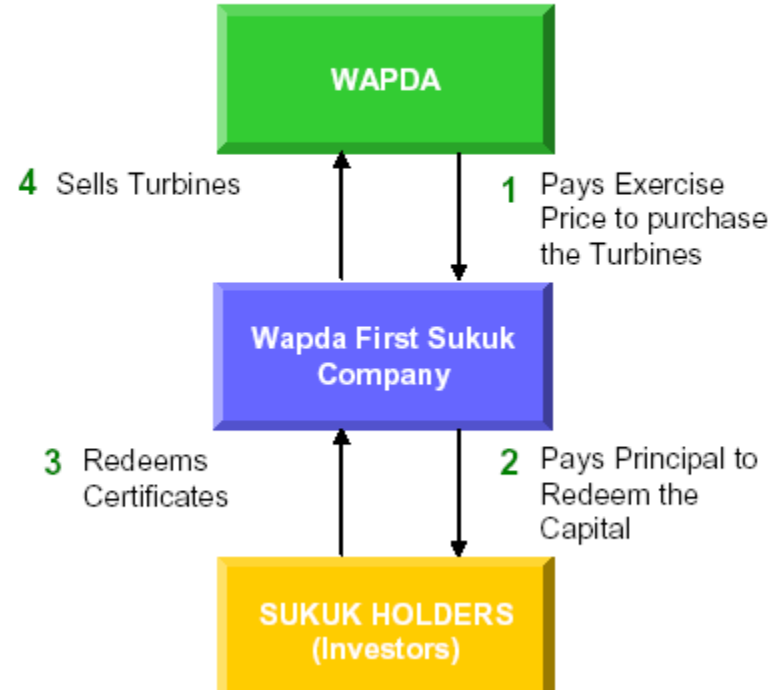
Transaction Structure



Periodic Distribution



At Maturity or Dissolution



Offering Summery



Principal Amount	PKR 8,000 mn
Periodic Distribution	6 month KIBOR + 35 bps
Tenor	7 years
Issuance Format	Privately Placed LCY Floating Rate Notes
Structure	Trust Certificates (Sukuk)
Issuer	WAPDA First Sukuk Company Limited
Lessee	WAPDA
Underlying Assets	WAPDA's 10 Mangla Dam Hydel Power Generation Units
Governing Law	Islamic Republic of Pakistan
Structuring Advisor	Citi Islamic Investment Bank E.C.

Motorway Sukuk

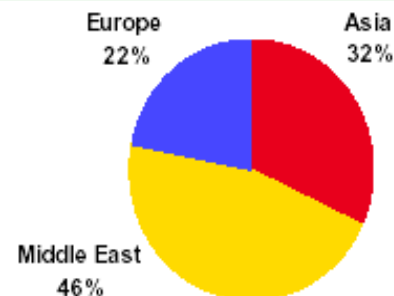


Offering Summary

Principal Amount	US\$600mn
Ratings (S&P)	B+
Maturity Date	January 27, 2010
Periodic Distribution	6 month Libor + 220 bps
Pricing Date	January 18, 2005
Settle Date	January 27, 2005
1st Coupon Date	27 July, 2005
Issuance Format	Reg S only
Structure	Trust Certificates (Sukuk)
Issuer	Pakistan International Sukuk Company
Lessee	President of the Islamic Republic of Pakistan
Underlying Assets	Highway Land (Motorway)
Joint Lead Managers/ Bookrunners	Citigroup, HSBC

Distribution

Geographical



Type





Sukuks – Islamic alternative to Bonds

▶ Thanks for the Patience

▶ Any Questions ???

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