



PROSPECTS & OPPORTUNITY IN ISLAMIC CAPITAL MARKETS

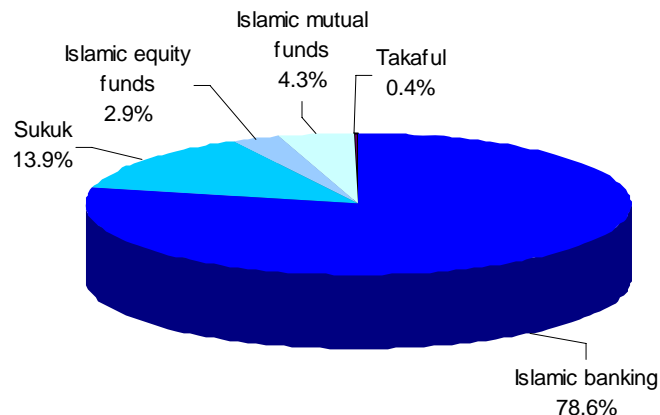
Baljeet Kaur Grewal
Group Chief Economist/ Head, Global Research
30th April 2008

ISLAMIC FINANCE: A GLOBAL VIEW

Global Deployment of Islamic Products



Breakdown of Shariah-Compliant Assets Worldwide (2007)



- Shariah-compliant assets worldwide estimated at USD700 billion in 2007 vs. USD150bln in the mid-1990s, with annual growth rate of **23.5%** over the past 5 years
- There is approx. **USD1.5 trillion of GCC funds** held in investment assets worldwide. Of this USD1.5 trillion, USD250 billion constitutes of High Net Worth Individual
- The potential is huge. By 2020, there will be 2.5 billion of Muslim population worldwide from the current 1.5 billion level
- Islamic banks are expected to manage 40%-50% of total savings of Muslim population in 8 to 10 years. Potential for Islamic financial services is estimated at **USD4 trillion by 2020**

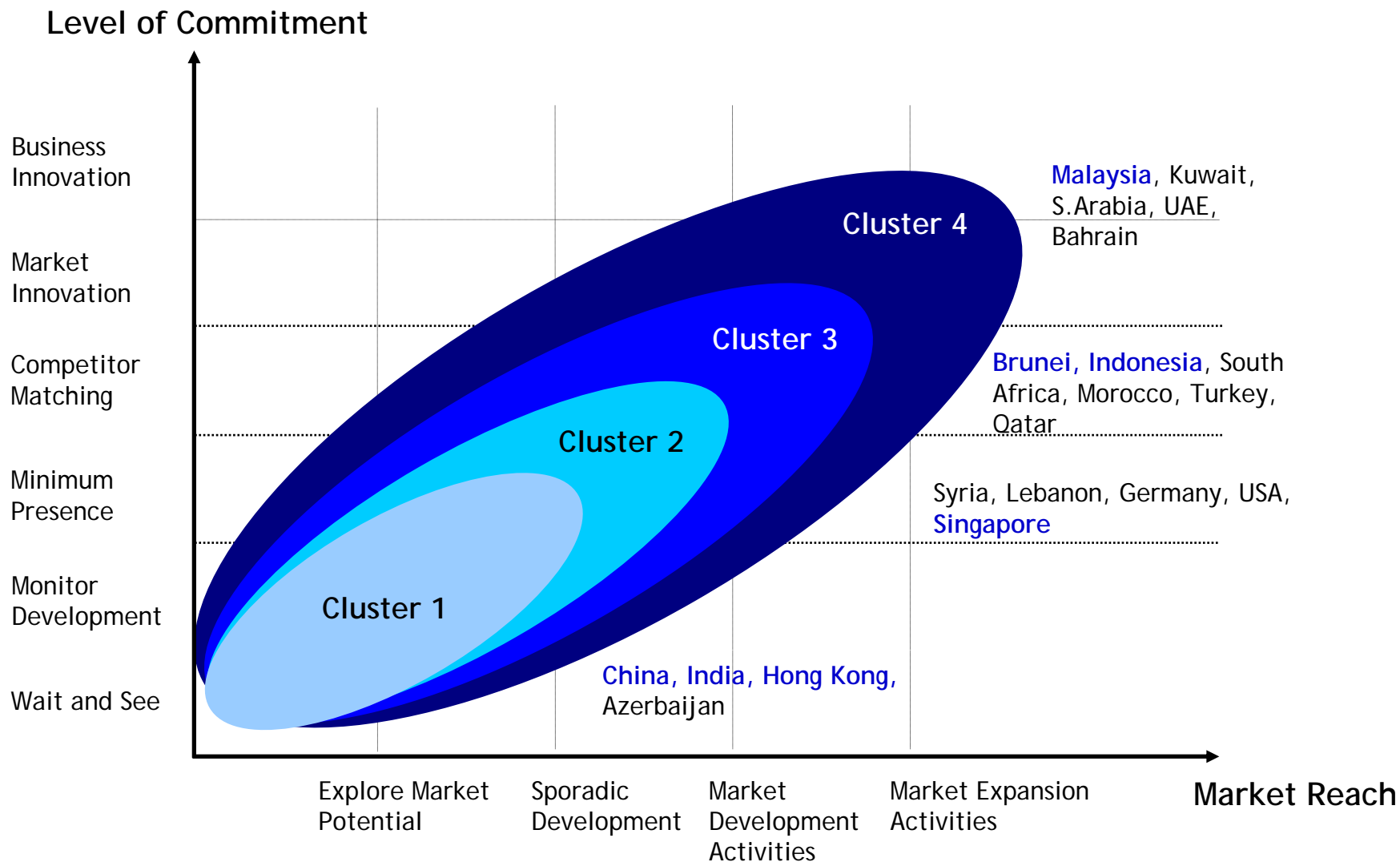


INCREASING DEPTH & BREADTH OF ISLAMIC FINANCE

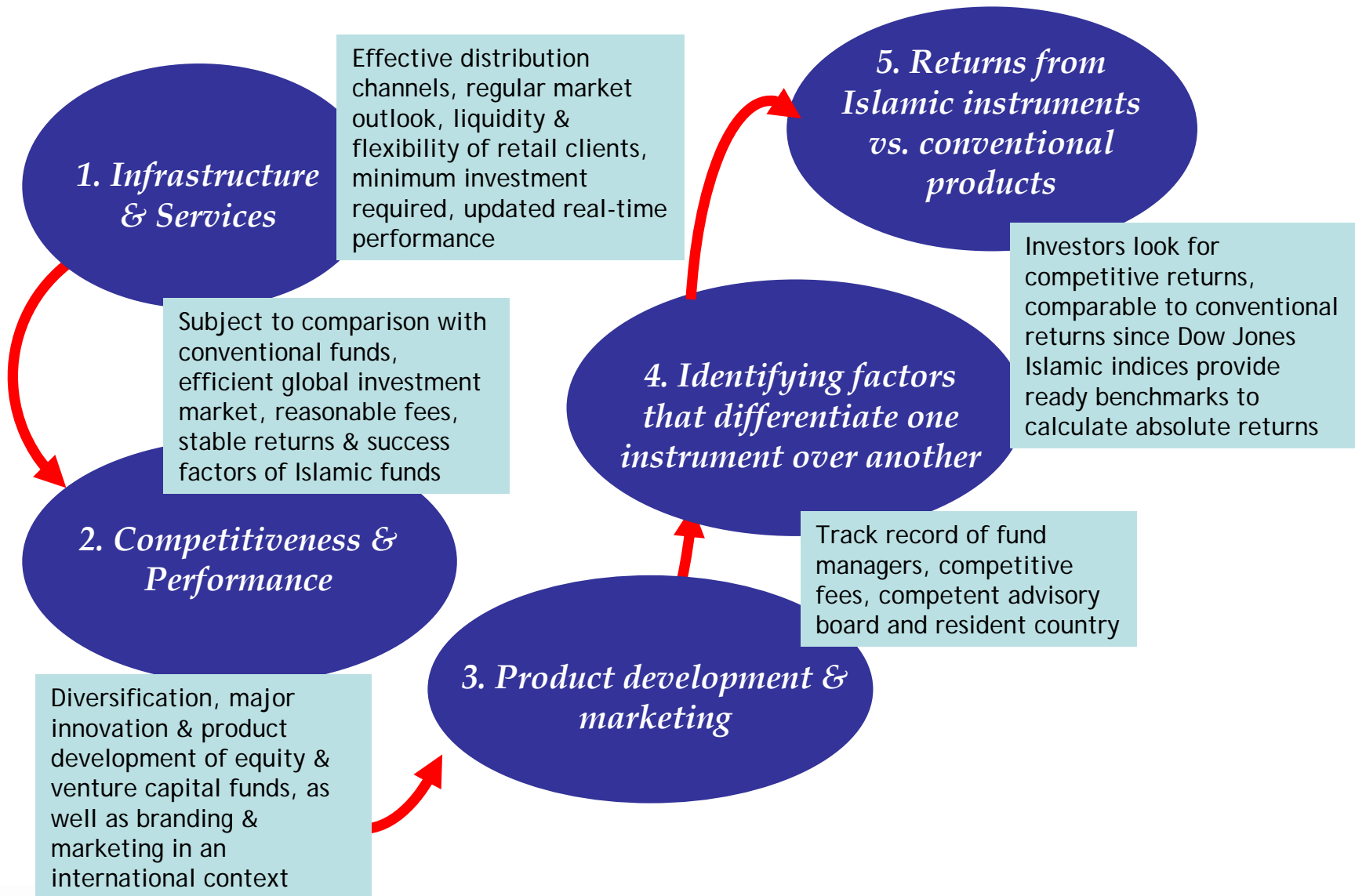
	Institutions	Products	Area
2000s	<ul style="list-style-type: none"> • Commercial Islamic banks • Takaful • Islamic investment companies • Islamic investment banks • Asset management companies • E-commerce • Brokers/ Dealers 	<ul style="list-style-type: none"> • Commercial Islamic banking products • Takaful • Islamic Wealth Management (Mutual Funds/Unit Trust/BankaTakaful) • Sukuk • Shariah-compliant stocks • Islamic stock broking • Islamic Hedging 	<ul style="list-style-type: none"> • Gulf/ Middle East • Asia Pacific • Europe/ Americas • Global Offshore Market
1990s	<ul style="list-style-type: none"> • Commercial Islamic banks • Takaful • Islamic investment companies • Brokers/ Dealers 	<ul style="list-style-type: none"> • Commercial Islamic banking products • Takaful • Mutual Funds/ Unit Trust • Islamic bonds • Shariah-compliant stocks • Islamic stockbroking 	<ul style="list-style-type: none"> • Gulf/ Middle East • Asia Pacific
1980s	<ul style="list-style-type: none"> • Commercial Islamic banks • Takaful • Islamic investment companies 	<ul style="list-style-type: none"> • Commercial Islamic banking products • Takaful 	<ul style="list-style-type: none"> • Gulf/ Middle East • Asia Pacific
1970s	<ul style="list-style-type: none"> • Commercial Islamic banks 	<ul style="list-style-type: none"> • Commercial Islamic banking products 	<ul style="list-style-type: none"> • Gulf/ Middle East



GROWING RELEVANCE OF ISLAMIC FINANCE



WHAT DO INVESTORS LOOK FOR IN ISLAMIC INSTRUMENTS?

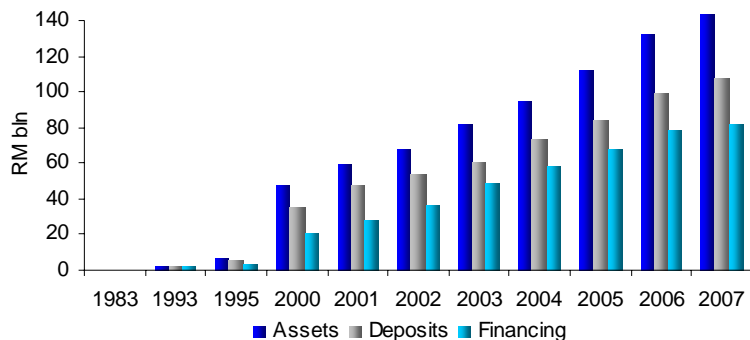


ISLAMIC BANKING ASSETS WORLDWIDE

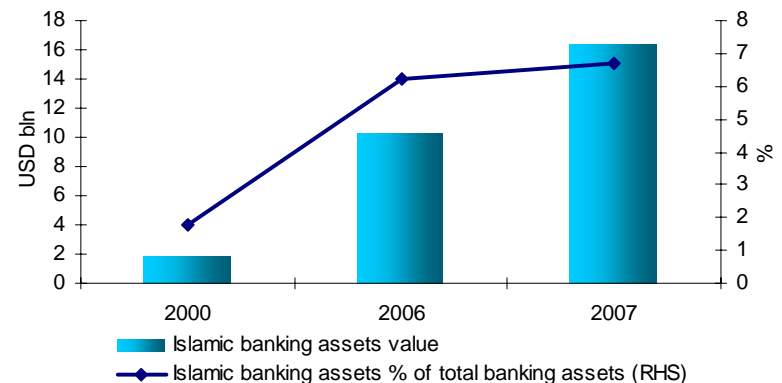
Factors fuelling the growth of Islamic banking worldwide:

- **Growing demand for Shariah compliant products.** Research shows in the GCC and parts of Asia, it is estimated that 20% of banking customers spontaneously choose an Islamic financial product over a conventional one with a similar risk-return profile
- **Abundant liquidity.** The market for Islamic finance products is projected to grow 10 times over the coming years, and it is likely to be closely related to the liquidity of oil producing nations
- **Encouraging demographics.** GCC countries and markets in SEA are home to a relatively young population, forming a strong demand base for Islamic financial products
- **Government & regulatory push for Islamic financial model.** Supportive authorities help foster favourable views of Islamic finance
- **Flexibility of Islamic finance system.** Various Islamic financing instruments vs. conventional interest rates basis
- **Product development.** Newly created Shariah compliant instruments will rival product offerings at conventional banks

Malaysia's Islamic Banking Assets (2007)

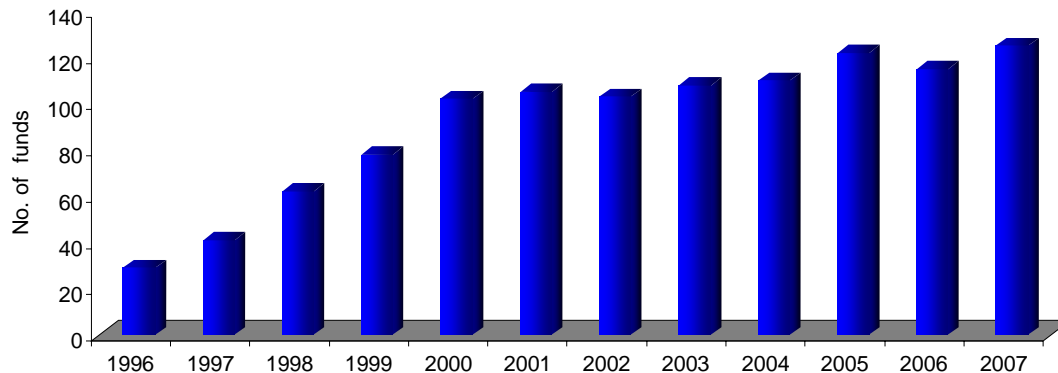


Bahrain's Islamic Banking Assets (2007)

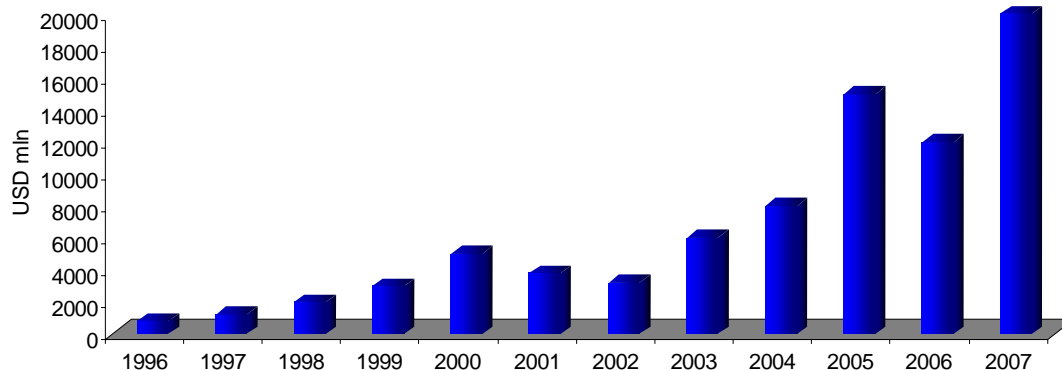


GROWING SIZE OF ISLAMIC EQUITY FUNDS

Number of Global Islamic Equity Funds (1996-2007)



Total Value of Global Islamic Equity Funds (1996-2007)



- Islamic equity funds market is one of the fastest growing sectors within the Islamic financial industry
- Prior to 1995, there were approximately 10 equity funds on the market. Since 1996, the number of equity funds has doubled every year to over 120 funds as of today, estimated at USD14.5 billion and is growing by 12%-15% per annum
- Much of the money flowing into equity funds has come from founding institutions or high profile investors
- Global distribution of mutual funds: Equity (84%), Balanced (14%) and Bonds (2%)
- Total value of Islamic equity funds estimated at **USD20bln in 2007**



WHAT IS A SUKUK?

- ✓ Sukuk is the Arabic name of a financial certificate
- ✓ In general, Sukuks are similar to bonds, but with an underlying asset and in accordance with Shariah principles
- ✓ Shariah requires that financing should only be raised for trading in, or construction of, specific identifiable assets
- ✓ Therefore, Sukuk represents an undivided and proportionate ownership in the underlying assets
- ✓ Sukuk holders are entitled to a share in the revenues generated by the sukuk assets as well as being entitled to share in the proceeds of realisation of the Sukuk assets

Similarities & Differences of Conventional Bonds & Sukuks

Conventional Bonds	Islamic Bonds/ Sukuks
1. Debt-based	1. Asset-based
2. Conventional investor	2. Islamic + Conventional investor
3. Maturity	3. Maturity
4. Pricing	4. Lower pricing given wider investor base
5. Coupons/ interest payments	5. Profit/loss-sharing at a pre-determined rate
6. Issuers	6. Issuers



INCREASING POPULARITY OF SUKUKS FOR LONG-TERM PROJECT FINANCING

Wide Array of Islamic Concept

Various structures available to cater different needs of financing :-

Istisna, Ijarah, Musharakah, Mudarabah, Murabaha

Cheaper Cost of Financing

Fine pricing achievable due high demand on Syariah-compliant and ethical investment instruments and also larger pool of investors (incl. Islamic investors)

Alternative Mode of Financing

Alternative source of financing especially for long term and riba-free financing

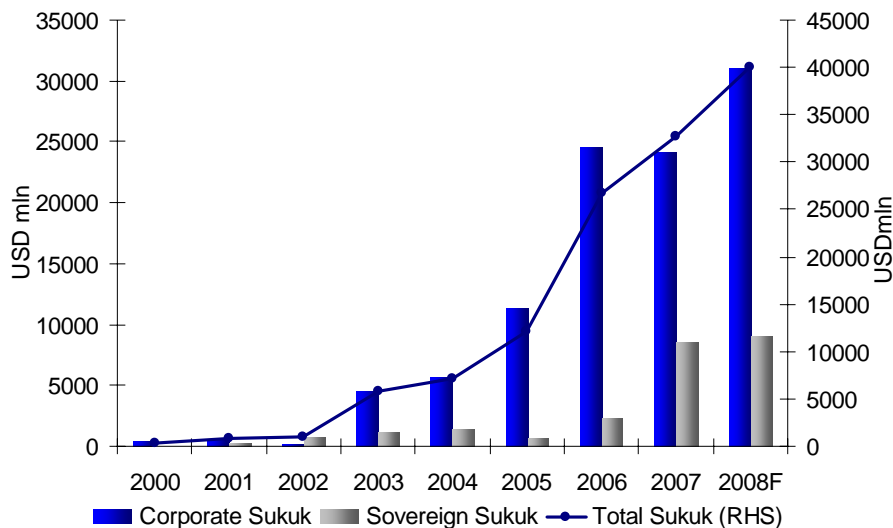
Financing via Asset Securitisation

Sukuk provides mechanism for financing through mobilization of Islamic dormant asset, thus enhancing value & maxising returns

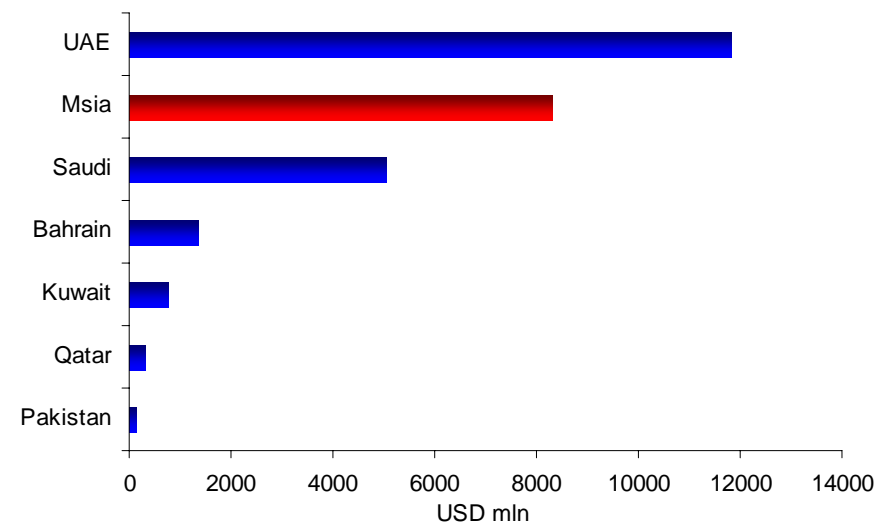


GLOBAL SUKUK MARKET

Global Sukuk Issuance Trend (2000-2008F)



Sukuk Issuance (2007)



- Global Sukuk Issuance Trend - 2004 : US\$7.2 billion, 2005 : US\$12.1 billion, 2006 US\$26.8bil, **2007: USD32.65bln, 2008F: USD40bln-USD45bln, 2009F: USD45bln-USD50bln**
- 2007 Sukuk issuances were dominated by the UAE 43%, Malaysia 30%, Saudi Arabia 18%, Bahrain 5.0% and Kuwait 3.0%
- To-date, 2008 announced Sukuk pipeline estimated at USD34.5bln
- Global Sukuk outstanding is expected to reach USD200bln by 2010 from current USD97.3bln, an annual growth rate of 35%
- Islamic bond market is becoming more global, attracting non-Muslim issuers. The overall market for Islamic banking and finance stood at USD700bln in 2007, and growing at 23.5% annually over the past 5 years

EXPANSION OF THE SUKUK MARKET

- The international Sukuk market began in 2002 with a USD600 million issuance by the Government of Malaysia - it has grown rapidly since
- Recent trends in the Middle East have encouraged development of the Sukuk market:
 - ✓ Corporate expansion, both organic and M&A related
 - ✓ Increase in international investment
 - ✓ Perceived reduction in geopolitical risk for the GCC region
 - ✓ Economic diversification away from hydrocarbon
- As the product has gained visibility, demand for Sukuk assets has increased, leading to significant oversubscription of transactions:
 - ✓ Estimated USD250-300 billion of Islamic funds available for investment
 - ✓ Conventional funds now form the bulk of benchmark size sukuk investors
- Traditionally, Sukuk issuance has been dominated by corporates, however, today major Islamic banks and non-Islamic/non-Mid East players are also using Islamic finance structures

Selected Global Sukuks

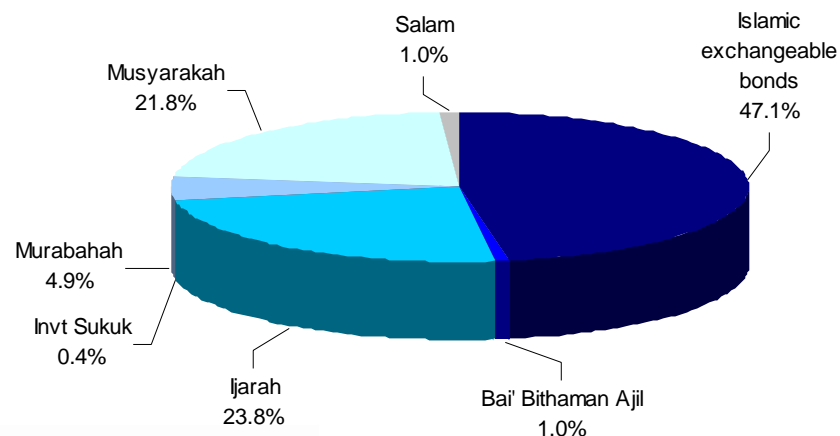
Issuer	USDm equiv	Issue Date	Type	Country
Nakheel	3,520	Dec-06	Corp- Pre IPO Sukuk	UAE- Dubai
PCFC (Dubai Ports)	3,500	Jan-06	Corp- Pre IPO Sukuk	UAE- Dubai
Aldar	2,530	Feb-07	Corp-Convertible Sukuk	UAE- Abu Dhabi
Mobily	1,900	Mar-06	Corp- Bridge Finance	Saudi Arabia
MTC	1,200	Dec-06	Corp- Syndicated Murabaha	Kuwait
Kuwait Finance House	850	Mar-06	FI- Syndicated Murabaha	Kuwait
SABIC	800	Sep-06	Corp- Sukuk	Saudi Arabia
Abu Dhabi Islamic Bank	800	Dec-06	FI- Sukuk	UAE- Abu Dhabi
MTC	750	Feb-06	Corp- Syndicated Murabaha	Kuwait
Rabigh	600	Mar-06	Corp- Project Finance	Saudi Arabia
Al Rajhi Bank	500	Apr-06	FI- Syndicated Murabaha	Saudi Arabia
Etihad Airlines	400	Oct-06	Corp- Aircraft Finance	UAE- Abu Dhabi
Bank TuranAlem	200	May-06	FI- Syndicated Murabaha	Kazakhstan

EVOLUTION OF SUKUK STRUCTURE

Sukuk Structures in GCC & Malaysia

Year	Type	Issuer	Year	Type	Issuer
1990	Bai Bithaman Ajil/ Murabahah	Shell MDS Sdn Bhd	2004	Sukuk Ijarah	Qatar Global Sukuk
1994	Mudharabah	Cagamas Bhd	2005	Sukuk Musharakah	Emirates Airline
1996	Bai Bithaman Ajil	Kuala Lumpur International Airport	2006	Sukuk Musharakah	Dubai Port Authority
2000	Syndicated Ijarah Muntahiyah Bit-Tamlik	Kumpulan Guthrie	2006	Sukuk Istisna/ Ijarah	Tabreed
2001	Sukuk Ijarah	Kumpulan Guthrie	2006	Sukuk Exchangeable	Rafflesia Capital Ltd
2002	Sukuk Ijarah	Government of Malaysia	2006	Sukuk Musyarakah	SABIC
2003	Sukuk Istisna	SKS Power Sdn Bhd	2006	Sukuk Ijarah	Nakheel Development
2003	Sukuk Ijarah, Istisna & Murabahah	Time Engineering Bhd	2006	Sukuk Trust Certificates	Abu Dhabi Islamic Bank
2003	Sukuk Ijarah	Bahrain Monetary Agency	2007	Mudharabah Exchangeable	Aldar Properties
2004	Sukuk Ijarah	Dubai Global Sukuk FZCO (Government)	2007	Sukuk Musharakah	Sharjah Islamic Bank

Sukuk Issuance by Structure (2007)



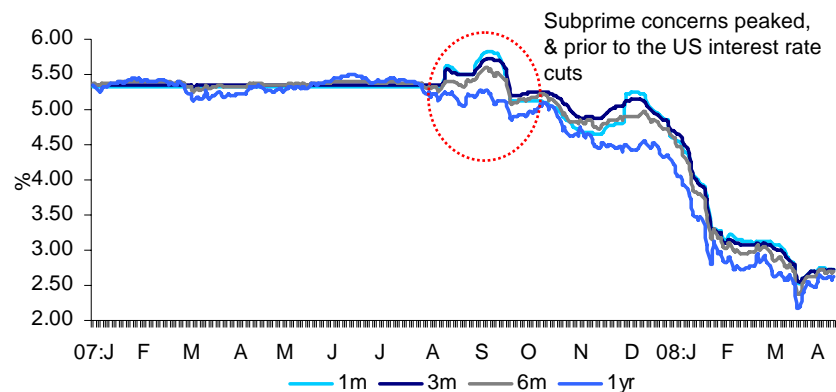
- Earlier Sukuk structures were centred on Ijarah/ Bai Bithaman Ajil (Malaysia) because these structures closely mirror the conventional structures & easy to understand
- In recent years, there is shift to other Islamic structures such as Musharakah/ Mudharabah/ Exchangeable etc
- Investors & issuers are more sophisticated given efforts to further develop the ICM and products range

SUBPRIME IMPACTS THE SUKUK MARKET

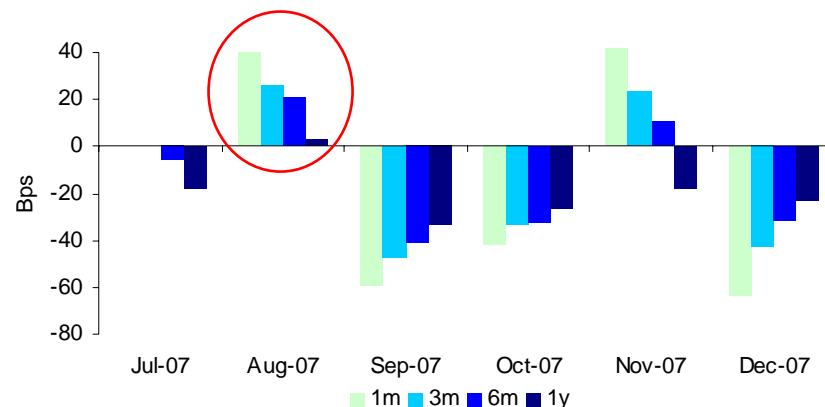
Several companies were forced to delay or withdraw planned debt offerings in 2H07 due to heightened debt market volatility:

- Dana Gas, the first victim of the subprime turmoil, postponed its USD1bln issue from July 07 to Oct 07
- Pricing of Ithmaar Bank's USD300mln sukuk was delayed
- National Bank of Abu Dhabi delayed its USD1.7bln bond programme until conditions improve in global debt markets
- Amlak Finance, an Islamic mortgage company in Dubai, delayed its plan to issue USD260mln mortgage-backed Sukuk scheduled for end-07
- In Aug 07, Malaysia's MISC deferred the sale of its planned USD750mln 10-year dollar-denominated bond issue
- Saudi Basic Industries Corp was forced to lower the senior unsecured bond portion of its financing to buy GE Plastics from around USD2.76bln to USD1.5bln and raise the bank loan portion from USD5.4bln to around USD6.6bln

Libor Month-on-Month Yield Change
(Jul 07- Apr 08)

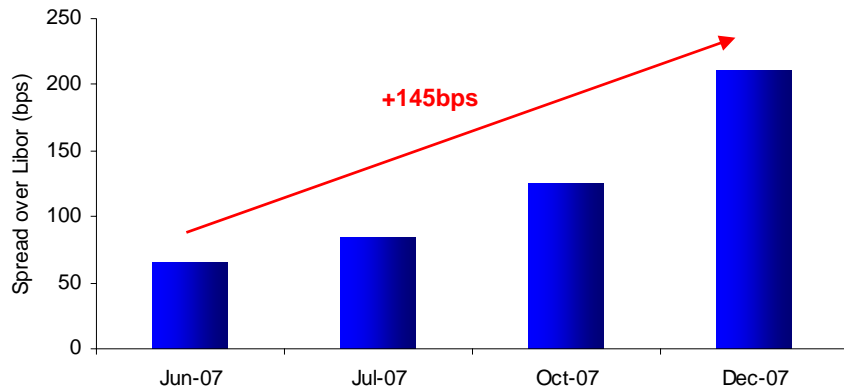


Libor Month-on-Month Yield Change
(Jul 07-Dec 07)

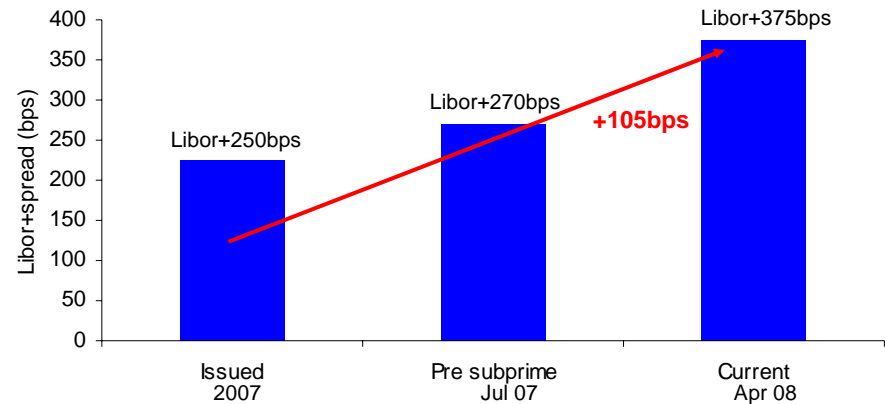


CREDIT SPREADS & SUKUK PRICING

HSBC-DIFX Islamic Bond Index Trend
(Jun 07-Dec 07)



Dar Al Arkan Sukuk Maturing in 2012:
Change in Credit Spread



Korea Development Bank Dollar Debt Maturing in
2012: Spread over US Treasury (Jul 07-Apr 08)



- 3m Libor peaked at 5.7283% on 6th Sept 07, an increase of 36bps within a month due to subprime concerns
- The HSBC-DIFX index of Sukuk average spreads over Libor jumped from 65bps in Jun 07 to 210.6bps in Dec 07
- Concurrently, the yield on dollar-denominated Sukuk (e.g Dar Al Arkan) rose by 105bps between Jul 07 to Apr 08
- To compare, yields on dollar-denominated conventional bonds of comparable maturity widened by 145bps over the same corresponding period



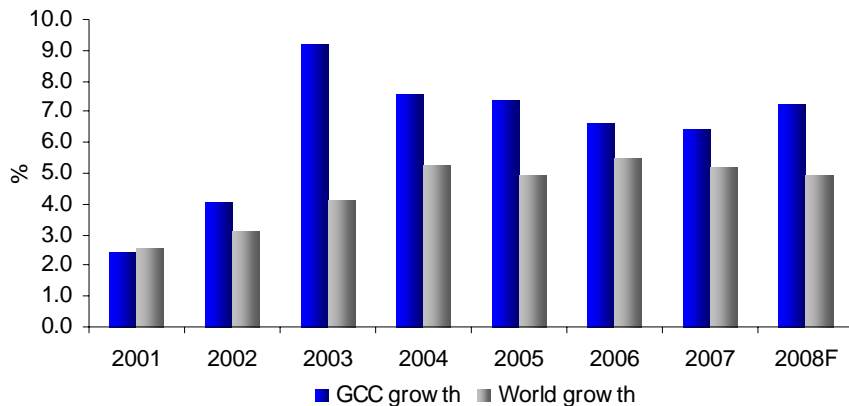
IMPACT OF SUBPRIME ON GCC ECONOMIES

The US subprime is unlikely to trigger a contagion liquidity crunch in GCC given the following reasons:

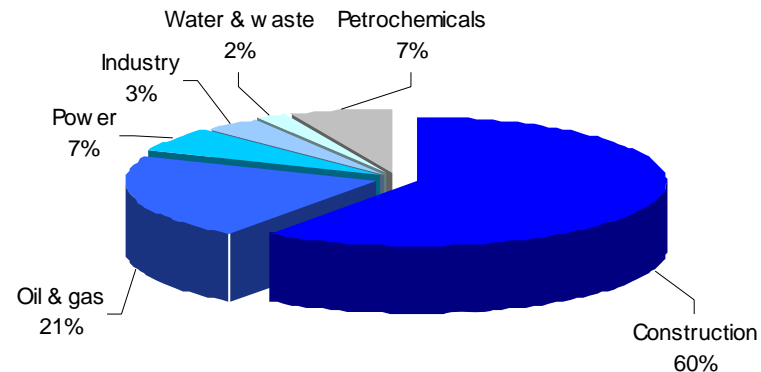
1. GCC's huge pool of liquidity with current account and fiscal surpluses estimated at USD226.1bln and USD127.6bln respectively in 2007 will cushion the region from the subprime crisis
2. GCC markets have proven their low correlation or immunity to developments in global capital markets given domination of local retail investors in the region's markets
3. The direct exposure of GCC corporations and banks to the US subprime is almost negligible. Total assets of GCC banks stood at USD287bln as at end-07. Only three GCC banks reported a combined lost of USD1.5bln (~0.5%) from the subprime
4. Banking institutions keep diversified portfolios in high-grade investments to mitigate risk and ensure positive return. The financial profile of GCC banks is strong, with good asset quality, high profitability and robust capitalisation
5. Overtime, GCC has gradually diversify its export markets, from traditional US market to the EU, Japan and rest of Asia
6. Nevertheless, the indirect effect of the subprime crisis may be that it increases the cost of raising capital for banks, corporates and investment bodies. In the medium to longer-term, as deals get bigger in size and more complex, access to cheap international capital is becoming more important

ROBUST GROWTH IN GCC & ASIA

GCC vs. World GDP Growth Comparison (2001-2008F)

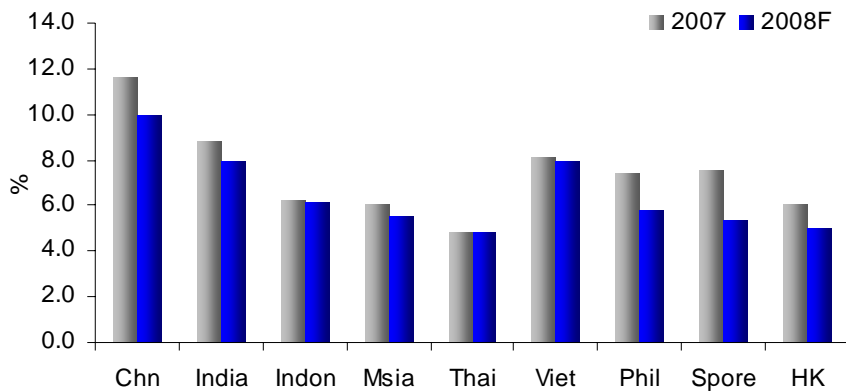


GCC Planned/ Under Construction Infrastructure Projects

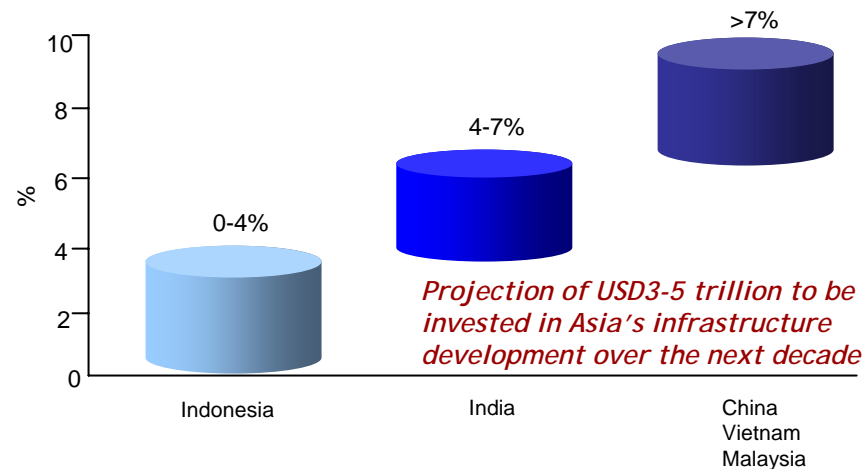


GCC planned/ under construction infrastructure projects estimated at USD2 trillion

Asia GDP Growth Comparison (2007-2008F)



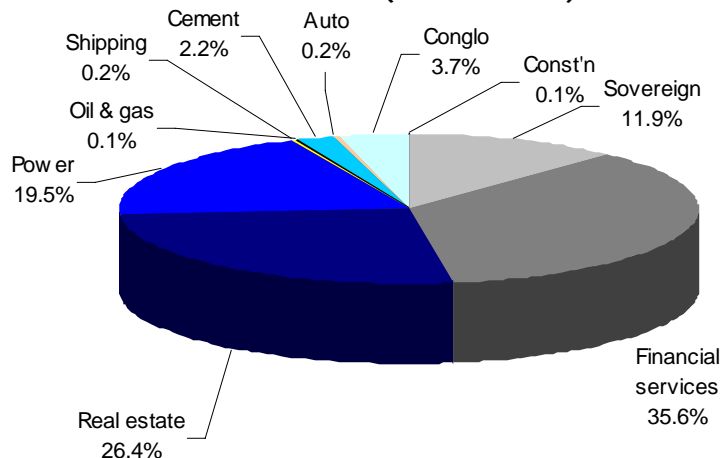
Asia Infrastructure Investment as % of GDP



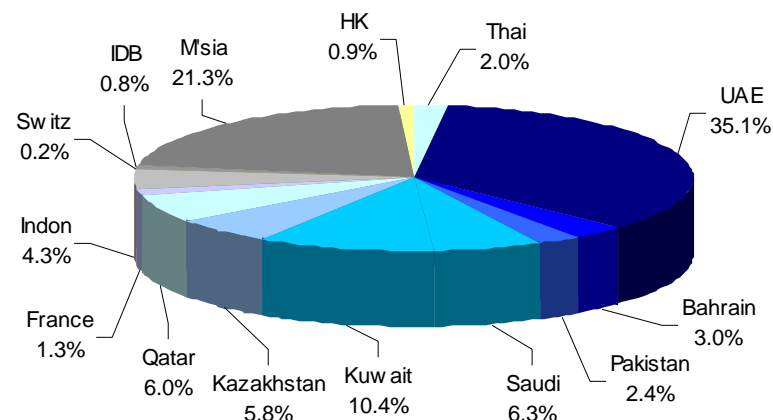
Projection of USD3-5 trillion to be invested in Asia's infrastructure development over the next decade

ROBUST 2008 SUKUK PIPELINE

Total Value of Announced 2008 Sukuk Pipeline by Sector (USD34.5bn)



Total Value of Announced 2008 Sukuk Pipeline by Country (USD34.5bn)



Notable Sukuks Announced in 2008

Issuer	Amt (USD mln)	Sector	Country
Abu Dhabi National Energy Co (Taqa)	1,500	Power	UAE
Doha Bank	1,000	Financial services	Qatar
Khabary Fahaleel Future City	1,842*	Real Estate	Kuwait
Islamic Bank of Thailand	175	Financial services	Thailand
National Central Cooling Co (Tabreed)	570	Industrial products	UAE
Govt of Kazakhstan	2,000	Sovereign	Kazakhstan
Govt of Thailand	500	Sovereign	Thailand

*Kuwaiti Dinar- denominated Sukuk

**Statistics above include both local & dollar-denominated Sukuks

- To-date, 2008 announced Sukuk pipeline estimated at USD34.5bn
- Real estate, financial services and infrastructure (power/ oil & gas/ roads) sectors are expected to dominate the primary Sukuk market in 2008
- The UAE is anticipated to lead at 35.1%, followed by the Malaysia at 21.3% and Kuwait at 12.2%
- 2008 will see Sukuk debuts from new markets such as Thailand, Indonesia, Hong Kong and Kazakhstan

Source: Zawya, Bloomberg, IFIS, Central Banks, KFH



THE SUCCESS OF ISLAMIC CAPITAL MARKETS

Market & Product Development

Development of innovative, competitive and wider range of Islamic funds

Tax and Legal Framework

Facilitate tax and legal framework to promote the development of Islamic funds

Mobilization of Islamic Asset

Mobilize dormant Islamic asset held by Islamic Institutions through Islamic funds to enhance liquidity and provide new sources of income

International Practice

Promote international harmonization and standard setting to enhance cross-border linkages and accelerate the region as investment destination

Awareness & Education

Enhance awareness at domestic and international level. Increase pool of Islamic capital market expertise through training and education

Foreign Participation

Encourage foreign participation in domestic market. Supranational and multinational corporations are allowed to issue local currency-denominated Islamic debt/Sukuk





POTENTIAL NEW MARKETS

✓ Asia Pacific

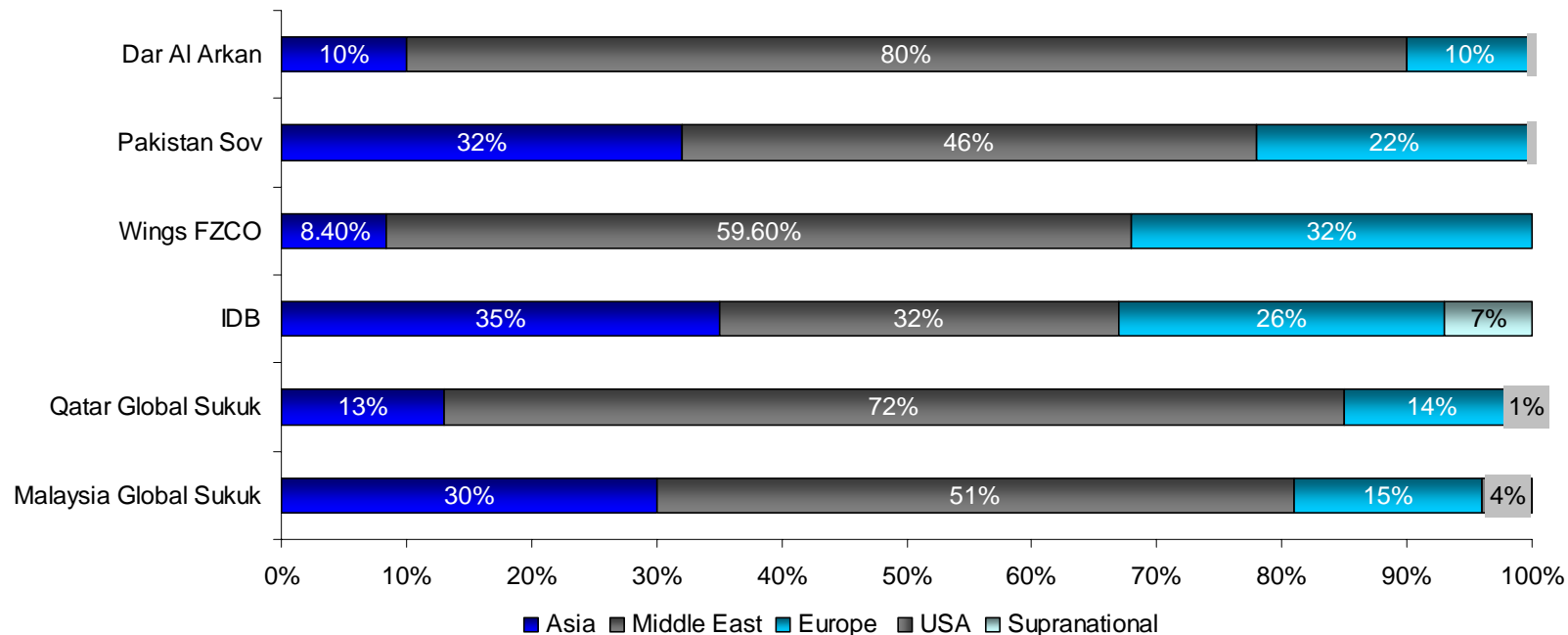
- **Asia**- Arab investors, flushed with liquidity due to high oil prices, are shifting their focus to Asia due the region's revived economic growth
- **Japan** - The government will issue its first sovereign Islamic Sukuk (via Japan International Bank for Corporation) in 2008
- **China**- China has the largest population in the world & Muslim constitute 3% or 38 million (Malaysia: 10 million)
- **Hong Kong** - Hong Kong could become a platform for the development of Islamic securitisation and Islamic funding for China's infrastructure projects. In Nov 07, the Securities & Futures Commission approved the first Islamic fund (Hang Seng Islamic China Fund) available to retail investors
- **Singapore** - Contemplating issuing first Sukuk in 2008. Concessionary tax treatment for Sukuk is similar to that of conventional bonds, has also waived the double imposition of stamp duties on real estate financing structured under Shariah law
- **Brunei** - Had issued its first short term government Sukuk Ijarah to pave ways for the development of Islamic capital market though the government doesn't really need the money
- **Indonesia** -Highest population of Muslim in S.E.A. The country has recently passed Shariah bond bill into law

✓ Europe

- **EU**- Successful closure of the 1st Islamic Euro-dominated German Aglo-Anhalt Sukuk will be the catalyst for development of Sukuk in Europe. German is the 2nd largest Muslim population country in Europe after France
- **UK**-Made significant changes to its tax legislation to facilitate Islamic finance transactions. The UK treasury is considering issuing its first sterling Sukuk
- **Russia** - Proposing conversion to Islamic banks

✓ USA - is now allowing Islamic banks to operate in USA

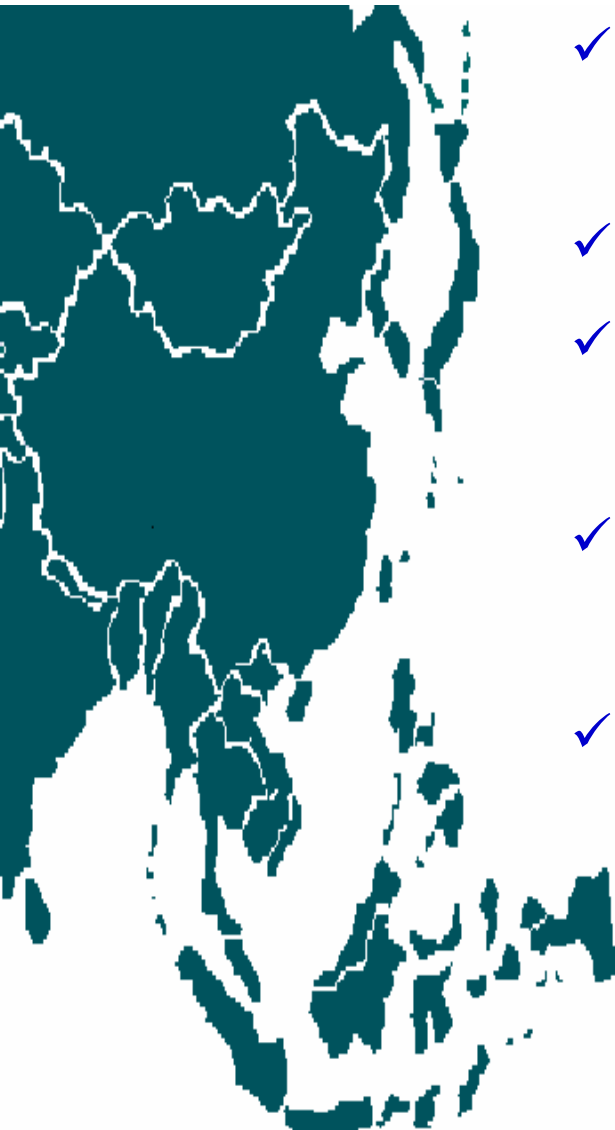
GEOGRAPHICAL DISTRIBUTION OF SUKUKS



- Increasing number of mutual funds, pension managers, financial institutions and central banks are holding Sukuk paper as part of diversification strategy
- The recent geographic distribution of Islamic Development Bank USD1.0bln Sukuk reflects a move away reliance on Europe & Middle East
- For the first time for a GCC promoted Sukuk, Asian investors outstripped investors from Europe & Middle East - Asia 35%, Middle East 32%, Europe 26% & Supranational 7%



WHY DISTRIBUTION IN ASIA?

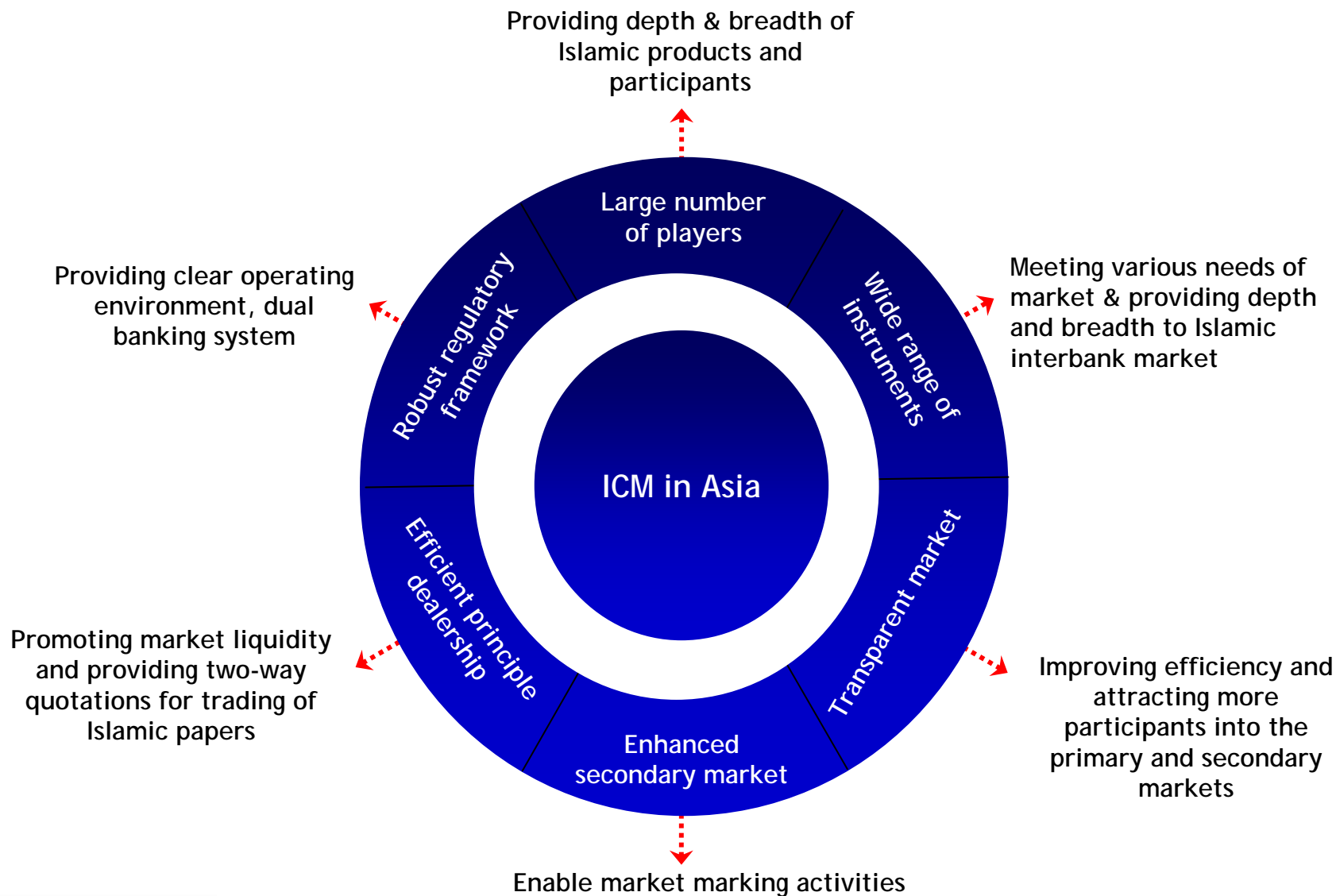


- ✓ Strong liquidity in the Asian region driven by capital inflows and positive export revenues. Total foreign exchange reserves of Asian countries estimated at USD4.2 trillion (incl. China & Japan)
- ✓ Rarity value of Islamic bonds will ensure good demand
- ✓ Demand on high-grade investment papers from regional banks have kept high-grade dollar credits well supported over the past few years
- ✓ Growing participation from insurance companies, pension funds and fund manager given continuous liberalisation of foreign exchange administration rules
- ✓ Robust & Sustainable growth momentum in the Asian region

The recent geographic distribution of the Islamic Development Bank USD1.0 billion Sukuk reflects a move away from reliance on Middle East. In fact, for the first time for a GCC promoted Sukuk, Far East investors outstripped investors from the Middle East - Far East 35%, Middle East 32%, Europe 26% and Supranationals 7%



THE SUCCESS OF ISLAMIC CAPITAL MARKET IN ASIA



KFH GLOBAL INVESTMENT RESEARCH



THANK YOU

