



SCZLES

A D V I S O R S

BANKING | FINANCE | INVESTMENTS

About



- Scales Advisors FZ LLC (**SCALES**) is a specialist advisory company incorporated in the RAKEZ free zone in the UAE since 2009, with specific institutional focus on advising and structuring Banking, Finance and Investment Banking transactions, Private Investments advisory, as well as Placement and Distribution of financial products.
- We aspire to deliver personalised solutions through our expertise, providing a specialised approach to meet your objectives.
- Our panel of advisors ensure that our clients and their organizations benefit from our proactive approach, making us integral in their continued success.
- Our international pool of associates also allows us to specialise in originating and structuring cross border transactions, raising funding for our clients on a global scale.

Strategy

We pursue a business strategy covering;

- Banking & Finance advisory
- Investment Banking advisory
- Private Wealth / Investment Advisory
- Placements & Distribution of financial products

Rationale for Capital Market Issuance

- ✓ Diversity of funding sources
- ✓ Access cost effective debt investment capital for longer tenors
- ✓ Effective and improved liability management
- ✓ More transparent pricing
- ✓ Access to a wider variety of investments for institutional investors
- ✓ Improved liquidity through transparent secondary market

Bond Market Overview

- ✓ Established local and International Bank market
- ✓ Nascent regional/domestic Bond markets
- ✓ Limited Euro-market issuance from GCC issuers
- ✓ Strong Regional and International liquidity
- ✓ Increased appetite for Sukuk Issues
- ✓ Global appetite for GCC issues – rating driven
- ✓ Competitive financing cost environment
- ✓ Opportune timing for accessing markets

Market Challenges

- ✓ Developing market regulation
- ✓ Absence of effective intermediate maturity benchmarks
- ✓ Lack of familiarity by potential borrowers
- ✓ Limited usage of credit rating agencies
- ✓ Lack of deep non-bank investor base particularly for unrated Issues
- ✓ Limited secondary market liquidity

What is a Sukuk?

- ✓ According to the definition of Accounting and Auditing of Islamic Financial Institutions (“AAOIFI”), Sharia Standards: “[Sukuk] represents certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or special investment activity.”
- ✓ **Sukuk:**
 - ✓ Sharia-compliant tradable security.
 - ✓ Principally asset-based / asset-linked financing .
 - ✓ Underlying business contract has to be compliant with Sharia.
 - ✓ Instruments providing access to the huge and growing Islamic liquidity pool.
- ✓ **Advantages:**
 - ✓ Allows accessing the broad global capital markets through a Sharia-compliant instrument.
 - ✓ Provides long term funding to match needs.
 - ✓ Priced in line with global capital markets (for similar maturities).
 - ✓ Innovative structuring and globally well accepted documentation.
 - ✓ Establishes and enhances profile in global markets:
 - ✓ Listing of tradable securities on established exchanges
 - ✓ Coverage by major rating agencies
 - ✓ Strong investors’ demand
 - ✓ Conventional investors can buy Sukuk whereas Sharia compliant investors cannot buy bonds. Therefore, a larger potential investor base.

Sukuk Potential

- ✓ An accepted way of raising funds
- ✓ Used by private & public sectors
- ✓ A growing method of financing
- ✓ Widely accepted by all types of investors
- ✓ Has created a global investment opportunity
- ✓ Achieves wider distribution across sectors and geography
- ✓ Diversifies the funding/investor base
- ✓ Can support projects beyond traditional financing sources
- ✓ Can achieve the most efficient terms and conditions
- ✓ Establishes a platform for a sustainable issuance program
- ✓ Promotes the development of the Islamic capital markets

Types of Sukuk

- ✓ Most commonly structured Sukuk Issuance are:
 - ✓ Ijara Sukuk
 - ✓ Musharaka Sukuk
 - ✓ Mudarabah
 - ✓ Wakala Sukuk
- ✓ These are tried & tested in the International Capital Markets
- ✓ Choice of structure requires some basic due diligence on:
 - ✓ Availability of unencumbered assets/rights
 - ✓ Ownership rights of underlying assets
 - ✓ Size of issue
 - ✓ Cost implications

Sukuk Al Ijara - Description

- ✓ The most commonly used sukuk structure (based on volume of issuances) is that of sukuk al-ijara. The popularity of this structure can be attributed to a number of different factors but mainly due to its simplicity and its favour with Shari'a scholars as the key contributing factors. In the Islamic finance industry, the term "ijara" is broadly understood to mean the 'transfer of the usufruct of an asset to another person in exchange for a rent claimed from him' or, more literally, a "lease".
- ✓ In the initial setup in Sukuk Al Ijara, the SPV (issuer) will issue Sukuk certificates to the Investors (Lenders) in return of proceeds that will be used to purchase the assets from the Seller (Borrower) at par value. The SPV will lease these assets to Borrower in return of rental. The Trustee (SPV) and (Borrower) also enter into a Purchase Undertaking pursuant to which the Trustee (SPV) can require Borrower to purchase a the assets on maturity at applicable exercise price equal to par value.
- ✓ The SPV will appoint a Servicing Agent (Borrower) to carry out certain of its obligations under the lease arrangement, namely the obligation to undertake any major maintenance in connection with the Assets. To the extent that Servicing Agent claims the "Servicing Costs" for performing these obligations, the Rental for the subsequent lease period under the lease arrangement will be increased by an equivalent amount (a "Supplemental Rental").
- ✓ Borrower (as Lessee) makes Rental payments at regular intervals to Trustee/SPV (as Lessor). The amount of each Rental is equal to the Periodic Distribution Amount payable under the sukuk at that time that will passed to investors.
- ✓ On Maturity, Trustee (SPV) will sell, and Originator (Borrower) will buy-back, the Assets at the applicable Exercise Price, which will be equal to the Principal Amount plus any accrued but unpaid Periodic Distribution Amounts owing to the Investors.
- ✓ One of the main critical issues to Sukuk Al Ijara is that the size of the sukuk issue is restricted by the value of the assets which are being transferred by the originator (Borrower) to the special purpose vehicle. This means that the Sukuk-al-Ijara structure issue is inherently inflexible. Additionally once the assets have been used for a sukuk issue they cannot be used for any other purpose until the sukuk issue has matured.

Sukuk Al Musharaka - Description

- ✓ Given the lack of flexibility inherent in the Sukuk-al-Ijra, another sukuk product known as the Sukuk-al-Musharaka has been developed. This sukuk variant permits greater flexibility in the asset transfer to cash to be raised as the amount of cash to be raised does not need to correspond to the value of the assets available for transfer into the musharaka.
- ✓ In the initial setup in Sukuk Al Musharka, the SPV (Issuer) will issue Sukuk certificates to the Investors (Lenders) in return of proceeds that will be contributed to the musharaka while the Borrower will contribute either cash or in kind to the musharaka. As the musharaka is not a legal entity, the partners will appoint a managing agent to act on behalf of the musharaka and this managing agent will often be the originator (Borrower) itself.
- ✓ The parties' respective interests in the Musharaka are represented by contractual "Units" held by each party. The Trustee (SPV) and the Musharaka Party (Borrower) also enter into a Purchase Undertaking pursuant to which the Trustee (SPV) can require Borrower to purchase all Trustee Units in Musharka on maturity at applicable exercise price.
- ✓ On each periodic distribution date, Trustee (SPV) shall receive a pre-agreed percentage share of the expected profits generated by the Musharaka and, where the Musharaka generates a loss, Trustee (SPV) shall share that loss in proportion with its capital contribution to the musharaka. Trustee's share of profits will typically be a percentage high enough to at least equal the Periodic Distribution Amounts payable under the sukuk. SPV (Trustee) pays each Periodic Distribution Amount to the Investors using the profit it has received from the Musharaka.
- ✓ On Maturity, Trustee (SPV) will sell, and Originator (Borrower) will buy, all of Trustee's units in the musharaka at the applicable Exercise Price, which will be an amount equal to the Trustee's share in the fair market value of the Musharaka Assets at the time of sale. Trustee (SPV) will pay the dissolution amount to the investors.
- ✓ There is a risk that the Exercise Price will be less than the amount required to pay the Principal Amount and all accrued but unpaid Periodic Distribution Amounts owing to the Investors. However, it can be mitigated by: 1) the maintenance of a reserve account which holds any excess profits from time to time during the life of the sukuk and/or (2) the option of a third party providing Shari'a-compliant liquidity funding to fund any shortfalls in any payments due to Certificateholders.

Sukuk Al Mudaraba - Description

- ✓ Sukuk Al Mudaraba may be a viable alternative to the Sukuk Al Ijara structure.
- ✓ In the Islamic finance industry, the term mudaraba is broadly understood to refer to a form of equity-based partnership arrangement whereby one partner provides capital (the Rab al-Maal) and the other provides managerial skills (the Mudarib).
- ✓ In initial step, Issuer SPV (Trustee) issues sukuk which represent an undivided ownership interest in an underlying asset, transaction or project. The Investors subscribe for sukuk and pay the proceeds to Issuer SPV (the “Principal Amount”).
- ✓ Issuer SPV and Originator (Borrower) enter into a Mudaraba Agreement with Originator as Mudarib and Issuer SPV as Rab al- Maal, under which Issuer SPV agrees to contribute the Principal Amount for the purpose of a Shari’a compliant Mudaraba enterprise while Originator, as Mudarib under the Mudaraba Agreement, agrees to contribute its expertise and management skills to the Shari’a compliant Mudaraba enterprise, with responsibility for managing the Rab al-Maal’s cash contribution in accordance with specified investment parameters. Shari’a compliant mudaraba enterprise is formed with the goal of generating profit.
- ✓ Profits generated by the Mudaraba enterprise are divided between Issuer SPV (as Rab al-Maal) and Originator (as Mudarib / Borrower) in accordance with the profit sharing ratios set out in the Mudaraba Agreement but accrued for the duration of the Mudaraba enterprise .
- ✓ Profit received by Trustee is then distributed among the investors as periodic return
- ✓ On maturity, the Mudaraba enterprise would be dissolved in accordance with the terms of the Mudaraba Agreement and the Trustee would exercise a purchase undertaking to call on Originator (Borrower) to buy its Mudaraba interests at market value so that the proceeds can be used to service the outstanding amounts (principal amount) due to the Investors.
- ✓ For Shari’a purposes, at least 33% of the capital of the Mudaraba enterprise should be invested in tangible assets.

Sukuk Al Wakala - Description

- ✓ Sukuk Al Wakala Structure stems from the concept of a wakala which means an arrangement whereby one party entrusts another party to act on its behalf. A wakala is thereby akin to an agency arrangement. A principal (the investor) appoints an agent (wakeel) to invest funds provided by the principal into a pool of investments or assets and the wakeel lends its expertise and manages those investments on behalf of the principal for a particular duration, in order to generate an agreed upon profit return.
- ✓ Sukuk Al Wakala structure is one of the recent innovations in Sukuk Structures.
- ✓ In the initial setup in Sukuk Al Wakala, the SPV (issuer) will issue certificates to the Investors (Lenders) in return of proceeds that will be used to purchase the wakala portfolio from the Seller (Borrower) at par value. Then, the SPV (Trustee) will appoint a Servicing Agent (Borrower) to manage the wakala portfolio.
- ✓ On each periodic distribution date, the Servicing Agent (Borrower) will pay the trustee the return on Wakala portfolio which will be passed to the investors (lenders). Any return in excess of required amount shall be retained with Servicing Agent as a reserve to meet any shortfall in the coming periodic distribution payment.
- ✓ On the maturity date, the trustee (SPV) will have the right under the Purchase Undertaking to require the buyer (Borrower) to purchase the wakala portfolio at exercise price equal to the par value.
- ✓ One of the main advantages of Sukuk Al-Wakala is that it enables the originator (Borrower) to utilise certain assets that cannot be traded on the secondary market such as murabaha and istisna contracts. In addition, it allows the Borrower (which may also be the wakeel) to build its balance sheet by acquiring the investments comprised in the portfolio and to utilise those investments as underlying assets for a sukuk issuance. Moreover, the portfolio of assets may comprise a broad range of Shari'a compliant assets that will be selected by the wakeel for a period of time corresponding to the duration of the sukuk.

Sukuk Al Murabaha - Description

- ✓ Sukuk Al Murabaha structure is less commonly used in comparison to some of the other sukuk structures. It could be considered as a possible alternative where it is not possible to identify a tangible asset for the purposes of the underlying investment.
- ✓ The term “murabaha” is broadly understood to refer to a contractual arrangement between a financier (the seller) and a customer (the purchaser) whereby the financier would sell specified assets or commodities to the customer for spot delivery in the expectation that the customer would be able to meet its deferred payment obligations under the murabaha agreement. The deferred price would typically include cost plus pre-agreed mark up representing profit.
- ✓ In initial step, Issuer SPV (Trustee) issues sukuk which represent an undivided ownership interest in an underlying asset, transaction or project. The Investors subscribe for sukuk and pay the proceeds to Issuer SPV (the “Principal Amount”).
- ✓ Then, Originator (as Purchaser / Borrower) enters into a murabaha agreement with Trustee (as Seller), pursuant to which Trustee agrees to sell, and Originator agrees to purchase, certain commodities (the “Commodities”) from Trustee on spot delivery and deferred payment term. Trustee purchases the Commodities from a third party Commodity Supplier for a Cost Price representing the Principal Amount for spot payment and sells it to Originator upon delivery from Commodity Supplier.
- ✓ Originator (as Purchaser) makes payments of deferred price at regular intervals to Trustee (as Seller). The amount of each deferred price instalment is equal to the returns payable under the sukuk at that time. The amount then is distributed among investors.
- ✓ As the sukuk certificates in a sukuk al-murabaha essentially represent entitlements to shares in receivables from the purchaser of the underlying murabaha, they are not negotiable instruments that can be traded on the secondary market because Shari’a does not permit trading in debt except at par value. This reduces the popularity of sukuk al-murabaha for potential investors and is reflected by the limited number of sukuk al-murabaha issuances in the sukuk market. However, it can be negotiable based on some conditions.

Sukuk Al Istisna - Description

- ✓ Istisna translates as being ‘to order a manufacturer to manufacture a specific good for the purchaser’. Under an istisna, it is important that the price and specification of the good to be manufactured are agreed at the outset. The structure of sukuk al-istisna has not been that widely used.
- ✓ In the modern day context of Islamic finance, the istisna has developed into a particularly useful tool in the Islamic funding of the construction phase of a project. In order to enable investors to receive a return during the period where assets are being constructed under an istisna arrangement, some Shari’a scholars have permitted the use of a forward lease arrangement (known as ijara mawsufah f al-dimmah) alongside such istisna arrangement.
- ✓ In initial step, Issuer SPV (Trustee) issues sukuk which represent an undivided ownership interest in an underlying asset, transaction or project. The Investors subscribe for sukuk and pay the proceeds to Issuer SPV (the “Principal Amount”).
- ✓ Originator enters into an istisna arrangement with Trustee, pursuant to which Originator agrees to manufacture or construct certain assets (the “Assets”) and undertakes to deliver those Assets at a future date, and Trustee agrees to commission those Assets for delivery at such future date and pays a price to Originator (Borrower) in consideration for assets in amount equal to principal amount.
- ✓ Then, trustee undertakes to lease the Assets to Originator under a forward lease arrangement for a term equal to Sukuk maturity. Originator (as Lessee) makes payments of: Advance Rental (prior to the delivery of the Assets) and Actual Rental (following the delivery of the Assets) at regular intervals to Trustee (as Lessor) equal to the Periodic Distribution Amount .
- ✓ On Maturity, Trustee will exercise the option to sell the assets to Originator at value equal to principal amount. The proceeds then will be distributed to investors.
- ✓ Trustee and Originator will enter into a service agency agreement whereby Trustee will appoint Originator as its Servicing Agent, on and from delivery of the Assets, to carry out certain of its obligations under the forward lease arrangement.

Sukuk Al Istithmar - Description

- ✓ The term “istithmar” is broadly understood to mean an “investment”. Under a sukuk al-istithmar structure, it is possible for ijara contracts (and the relevant underlying assets), murabaha receivables, and/or istisna receivables (each generated by the originator), as well as shares and/or sukuk certificates to be packaged together and sold as an investment. The income generated by such investment can then be used to make payments to the investors under the sukuk.
- ✓ In initial step, Issuer SPV (Trustee) issues sukuk which represent an undivided ownership interest in an underlying asset, transaction. The Investors subscribe for sukuk and pay the proceeds to Issuer SPV (the “Principal Amount”).
- ✓ Originator (Borrower) enters into a sale and purchase arrangement with Trustee, pursuant to which Originator agrees to sell, and Trustee agrees to purchase, a portfolio of certain financial assets (the “Sukuk Assets”) from Originator. Then Trustee pays the Originator in consideration for Sukuk Assets in amount equal to Principal Amount and appoint the Originator as its Wakeel (agent) to manage the Sukuk Asset
- ✓ Originator collects and deposits income generated by Sukuk Assets into collection account (Reserve Account).
- ✓ At regular interval, Originator will be required to make the required income payment to Trustee in amount equal to periodic distribution amount which is then transferred to investors. The balance in the Reserve Account (if any) can also be used to cover a shortfall in collections to meet the Required Income in any given collection period.
- ✓ On maturity, the Trustee will exercise the option and sell Sukuk Assets to Originator (Borrower) in amount equal to principal amount. The balance of the Reserve Account (if any) will be used in order to enable the payment of the Dissolution Amount to Trustee which is then distributed among the Investors. Any excess will be retained by Originator as incentive fees.

Sukuk Al Salam - Description

- ✓ Generally, in order for a sale to be valid under Shari'a, the object forming the subject matter of the sale must be in existence and in the physical or constructive possession of the seller. The exceptions to this general position are sales effected pursuant to salam and istisna contracts.
- ✓ In its simplest form, a salam contract involves the purchase of assets by one party from another party on immediate payment and deferred delivery terms. The purchase price of the assets is typically referred to as the salam capital and is paid at the time of entering into the salam contract. The assets sold under the salam contract are referred to as al-muslam fhi, delivery of which is deferred until a future date.
- ✓ Its use as the platform for issuing sukuk, as an alternative to conventional bonds, is rare in comparison to some of the more prevalent structures like sukuk al-ijara. This can be attributed to a number of factors, namely the non-tradability of the sukuk and the requirement that the Originator must be able to deliver certain 'standardised' assets to the Issuer at certain future dates which may be difficult where the Originator's business model does not provide for this.
- ✓ In initial step, Issuer SPV (Trustee) issues sukuk which represent an undivided ownership interest in certain assets (the "Salam Assets") to be delivered by Originator. The Investors subscribe for sukuk and pay the proceeds to Issuer SPV (the "Principal Amount").
- ✓ Originator enters into a sale and purchase arrangement with Trustee, pursuant to which Originator agrees to sell, and Trustee agrees to purchase, the Salam Assets from Originator on immediate payment and deferred delivery terms, in an amount equal to the Principal Amount.
- ✓ Prior to each date on which Periodic Distribution Amounts are due to the Investors, Originator delivers a proportion of the Salam Assets to Trustee. Originator (as Obligor) purchases a proportion of the Salam Assets from Trustee for an agreed Purchase Price equal to periodic distribution amount that is transferred to investors through Trustee.
- ✓ At Maturity, Trustee will exercise call option. The Originator will be obliged to deliver all salam assets to Trustee. Then, Trustee will sell and Originator will buy at applicable exercise price equal to principal amount.

Sharia Advisory

Sharia Advisor in Sukuk Issuance will:

- ✓ Advise on the Sukuk structure
- ✓ Give general advice to the Arranger on compliance
- ✓ Approve the terms & conditions of the Sukuk structure
- ✓ Advise on separation of non-compliant assets or profit from the Sukuk
- ✓ Review and approve the Offering Circular, Agreements & other documents
- ✓ Issue a fatwa

Credit Rating

- ✓ Obtaining credit rating is becoming a pre-requisite for successful access to the International Capital Markets
- ✓ The key benefits are deeper market access and finer pricing
- ✓ The initial rating process can be an extensive exercise in terms of senior management time
- ✓ Appointment of a rating advisor plays a key role in contracting-out most of the time-intensive tasks involved in the rating process

BENEFITS

- ✓ Universally accepted measure of an issuer's creditworthiness
- ✓ Greater access to Int'l Capital Markets
- ✓ Diversification of funding sources and investor base
- ✓ Reduced dependence on bank market
- ✓ Fulfills regulatory requirement for certain investors
- ✓ Potentially finer pricing & greater liquidity
- ✓ Also useful in dealings with customers/ trade creditors

COSTS

- ✓ Management time –initial rating and annual updates
- ✓ Rating agency fees and expenses

Pricing Drivers

- ✓ The credit story
- ✓ The individual market dynamics
- ✓ Issue size
- ✓ Maturity
- ✓ Market liquidity and investor appetite

Pricing is driven by a number of inter-related factors

Issue Process

- ✓ Mandate Lead Manager(s) who understands structuring & marketing Sukuk instruments
- ✓ Appoint professional third party consultants - law firm(s), sharia adviser
- ✓ Due Diligence and information gathering
- ✓ Create Sharia compliant structure
- ✓ Syndicate formation
- ✓ Allocation of roles including Paying Agent, Listing, etc.
- ✓ Rating (if applicable) & listing arrangements
- ✓ Transaction documents, including Offering Circular documentation
- ✓ Publication and Printing issues
- ✓ Selling techniques and types of arrangements
- ✓ Road shows, invitations, follow-up and order booking
- ✓ Deal Book Runner management & ticket writing
- ✓ Global Custodian for the Global Trust Certificate
- ✓ Financial closure and settlement

Why Choose us?

- ✓ Expert Advisory skills including origination and structuring of Sukuk
- ✓ Knowledge and expertise in each respective Sukuk Issuance process in the regional market environment
- ✓ Well established and respected relationship with Institutions, Sharia Scholars, Rating Agencies and Stock Exchanges
- ✓ Excellent track record and solid experience in Sukuk execution and closing

Contact



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