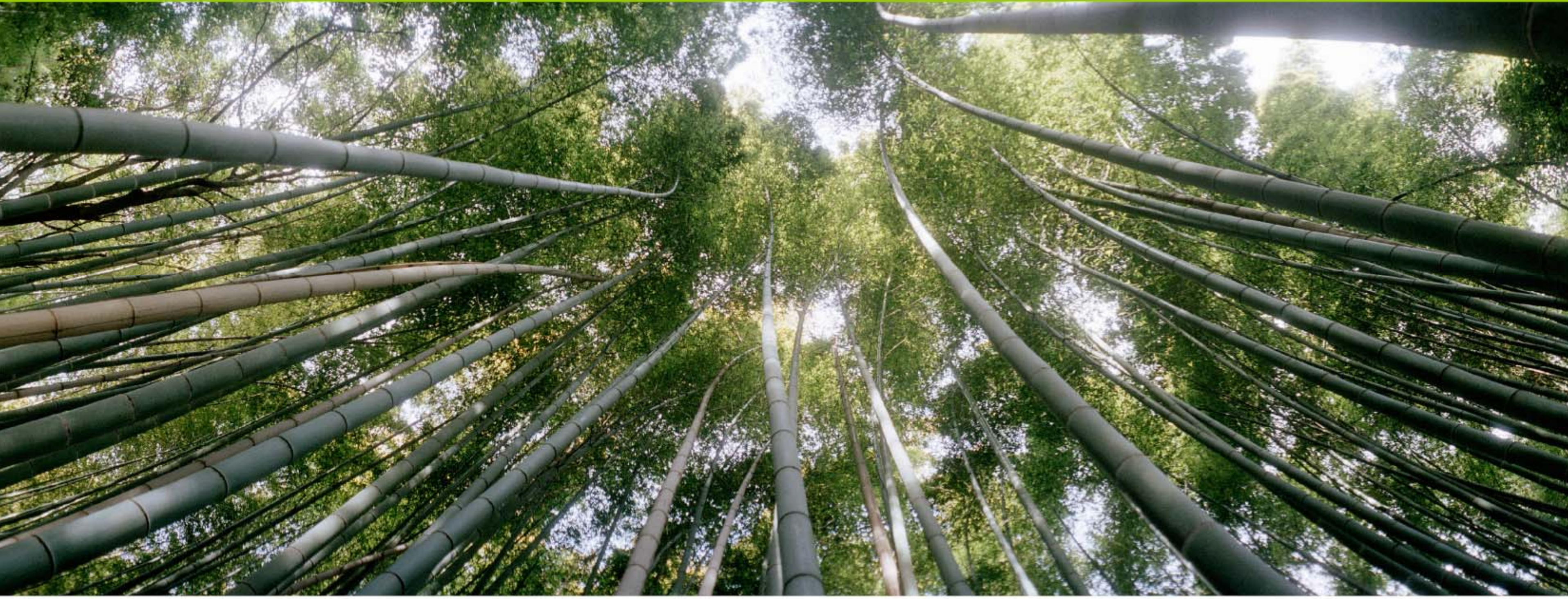

Walid Sarieddine
Head of Islamic Finance

IFN Europe – May 29, 2013 - London

Europe, Middle East & Africa

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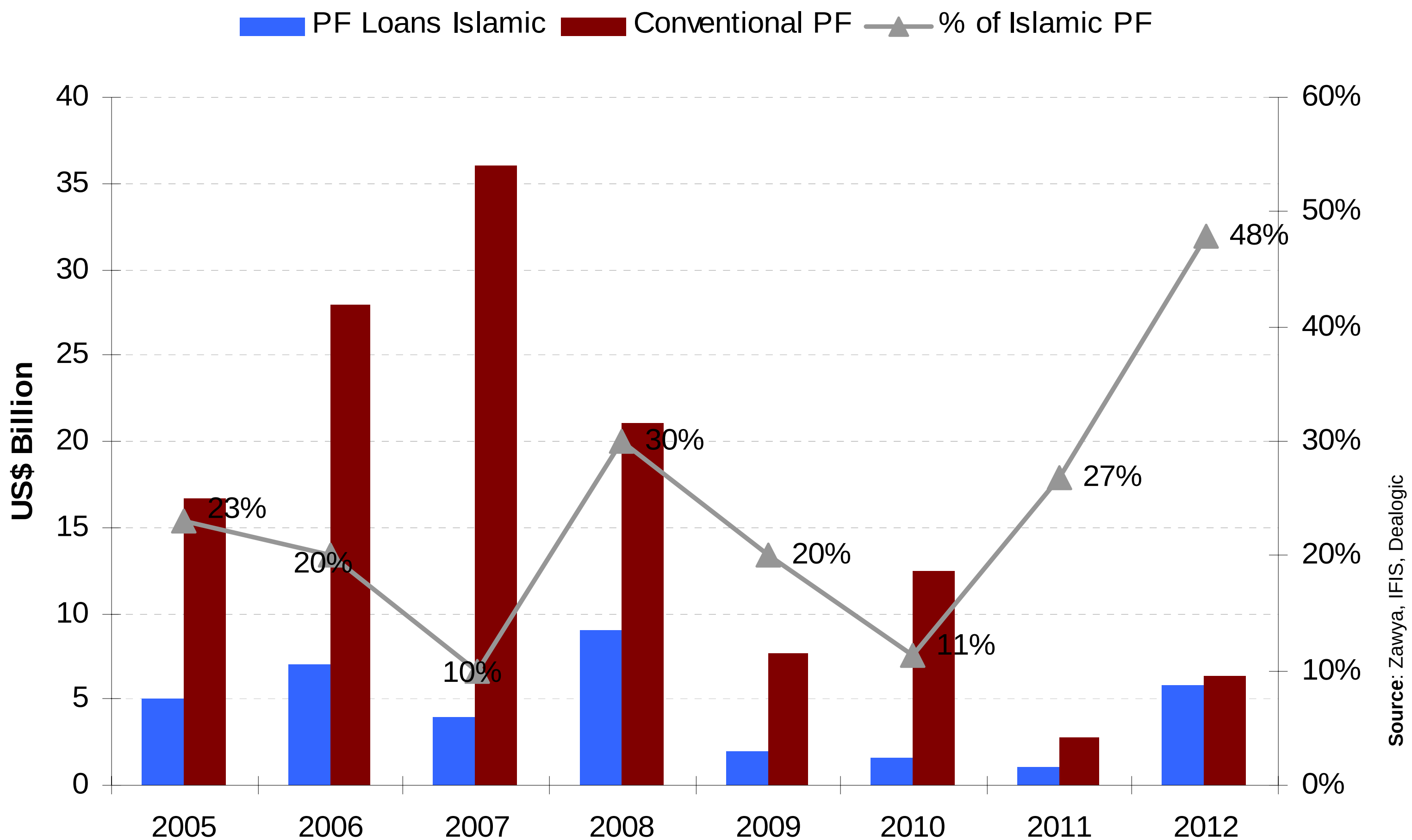
GCC Islamic Project Finance - Volumes



The reliance on Islamic tranches in PF has become a typical feature in many of the GCC countries and especially in Saudi Arabia. This was the case for the SATORP project (Islamic loan tranche + sukuk) as well as the all-Islamic financing of Madina Airport. This trend is set to strengthen with upcoming projects Rabigh2 and Sadara

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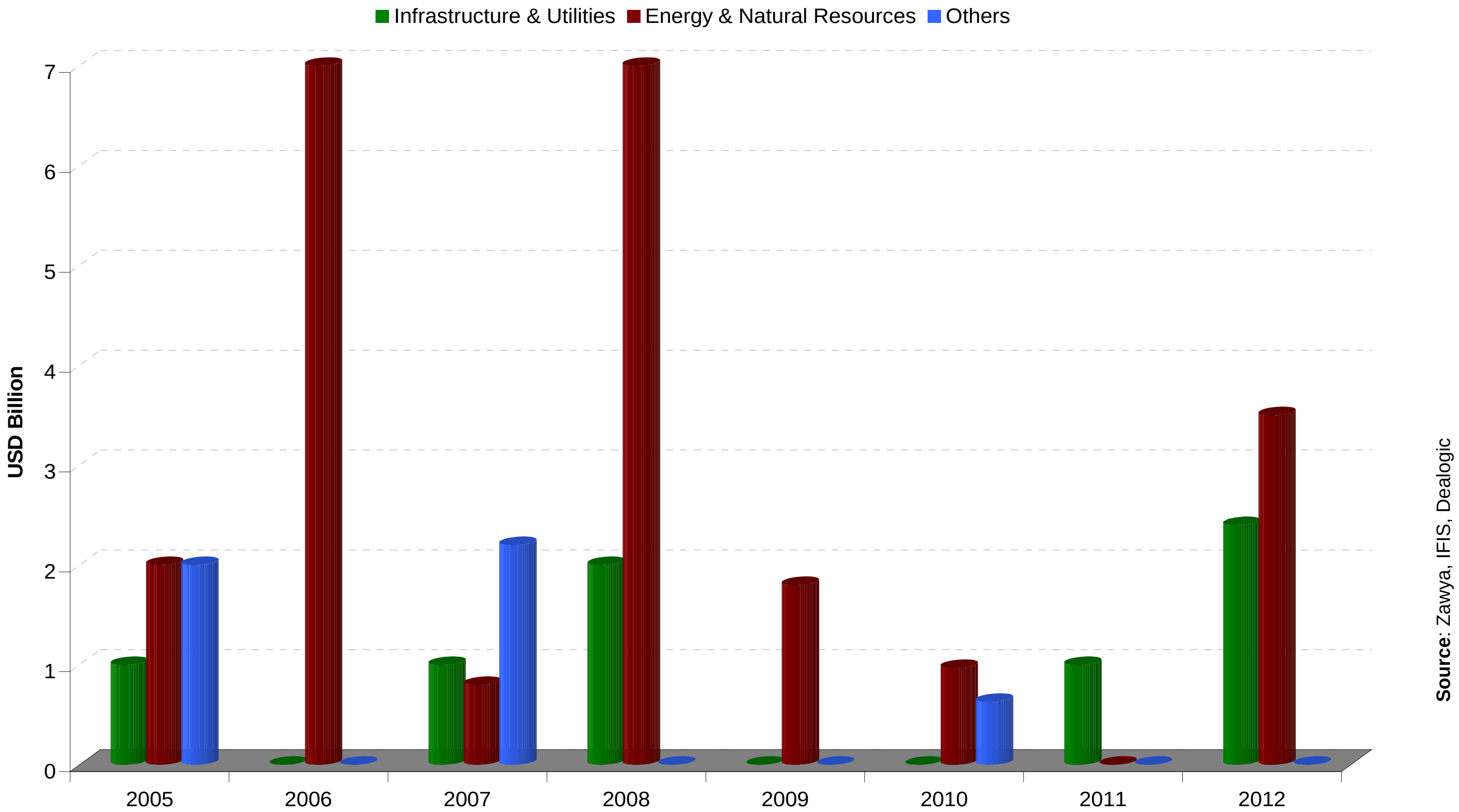
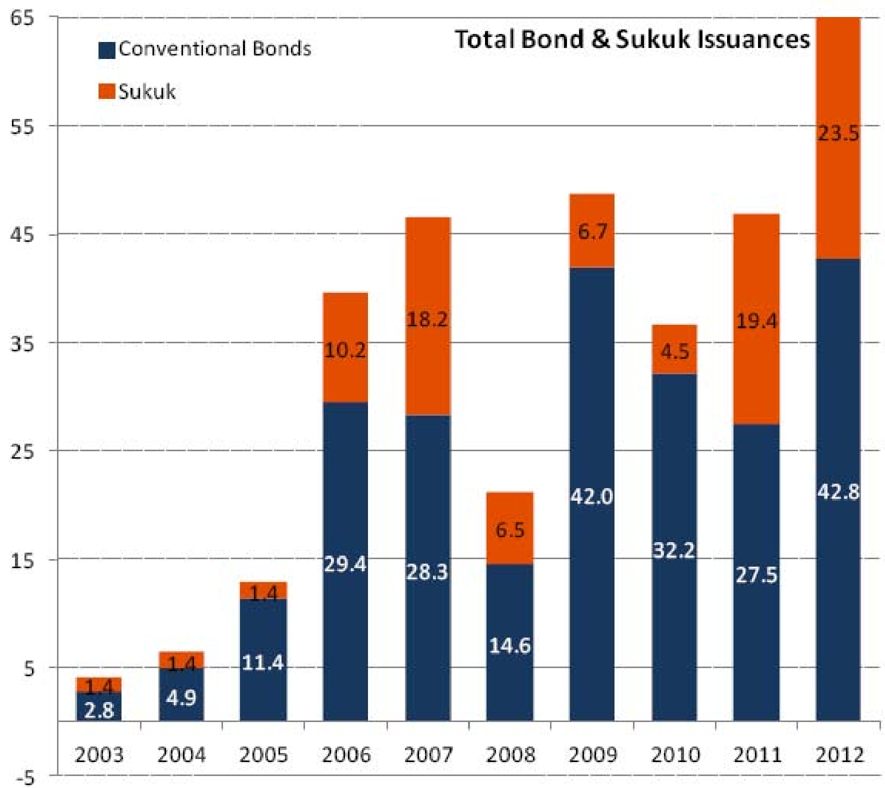
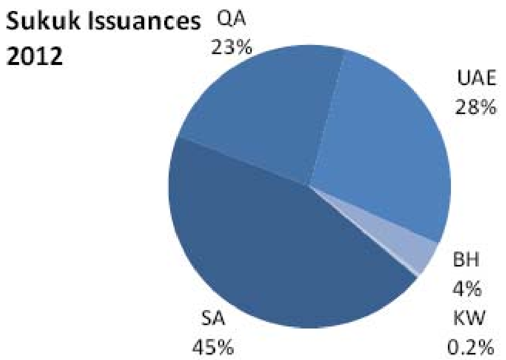
GCC Islamic Project Finance - SEctors

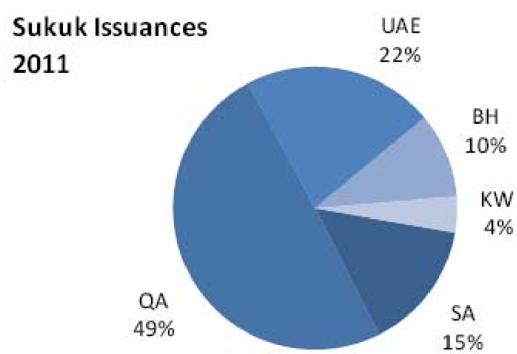


Historically, energy and natural resources projects benefitted from Islamic liquidity. Going forward, as more PPPs are brought to the market, Infrastructure projects will also attract Islamic financing as was the case with Madina Airport financing.

GCC Debt Capital Markets - Volumes







Source: Bloomberg, Zawya, GIC Research (as on 31 Dec 2012)

*Includes issuances by various GCC Central Banks in the domestic market

Sukuk issuance has regained a strong momentum in 2011-2012. Starting 2011, we saw its relevance to the project finance sector with SATORP sukuk. Last month, Aramco-sponsored sukuk returned with the $1.5bn Sadara (in SAR) sukuk.

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Selected Large Deals in the Last 18 Months

- ***Prince Mohamed B. Abdul Aziz International Airport (Madina Airport) – July 2012***

  >>U$ 1.2bn (mostly SAR) (Senior + EBL) / 18 year (Senior) / Istisna'a and Management

- ***SADARA Sukuk (Saudi Aramco / Dow Petrochemical Plant in Yanbu, KSA) – February 2012***

  >>US 1.5bn (all equiv. in SAR) / 16 year * / Musharaka Framework (into a Procurement/Ijara)

- ***MARAFIQ (Power and Water Plant in Jubail and Yanbu, KSA) – December 2012***

  >>US 1.2bn (all equiv. in SAR) / 15 year / Murabaha

- ***Etihad Airways (Aircraft Asset Finance of 2 new B 777's) – March 2013***

  >>US 360mil / 12 yr / Ijara

- ***Brunei Gas Carriers (Ship Asset Finance of 1 + 1 LNG tanker) – July - December 2012***

  >>US170-188mil / 12yr – 15.5yr/ Ijara - Ijara

- ***Barzan LNG (Gas Plant in Qatar) – December 2011***

  >>US 850mil Islamic tranche / 16yr / Istisna'a wa Ijara

What do We Note…

- Islamic Project Finance has now established itself as an essential component of the debt mix available (and sought) for large infrastructure and energy projects in the region
- The size of the Islamic tranche is increasing in size and has a growing number of financial institutions participating in it
- Recent emergence of all-Islamic project financing for some large projects (Madina Airport where SMBCE acted as Financial Advisor to the selected bidder)
- Sharia structures, not standardised, yet exhibiting a fair degree of consistency especially for the Istisna'a/Ijara model (and to an extent the Wakala/Ijara model)
- Consensus around structures underpinned by intangible assets yet to be reached
- Limited, yet persistent use of Murabaha structures
- Emergence (esp. in KSA) of project sukuk

Dynamics of Islamic Finance vs. Project Finance

Main Islamic Project Finance Banks in the GCC

Kuwait • KFH	**Saudi Arabia (*)** • Al Rajhi • Al Inma • NCB • ***IDB***
Qatar • QIB • Masraf Rayan • Barwa	**UAE** • ADIB • Al Hilal • Noor • DIB

(*) Note that other large Saudi banks like SAMBA, Riyad, SABB and Saudi Fransi are increasingly focused on Islamic PF

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Islamic Project Finance Structures

- Around 10 years ago, the "international Islamic tranche" started to appear in some PF transactions (Shuaibah, Taweelah, Dolphin*,..)
- Today the "Islamic Tranche" is much better understood and documented compared to four years ago
- Hybrid conventional/Islamic structures have allowed smooth "co-habitation with no adverse impacts on Sharia compliance
- Human resources to allow seamless documentation and agency management are better specialised and highly active
- PF structures are mainly based on Istisna'a and Ijara (or sometimes Wakala Mawsoufah bi Ijara) and therefore do not in general pose any specific Sharia compliance complication
- Further work is taking place to allow "carve out's" off existing security assets used on existing debt (typically conventional debt)

(*) Dolphin 2005 was indeed a long term bridge and not strictly PF debt

Focus on Local Markets

- Increasing reliance on the local/regional portion to be raised in order to meet the overall funding requirements (….in some cases, from minority to majority) esp. in KSA and Abu Dhabi.
- Today, most GCC banking markets (ex- Oman) is roughly 20-25% Islamic (based on a variety of measures). In KSA, total of Islamic banking assets is approx. 45% of total banking assets (*)
- GCC "Conventional" banks are clearly less sensitive to Sharia compliance and have been booking Sharia-compliant debt for years. Also, most of them have started their Islamic windows (with varying degrees of "autonomy")
- Most GCC governments have taken a number of steps to actively encourage the promotion and usage of Sharia-compliance financing
- IFI's are encouraged to be more active in PF to support local projects especially following the limited expected contribution from foreign banks into these projects ("National Effort")

……..In the GCC, Islamic financing can be viewed as the Common Denominator around which debt raising may be optimised

(*) Source – Mc Kinsey Report on Islamic banks 2011

The Considerations of Islamic Banks

- In principle, Islamic banks do not have "toxic assets" and should have a relatively lesser problem with liquidity
- A number of Islamic banks are new in the market and have not yet built up large books yet
- Most, if not all Islamic Banks are seeking higher quality assets and are conscious of the need to enhance asset diversification
- Many project finance assets have a strong link to governments in terms of debt service dependence (esp. PPP and PPP-like projects)
- PF transactions do in general present banks with a higher credit quality
- Depending on local central banks' regulations and on Basle III applicability, PF-related assets may benefit from more favourable capital treatment
- The further development of PF sukuk may encourage more Islamic banks to participate in Project Finance especially those who have limited tenor tolerance

The KASE of KSA

- One important pillar of liquidity is clearly the solid and well-managed Saudi Banks' market
- Large PF transactions never really slowed down in KSA as liquidity has been present – prices reflected global and regional credit and economic prevailing conditions
- The Kingdom provides an almost perfect illustration of how Islamic Banking may be turning into the ***Local Bank Common Denominator*** as "conventional" Saudi banks use Sharia compliance as a condition to their participation in PF transactions (and consequently their contribution of $200, $300 or $500mil tickets!)
- Saudi market also characterised by relatively deeper swap markets for SAR – banks have a strong preference for SAR lending and do selective USD loans
- Saudi banks focused on national market (SAMA approvals for external investment) but some players (SAMBA, NCB, Rajhi) are interested in other GCC markets and in Turkey
- Large national "champions" like Aramco, SABIC , SEC. STC have a clear preference for Islamic finance and are specifically interested in promoting the Tadawul sukuk exchange
- Saudi banks have well-established and experienced PF teams

The Horizon for Islamic Finance in PF

Islamic Finance seems to be surely taking steps towards further involvement in the Project Finance sector. Over the short/mid-term, the following features will play an important role in determining the shape of this involvement:

Traction

PF market looking forward for the leading IFI's to "anchor" Islamic tranches and thus usher in further participation. On the long run, the current model of the Saudi market is expected to influence other GCC markets

Standardised Sharia Structures

Albeit difficult to foresee a Malaysian model where all Islamic banking structures are centrally reviewed/approved, the GCC markets have started to establish two main models largely applicable to all jurisdictions and largely adopted by majority of lenders. The more challenging structuring requirement is probably related to PPP schemes were underlying assets are intangible in nature.

Sukuk

Project sukuk have appeared in Saudi Arabia and are actively supported by Saudi Aramco. The market expects a real opportunity to be available for sukuk refinancing of bank project debt on projects who have completed and accumulated a few years of normalised operations. Given the often prominent role of government or quasi-government in debt service of these projects, DCM refinancing instruments (like sukuk) will represent to many investors a paper that approximates sovereign risk in countries where sovereign issuance is limited

Official Stance

As further reliance shifts on official and/or supranational roles in PF (further encouraged by national PPP initiatives), we may see an explicit further encouragement of Islamic structures in PF

… Takaful

Will the growth in Takaful markets (including widening of products to cover large projects) create a critical mass of Takaful premium regular flows targeting high quality fixed income Sharia-compliant instruments (PF-related sukuk)?...

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