

# Sukuk Product Overview

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# Overview of Islamic Finance Market

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# Overview

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In this presentation, we describe the principles of Islamic finance and present an overview of the Sukuk market and Sukuk product.

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- The central principle of Islamic finance is the prohibition against interest
- Whilst interest is prohibited, a return on capital is permitted provided it is earned through an underlying Shari'a compliant asset transaction
- Islamic financing transactions are structured so that investors' capital is invested in an asset based transaction with the obligor (typically a sale or a lease) that replicates the cash flow and risk profile of a conventional financing arrangement
- The asset used for structuring the financing does not secure the financing. It is used purely as a means of manufacturing the stream of cash flows which will repay investors
- The asset classes suitable for Islamic structuring include any physical asset or – in a development pioneered by Citi – an intangible asset (such as minutes of airtime for a telecom operator, an entitlement to seats for an airline, rights of passage under road toll gates)



# Evolution of the International Islamic Finance Market

1970s	1980s	1990s	Early 2000s	2006-08	2009-11
<b>Industry Milestones</b>					
<p>First Islamic Banks:</p> <ul style="list-style-type: none"> <li>• Dubai Islamic Bank, UAE (1975)</li> <li>• Kuwait Finance House (1977)</li> <li>• Faisal Islamic Bank of Egypt (1979)</li> </ul> <p>An Islamic Multilateral:</p> <ul style="list-style-type: none"> <li>• Islamic Development Bank (1973)</li> </ul>	<ul style="list-style-type: none"> <li>• Conventional Banks start Islamic banking windows:                             <ul style="list-style-type: none"> <li>– Citi starts Islamic Banking in London (1981)</li> </ul> </li> <li>• Development of Bahrain as the hub of Islamic banking</li> </ul>	<ul style="list-style-type: none"> <li>• Establishment of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in Bahrain</li> <li>• Incorporation of Citi's Islamic Bank in Bahrain (1996)</li> <li>• First Islamic equity market index</li> </ul>	<ul style="list-style-type: none"> <li>• Establishment of the Int'l Islamic Financial Market (IIFM) in Bahrain</li> <li>• Establishment of the Liquidity Management Centre in Bahrain</li> <li>• Establishment of the Islamic Financial Services Board in Malaysia.</li> <li>• Issuance of the first International Sukuk by the Government of Malaysia</li> </ul>	<ul style="list-style-type: none"> <li>• New Islamic Banks:                             <ul style="list-style-type: none"> <li>– Islamic Bank of Britain (UK)</li> <li>– European Islamic Investment Bank</li> <li>– Noor Islamic Bank (UAE)</li> <li>– Al Hilal Bank (UAE)</li> <li>– Al Inma Bank (Saudi Arabia)</li> </ul> </li> <li>• Rapid growth in Malaysian Sukuk markets</li> </ul>	<ul style="list-style-type: none"> <li>• Market consolidation after financial crisis of 2008</li> <li>• Renewed focus on Islamic finance</li> <li>• First Sukuk from Turkey</li> <li>• First Sukuk from the United States</li> <li>• Oman, Japan introduce Islamic finance laws</li> <li>• Introduction of Islamic Interbank Benchmark Rate</li> <li>• 36 International Sukuk transactions in 2009-2011 (US\$ 22 bn)</li> </ul>
<b>Product Development</b>					
<ul style="list-style-type: none"> <li>• Commodity Murabaha placements and financings</li> </ul>	<ul style="list-style-type: none"> <li>• Introduction of Islamic Corporate and Consumer Banking</li> </ul>	<ul style="list-style-type: none"> <li>• Islamic syndications, project financings, mutual funds</li> </ul>	<ul style="list-style-type: none"> <li>• Greater range of retail products including mortgage, personal finance, and credit card products</li> <li>• Introduction of Islamic Finance under UCITS</li> </ul>	<ul style="list-style-type: none"> <li>• Islamic risk management solutions (derivatives)</li> <li>• Islamic structured products</li> <li>• Development of Islamic REIT</li> </ul>	<ul style="list-style-type: none"> <li>• Development of the ISDA Master Tahawut Agreement (equivalent of ISDA Master Agreement)</li> <li>• Introduction of Shari'a Income Mutual Fund under UCITS</li> </ul>



# Key Milestones in Sukuk Evolution

The Sukuk product has seen substantial innovation over the past decade

Issuer	Issue Year	Comments
Malaysia	2002	First Sukuk
Islamic Development Bank	2003	First Supranational to Issue Sukuk
Kingdom of Bahrain	2004	First Middle Eastern Sovereign Sukuk
Saxony Anhalt	2004	First Sukuk from Europe
Government of Dubai	2005	First US\$ 1Bn Sukuk
Dubai Ports, Customs and Free Zone Corp	2006	First Pre-IPO Convertible Sukuk
DP World	2007	First 10-Year 144A Sukuk
Sorouh Real Estate	2008	First Sukuk Securitization
GE Capital	2009	First US Sukuk
IFC	2009	First Sukuk by a Washington Supranational
<b>Kuveyt Turk</b>	<b>2010</b>	<b>First Turkish Sukuk</b>
Ras Al Khaimah	2010	First Sukuk Liability Management
HSBC	2011	First Sukuk by a Global Bank
Government of Malaysia	2011	First 10 year Sovereign Sukuk
<b>Republic of Turkey</b>	<b>2012</b>	<b>Largest Non-Investment Grade Sukuk, Largest International Non-Middle East Sukuk*, Largest Debut Sovereign Sukuk</b>

\*Together with Petronas '14

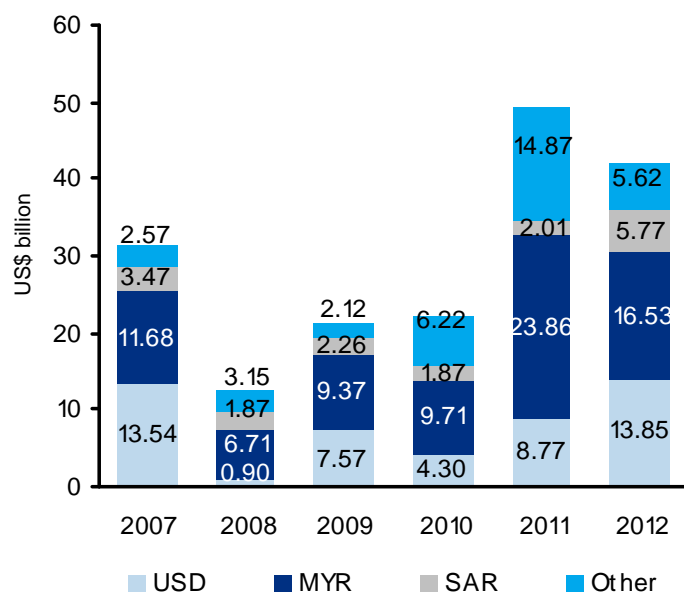


# Sukuk Market Overview

Source: Citi and Bloomberg, as of 23rd September 2012

The US\$ Sukuk market has been extremely active: **The total volume of Sukuk issuance in 2012 is US\$13.85bn, the highest in any calendar year.**

Global Sukuk Supply (2007 – 2012 YTD)



US\$ Sukuk Issuance – Past 12 Months (Total: US\$17.25 billion)

Issuer	Issue Date	Rating (M / SP / F)	Amount (\$mn)	Launch Pricing
Kuveyt Turk '16	Oct-11	- / - / BBB-	350	MS + 448 bps
Republic of Indonesia '18	Nov-11	Ba1 / BB+ / BB+	1,000	4.000%
ADCB '16	Nov-11	A1 / A / A+	500	MS + 275 bps
Kingdom of Bahrain '18	Nov-11	- / BBB / BBB	750	MS + 450 bps
ADIB '16	Nov-11	A2 / - / A+	500	MS + 245 bps
GIB '14	Dec-11	- / - / -	300	6M LIBOR + 130 bps
Emirates Islamic Bank '17	Jan-12	A3 / A+ / -	500	MS + 350 bps
First Gulf Bank '17	Jan-12	A2 / - / A+	500	MS + 287.5 bps
TAMWEEL Funding III Ltd. '17	Jan-12	- / Baa1 / A	300	MS + 400 bps
MAF Sukuk Ltd '17	Jan-12	- / BBB / BBB	400	MS + 482 bps
SEC '17	Mar-12	A1 / AA- / AA-	500	MS + 140 bps
SEC '22	Mar-12	A1 / AA- / AA-	1,250	MS + 195 bps
Dubai '17	Apr-12	NR	600	4.900%
Dubai '22	Apr-12	NR	650	6.450%
Banque Saudi Fransi '17	May-12	Aa3 / A /	750	MS + 185 bps
Dubai Islamic Bank '17	May-12	Baa1 / -- / A	500	MS + 365 bps
JAFZ '19	Jun-12	B1 / -- / B	650	7.000%
Islamic Development Bank '17	Jun-12	Aaa / AAA / AAA	750	MS + 40 bps
EIB '17	Jul-12	A3 / -- / A+	500	MS+310 bps
State of Qatar '18	Jul-12	Aa2 / AA / --	2,000	MS+115 bps
State of Qatar '23	Jul-12	Aa2 / AA / --	2,000	MS+155 bps
Emaar Properties '19	Jul-12	B1 / BB / --	500	6.400%
Republic of Turkey '18	Sep-12	Ba1 / BB / --	1,500	MS + 185 bps

## 2012 Year-to-Date Highlights

- The Sukuk market in 2012, has so far seen a total of US\$ 13.85 billion of US\$ international Sukuk
  - **On the 18<sup>th</sup> September, the Republic of Turkey priced the largest non-investment grade Sukuk, largest non-Middle East international Sukuk (together with Petronas 2014s) and the largest debut sovereign Sukuk**
- Although the sweet spot for Sukuk issues remains at 5 years, there is clearly appetite amongst investors for longer tenors given the recent 7-year Sukuk offerings by Emaar and JAFZ. Other noteworthy transactions that corroborate this point include:
  - Dubai's dual-tranche (5 and 10-year) US\$ 1.25 billion RegS transaction, with an orderbook exceeding US\$4.6 billion
  - the Government of Malaysia's US\$2 billion dual tranche (5 and 10-year) Reg S/144A Sukuk offering, which received in excess of US\$8.8 billion of orders
  - the Republic of Indonesia's US\$1 billion 7-year Regs/144A Sukuk offering



# Demand Patterns in International Sukuk Offerings



Republic of Turkey 144a / RegS due 2018



Jebel Ali Free Zone FZE RegS Only due 2019



Banque Saudi Fransi RegS Only due 2017



Government of Dubai RegS Only due 2017



Government of Dubai RegS Only due 2022

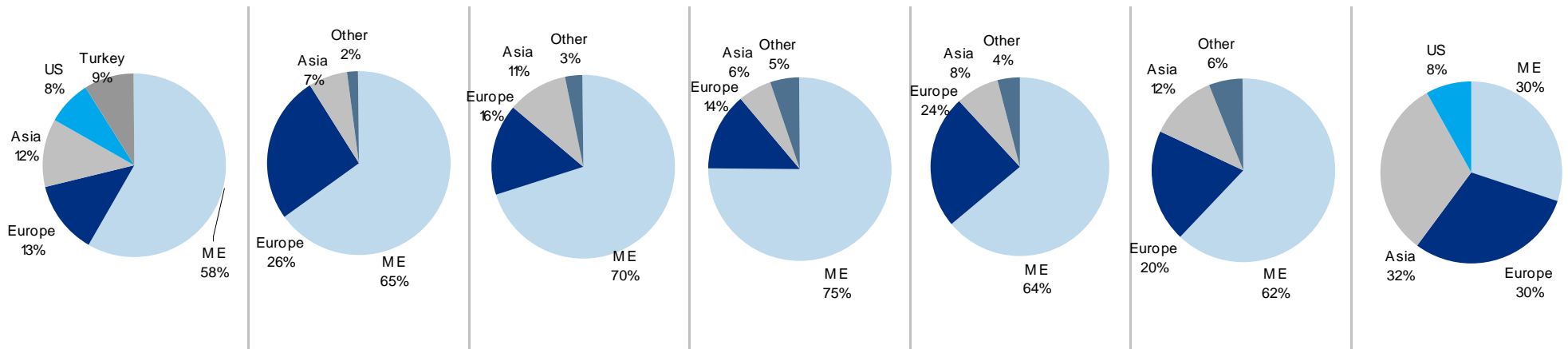


Kingdom of Bahrain RegS Only due 2018

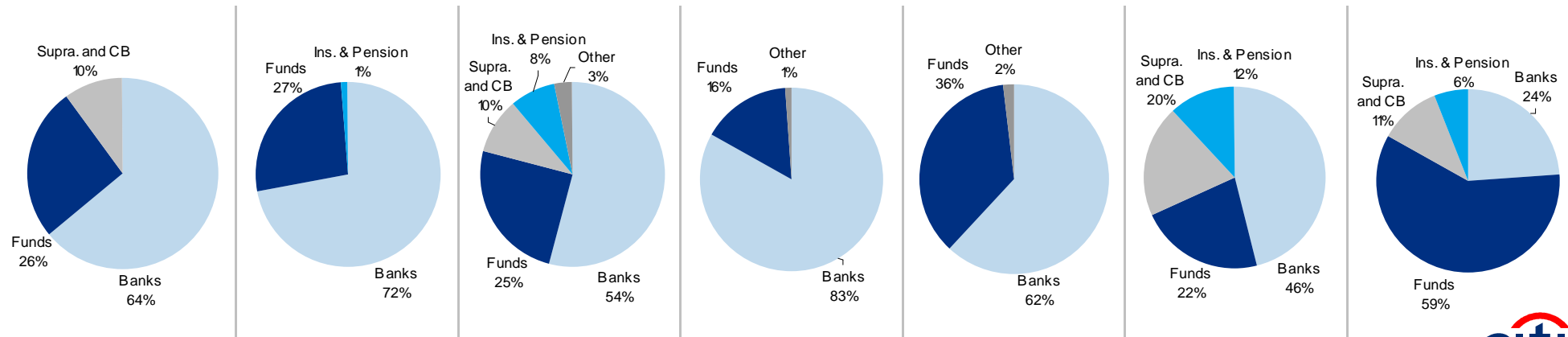


Republic of Indonesia 144a / RegS due 2018

Participation by Geography



Participation by Investor Type



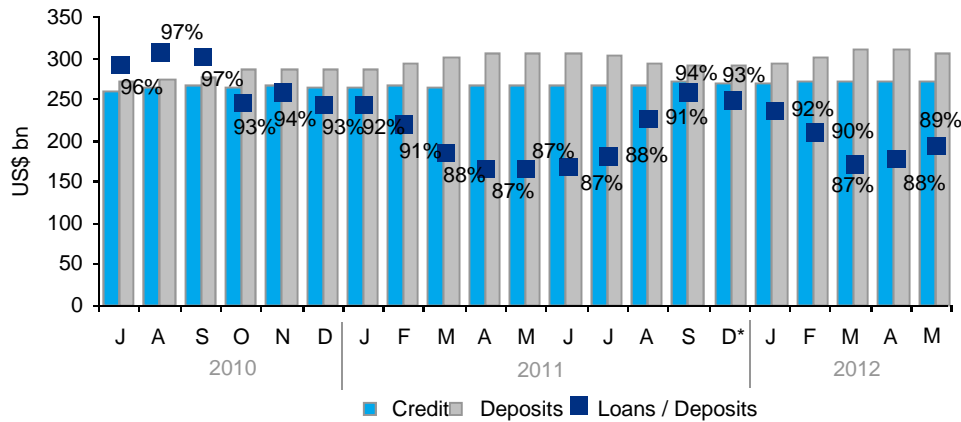


# Liquidity in Key Sukuk Markets

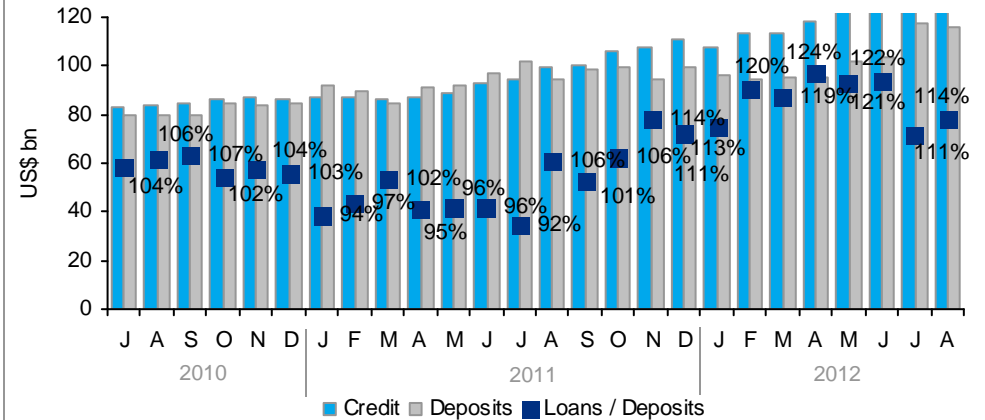
Source: Malaysia, UAE, Qatar and Saudi central banks

The Sukuk product continues to benefit from strong liquidity in key GCC bank markets

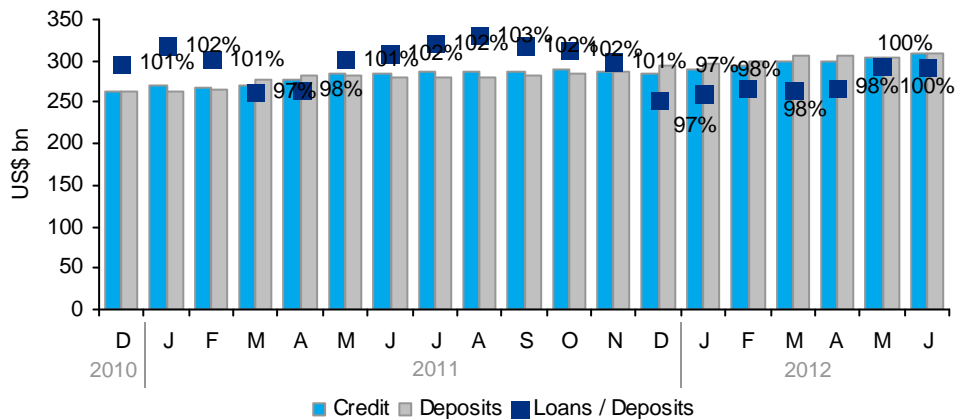
### UAE – Loans and Deposits



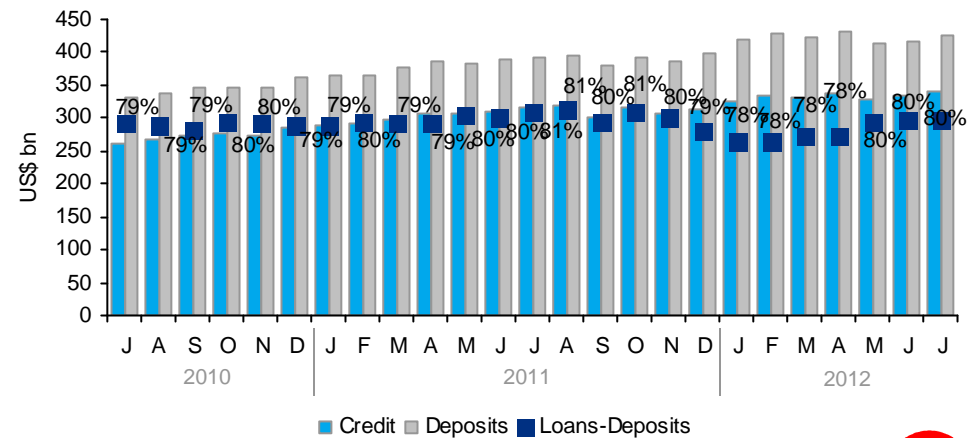
### Qatar – Loans and Deposits



### Saudi Arabia – Loans and Deposits



### Malaysia – Loans and Deposits



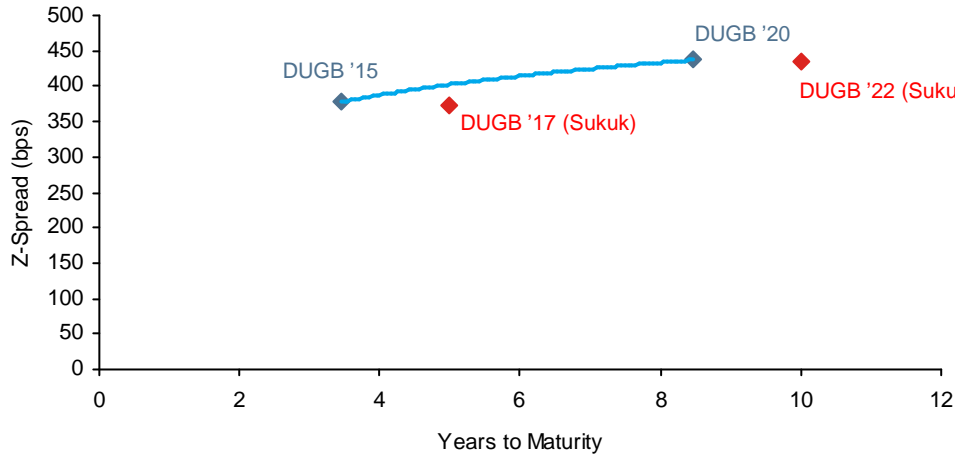
\*Figures for October and November 2011 are not provided by UAE central bank



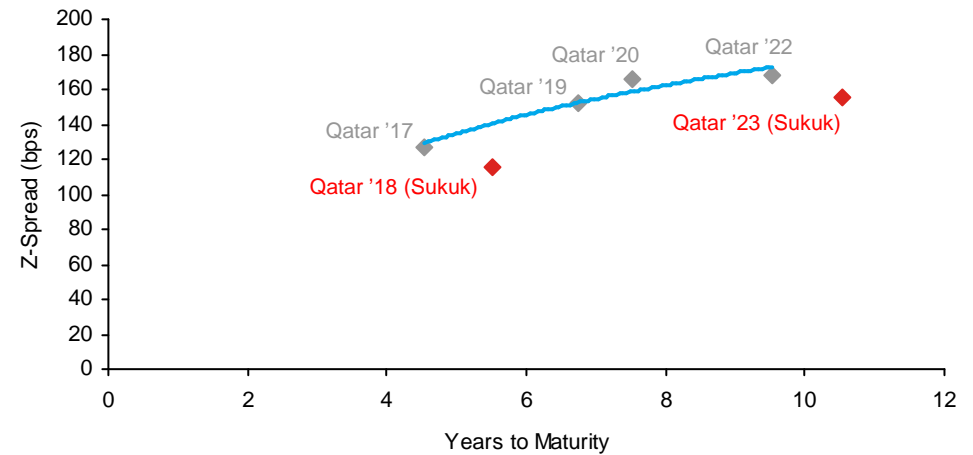
# Sukuk vs Conventional Bonds: Pricing Advantage

Sukuk generally attract additional liquidity from Islamic dedicated financial institutions in the GCC and Asia, resulting in more favourable pricing relative to their conventional peers

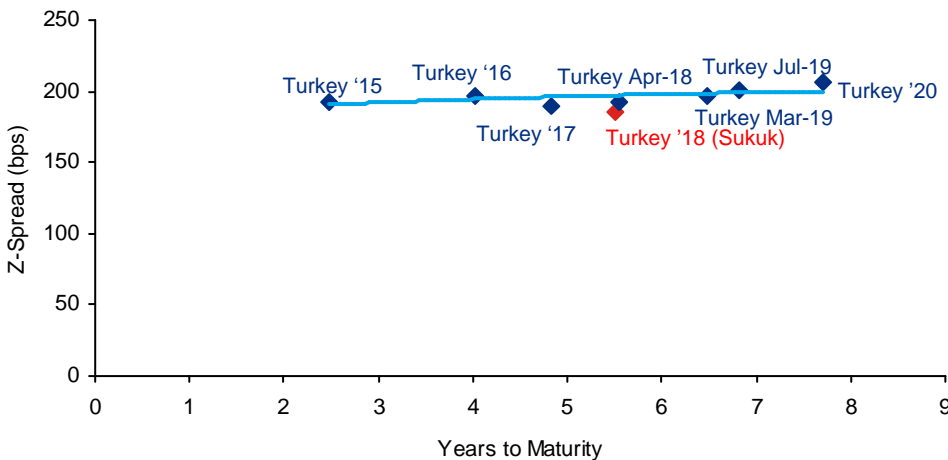
Dubai Dual-Tranche Sukuk – April 2012



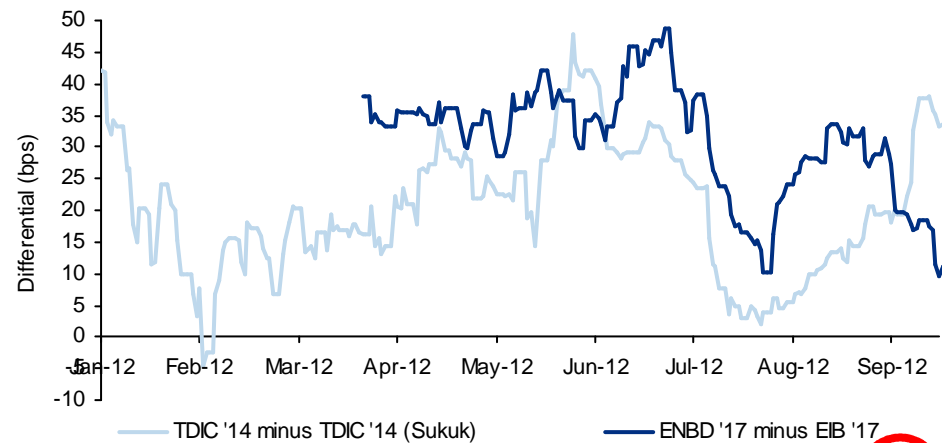
Qatar Dual-Tranche Sukuk – July 2012



Turkey 2.803% Sukuk due 2018 – September 2012

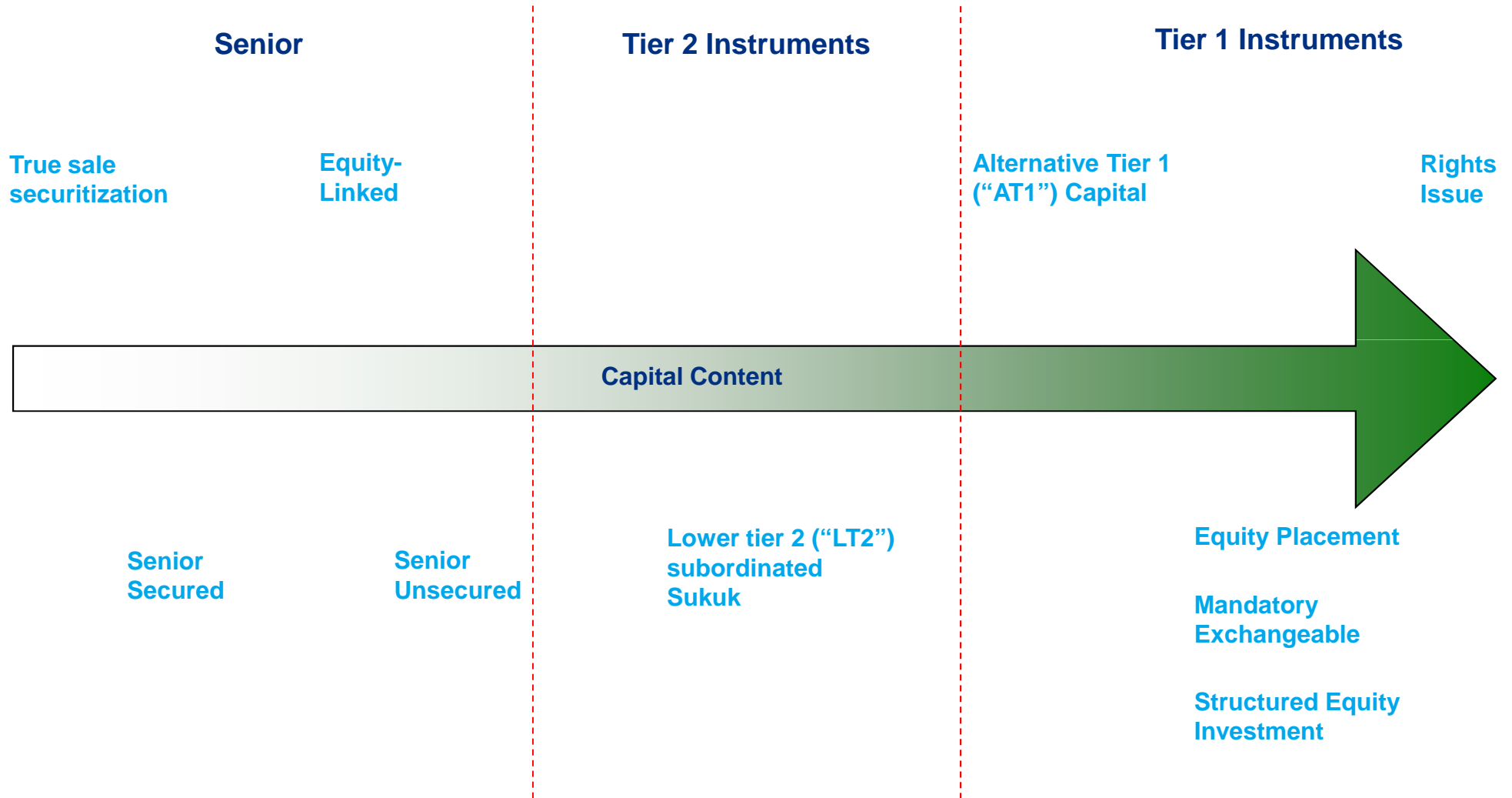


Selected Sukuk vs Conventional Peers – Spread Differential



# Sukuk Funding Alternatives

Although Sukuk are most commonly structured as senior unsecured instruments, Shari'a compliant structuring can be used to achieve varying degrees of capital content





## Case Study: Republic of Turkey Debut Sukuk Offering

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# Republic of Turkey US\$1.5 Billion 144a / RegS Debut due 2018

On September 18<sup>th</sup> 2012, the Republic of Turkey (“Turkey” or “the Republic”) priced a 5.5-year US\$ benchmark Sukuk offering. The much anticipated debut Sukuk from Turkey was extremely well received by the market, meeting all the Republic’s objectives of investor diversification, size and price.

## Transaction Overview

- Following the development of Turkey’s legal framework for Sovereign Sukuk issuance, the Republic mandated Citi to arrange its debut Sukuk offering. Citi had been previously advising the Republic on how to implement the most efficient legal framework to take advantage of the growing Islamic market
- As part of its marketing effort for the offering, the Republic held a series of investor meetings in Saudi Arabia, the UAE, Singapore, Malaysia and Qatar
- On September 17<sup>th</sup>, at 10:30 AM London time, initial price thoughts of ms+200 – 210 bps were communicated to the market
- By 4pm, strong momentum in the orderbook, which had surpassed US\$4.6billion, allowed the Republic to communicate official price guidance at ms+190 – 200 bps
- With a high quality orderbook that grew throughout the morning of the 18<sup>th</sup> to exceed US\$7.1bn, the Republic launched its transaction at a spread of 185 bps over Mid-Swaps, and was able to achieve its target size of US\$1.5bn
- The final pricing on the Sukuk was 8 bps inside the same-day opening z-spread on Turkey’s outstanding Global Bonds due April 2018 with an oversubscription for the offering of 4.7x
- Through the transaction, the Republic was able to achieve its objective of diversifying its investor base, with 58% of the Sukuk allocated to Middle East investors, and 41% to purely Islamic accounts

## Deal Highlights

- *Largest non-investment grade Sukuk*
- *Largest non-Middle East international Sukuk\**
- *Largest debut sovereign Sukuk*
- *Largest orderbook for a Turkey US\$ bond in almost 3 years*
- *Lowest coupon for a US\$ non-investment grade Sukuk*
- *Priced 8 bps inside z-spread on outstanding Global Bonds due April 2018*

## Key Terms Summary

Obligor	• The Republic of Turkey
Issuer	• Hazine Müsteşarlığı Varlık Kiralama Anonim Şirketi
Ratings	• Ba1 / BB (M / SP)
Format	• 144a / Reg S
Pricing Date	• September 18 <sup>th</sup> , 2012
Maturity Date	• March 26 <sup>th</sup> , 2018
Issue Size	• US\$1.5 Billion
Reoffer Price	• 100.0%
Profit Rate	• 2.803%
Issue Spread vs. UST	• UST + 211 bps
Issue Spread vs. Mid Swaps	• MS + 185 bps
Structure	• Sukuk Al Ijarah
Listing	• Irish Stock Exchange
Joint Lead Managers	• Citigroup + 2

\*Jointly with Petronas US\$1.5 billion 4.250% Sukuk due 2014

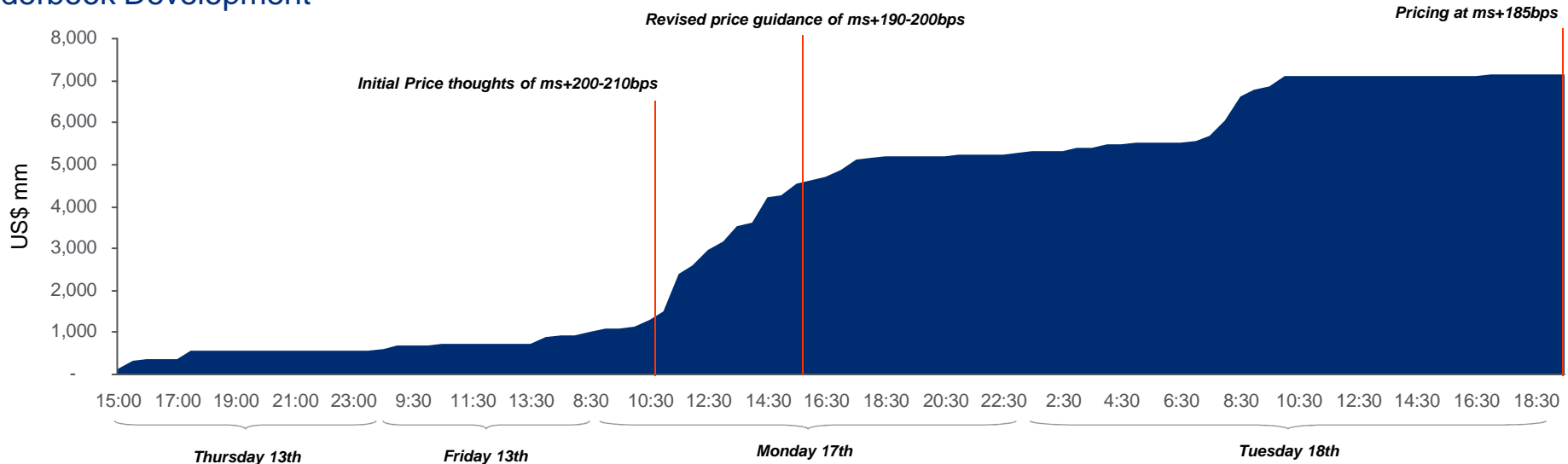




# Republic of Turkey US\$1.5 Billion 5.5-Year 144a / RegS Sukuk

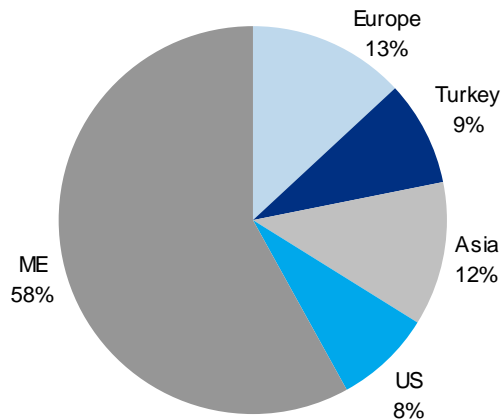
Middle East investors represented the largest participants in Turkey's inaugural Sukuk. Moreover, 41% of the final allocations were to purely Islamic investors.

## Orderbook Development

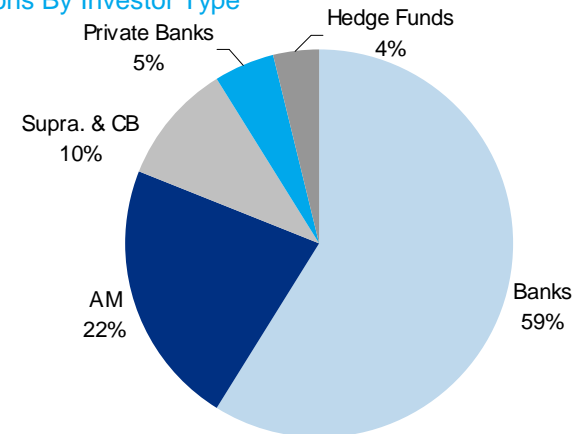


## Investor Distribution

### Allocations By Geography

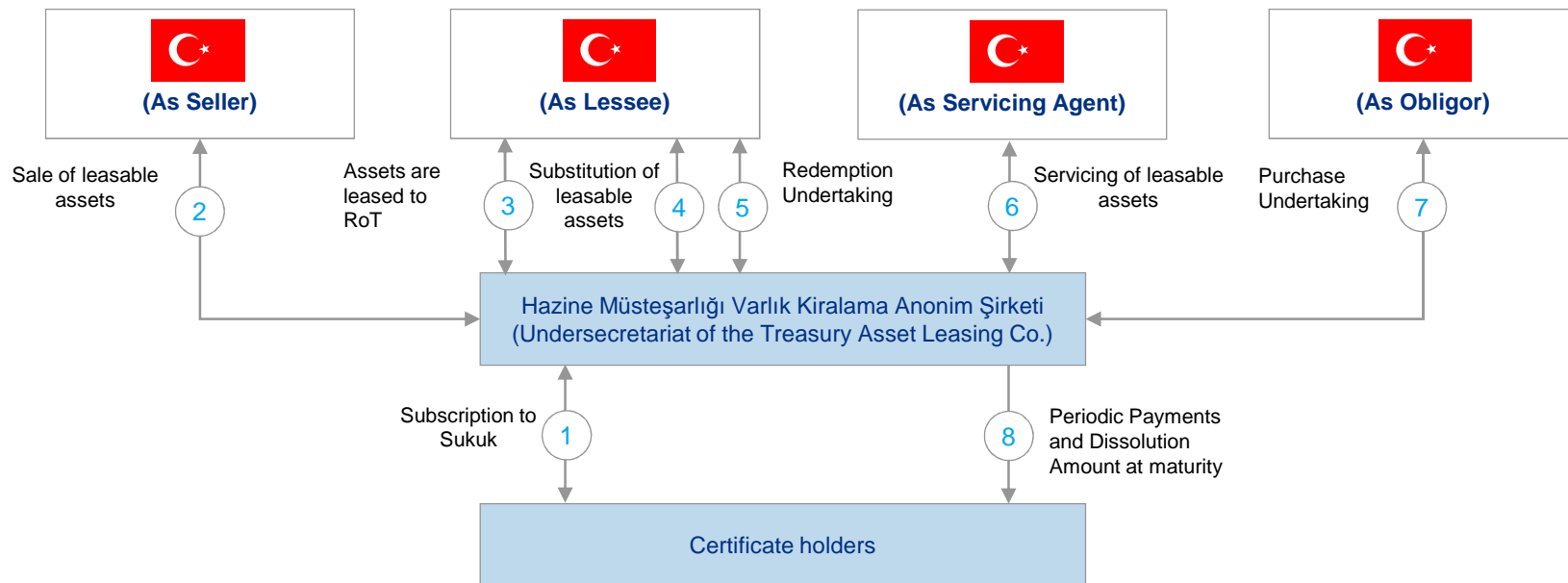


### Allocations By Investor Type



# Sukuk Structure Overview

The Republic of Turkey Sukuk was based on an Ijara (Sale-and-Leaseback) structure with full legal title transfer. The lease assets underlying the transaction comprised government buildings used by the Ministry of Health and the Ministry of Food, Agriculture and Livestock.



No.	Description	Legal Agreements
1	Investors fund the Asset Leasing Company ("ALC") and are issued Sukuk	Representative Agreement; Offering documents
2	The ALC purchases the leasable assets from the RoT	Purchase and Sale Agreement
3	The ALC leases the assets to the RoT	Lease Agreement
4	The RoT, as lessee, can substitute assets held by the ALC in exchange for assets of the same value	Substitution Undertaking
5	Upon purchasing Sukuk for its own account, the RoT can cancel such certificates and extract a proportionate value of assets from the ALC	Redemption Undertaking
6	The RoT, as Servicing Agent, is responsible for ensuring the assets are serviced on behalf of the ALC	Servicing Agency Agreement
7	The RoT provides an undertaking to purchase the assets from the ALC at maturity or upon the occurrence of a default	Purchase Undertaking
8	The ALC distributes profit periodically and the redemption amount at maturity	Representative Agreement; Offering documents



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Citi works with its clients in greenhouse gas intensive industries to evaluate emerging risks from climate change and, where appropriate, to mitigate those risks.

efficiency, renewable energy and mitigation

