



PRIVATE BANKING

SUKUK – A UNIQUE PROPOSITION

From the CIO Office



AN ASSET CLASS WITHIN THE FIXED INCOME ASSET CLASS

Sukuk (the plural of Sakk, which means certificate in Arabic) are Islamic finance certificates that comply with Islamic sharia investment principles. Sukuk give the investor a beneficial ownership right over tangible assets (real estate, development or agricultural land) or intangible assets (usufructs, services) which generate a profit. Sukuk were used extensively in the Middle Ages, but not in the form by which they are now known in modern finance. The very first issuance occurred in 1990, when a subsidiary of Shell in Malaysia raised USD 30mn. Since then, the Sukuk market has grown rapidly, especially during the boom years of 2006 and 2007 when large public investments spurred issuance from Malaysia and Middle East sovereigns and corporates entered the market.

Sukuk, as an effective investment tool, can play an important role in financing various infrastructure projects and the developmental needs of the country's economy.

Another important difference between bonds and Sukuk is that the assets involved in Sukuk certificates comply with all laws of Islam. In the case of bonds, the bond certificate may be backed by assets that are not compliant with Shariah, which may be bundled together with other types of assets without the investor's knowledge. The investor of Sukuk is assured that the value of the certificate corresponds to assets that are in the public good and not related to activities or products that are against Islam.

The main advantage of Sukuk over traditional bonds is that their value increases in relationship to the assets backing the Sukuk certificate. If the asset raises in value, then the value of the ownership of that asset, backed by the Sukuk, increases. Bonds do not have this characteristic. It is not possible to raise the main debt in a bond and increase in revenue from a bond is the direct result of the fixed interest rather than in any kind of tangible increase in value or productivity.



MOST COMMON SUKUK STRUCTURES

SUKUK TYPE	STRUCTURE AND MECHANISM
Ijara (leasing)	Most popular and widely traded due to its simplicity, it is certificate of ownership in leased assets. This Sukuk provides its owners the right to own real estate, receive the rent, and sale of the Sukuk without affecting the right of the lessee.
Murabaha	The certificate issuer is the seller of the Murabaha commodity, the investors are the buyers of that commodity, and the realised funds are the purchasing cost of the commodity. The investors own the Murabaha commodity and are entitled to its final sale price upon the re-sale of the commodity.
Istisna'a Sukuk	The certificates are issued to raise funds required for producing products that are owned by the investors.
Manafae	The Manafae Sukuk structure is based on rights over underlying assets. The underlying asset is the capacity or rights of commercial activities, and allows for the use of intangibles.
Mudarabah	Sharing type of investment Sukuk that represent ownership of units of equal value in the portfolio and their returns are based on the amount of share ownership. The owners of such Sukuk are the Rabbul-mal (financier). Mudaraba Sukuk is used for enhancing public participation in mega-investment projects.

SUKUK VERSUS CONVENTIONAL BONDS; HOW DIFFERENT ARE THEY?

	CONVENTIONAL	SUKUK
Asset ownership	Bonds are debt obligations from the issuer to the bond holder.	Sukuk provides partial ownership of the asset to the investor.
Investment criteria	Bonds can be used to fund any project, business, asset, or joint venture that complies with the local legislation.	The underlying asset must be Shariah compliant, with restrictions on the activities it can be associated with.
Issue price	The face value of a bond is based on the issuer's credit worthiness and its credit rating.	The face value of Sukuk is based on the current market value of the underlying asset.
Investment rewards and risks	Bond holders receive regular interest income for the duration of the bond, with the principal guaranteed to be returned on the maturity date.	Sukuk holders receive a share of profits from the underlying asset as well as any share of any loss incurred. Redemption for Sukuk holders is at the current market value, which could even be zero.

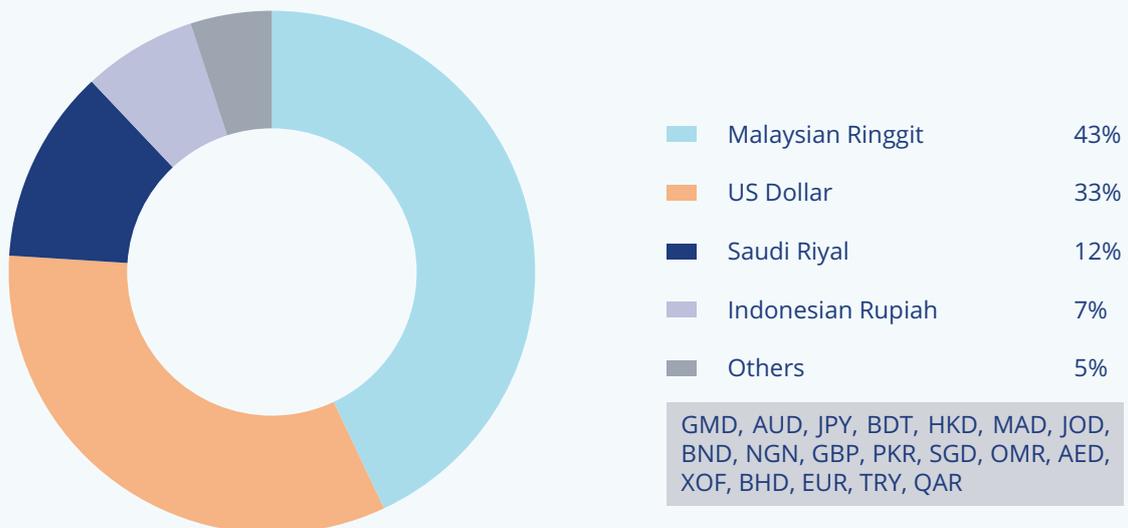
GLOBAL SUKUK ISSUANCE HAS SURPASSED \$1 TRILLION

THE SUKUK MARKET HAS EVOLVED BOTH IN TERMS OF MARKET DEPTH AND BREADTH



Source: Bloomberg data and IIFM Sukuk report (7th edition)

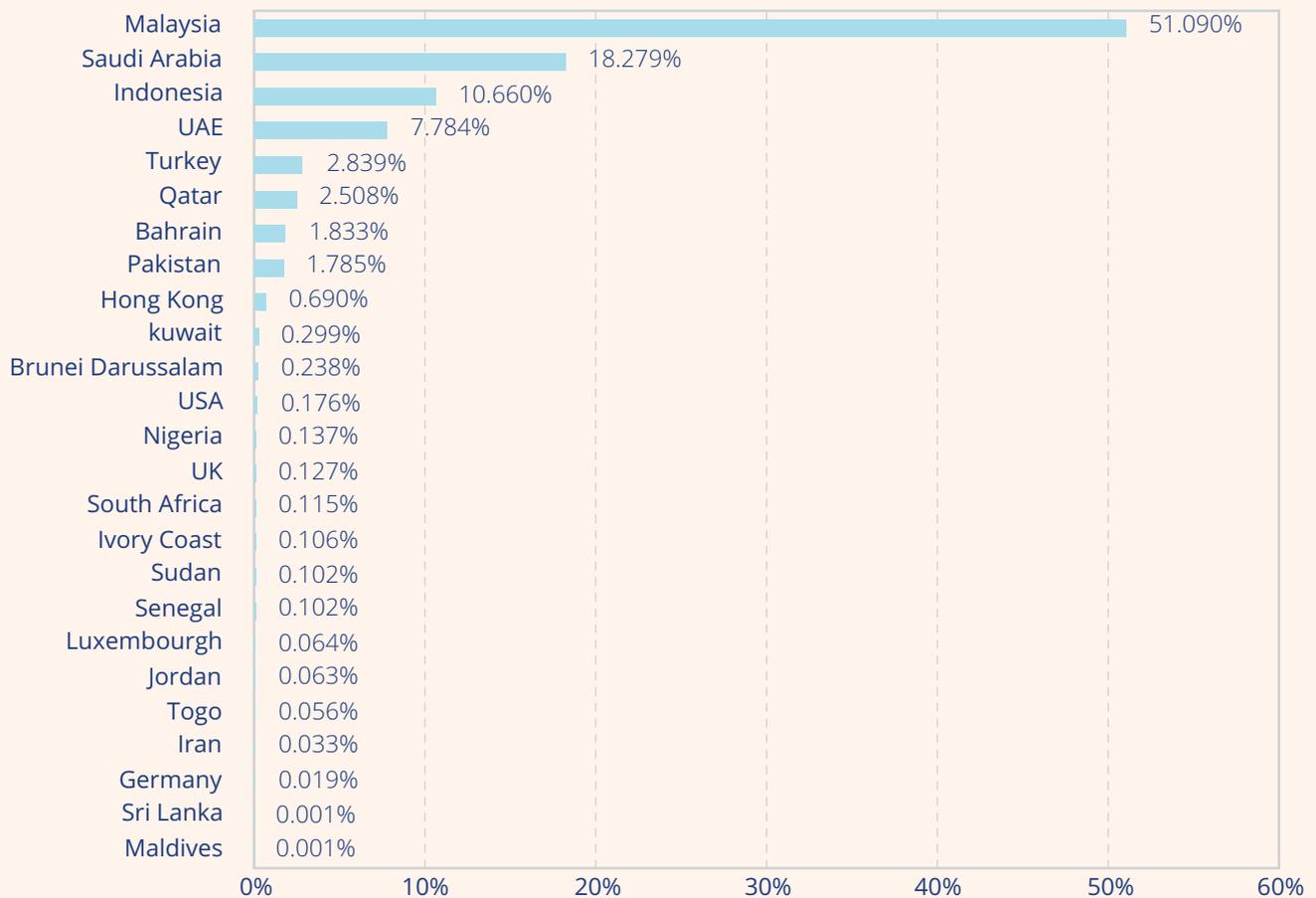
TOTAL OUTSTANDING SUKUK CURRENCY WISE (IN % TERMS)



Source: Bloomberg data and IIFM Sukuk report (7th edition)

ASIA – THE DOMINANT PLAYER IN THE SUKUK MARKET

COUNTRY WISE BREAKDOWN OF ALL SUKUK ISSUERS



Source: Bloomberg data and IIFM Sukuk report (7th edition)

THE FIVE PILLARS OF ISLAMIC FINANCE

- > **The Ban on Interest:** Interest must not be charged or paid on any financial transaction. Money has no intrinsic value and consequently cannot produce returns on its own. Rather, it is a vehicle to facilitate transactions.
- > **The Ban on Uncertainty or Speculation:** Uncertainty in contractual terms and conditions is forbidden. However, risk taking is allowed when all the terms and conditions are clear and known to all parties.
- > **The Ban on Financing certain Economic Sectors:** Financing of industries deemed unlawful by Sharia--such as weapons, pork, and gambling--is forbidden.
- > **The Profit and Loss Sharing Principle:** Parties to a financial transaction must share in the risks and rewards attached to it.
- > **The Asset-Backing Principle:** Each financial transaction must refer to a tangible, identifiable underlying asset.

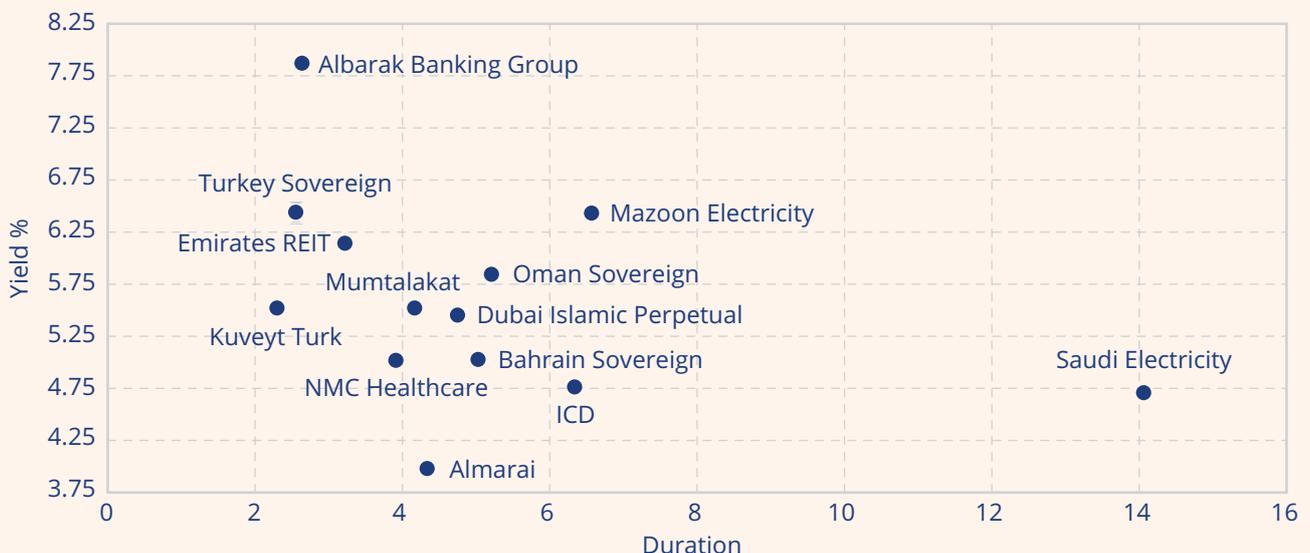


MOST SOUGHT OUT SUKUK THAT REFLECT VALUE IN THIS ENVIRONMENT

ISSUER	COUPON	MATURITY	LAST PRICE	YTM/ YTNC	COMP RATING	COUNTRY	GROUP
KT KIRA SERT VARLIK	5.136	11/02/21	99.142	5.501	N/R	Turkey	Banks
HAZINE MUSTESARLIGI VARL	5.800	02/21/22	98.397	6.422	BB-	Turkey	Sovereign
EMIRATES REIT SUKUK LTD	5.125	12/12/22	96.752	6.128	N/R	UAE	REITS
NMC HEALTH SUKUK LTD	5.950	11/21/23	103.830	5.005	N/R	UAE	Healthcare-Serv
MUMTALAKAT SUKUK HLDG	5.625	02/27/24	100.500	5.504	B+	Bahrain	Investment Comp
ALMARAI SUKUK LTD	4.311	03/05/24	101.500	3.969	N/R	KSA	Food
CBB INTL SUKUK SIX	5.250	03/20/25	101.220	5.008	B+	Bahrain	Sovereign
OMAN SOVEREIGN SUKUK	5.932	10/31/25	100.530	5.833	BB+	Oman	Sovereign
ICD SUKUK CO LTD	5.000	02/01/27	101.560	4.756	N/A	UAE	Diversified Fin
MAZOOON ASSETS CO SAOC	5.200	11/08/27	92.042	6.423	BB+	Oman	Electric
SAUDI ELECTRICITY GLOBAL	5.060	04/08/43	105.300	4.689	A-	KSA	Electric
DIB TIER 1 SUKUK 3 LTD	6.250	Perpetual	103.960	5.900	N/A	UAE	Banks
ABG SUKUK LTD	7.875	Perpetual	100.050	8.291	N/A	Bahrain	Banks

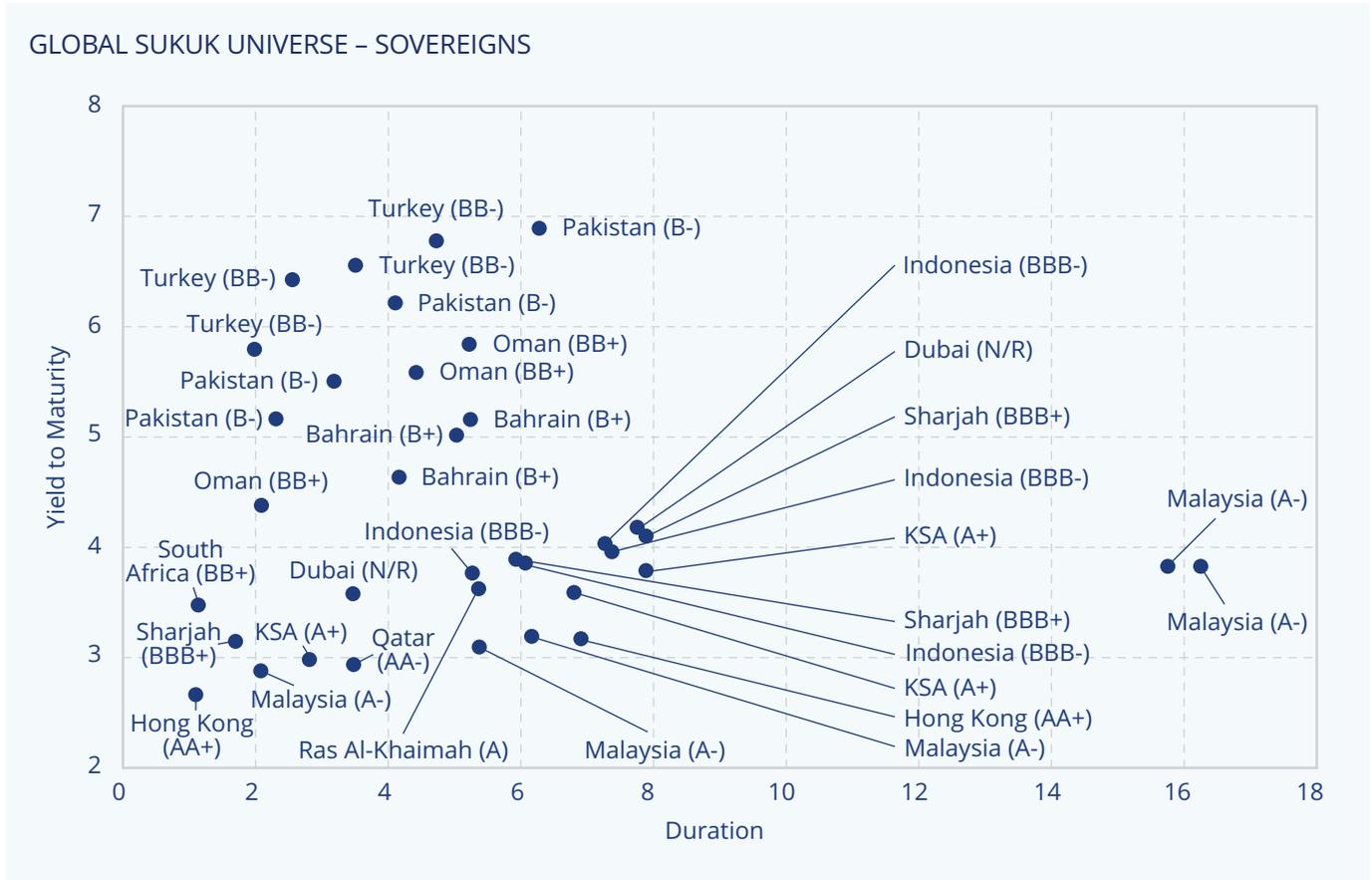
Source: Bloomberg pricing as of 15 April 2019

TRADE IDEAS THAT OFFER VALUE. A LOT OF UPSIDE TO BE CAPTURED

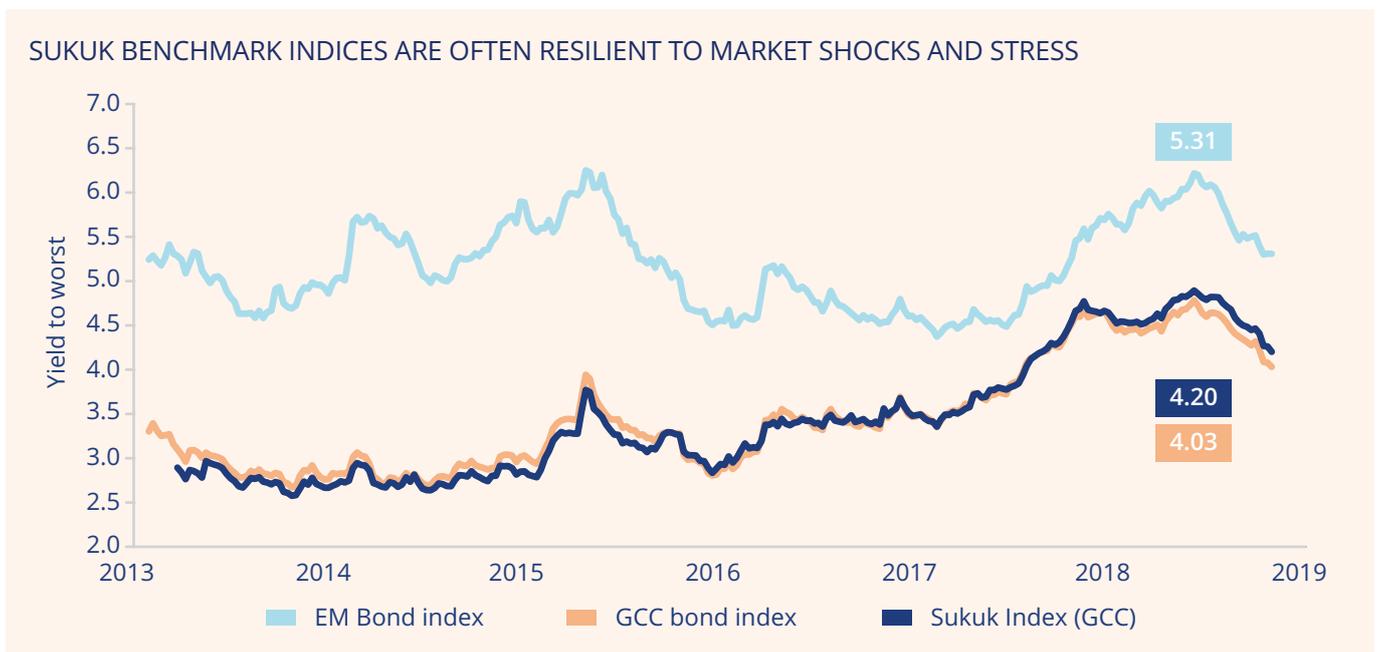


Source: Bloomberg pricing as of 15 April 2019, CIO Office

GLOBAL SUKUK UNIVERSE ACROSS ALL SOVEREIGN ISSUERS (USD ISSUANCE)



Source: Bloomberg Pricing as of 13 April 2019



Source: Bloomberg pricing as of 13 April 2019

COMPANY	ISSUER DESCRIPTION / RATIONALE
Almarai	Almarai is Middle East's leading food and beverage manufacturer and distributor – and the world's largest vertically integrated dairy company. Since its foundation in 1977, consumers across the region have come to recognise the Almarai brand as synonymous with quality. The maiden Sukuk offers value and has room to tighten significantly from current levels.
Kuveyt Turk	The Bank is 62% is owned by Kuwait Finance House, 9% by the Public Institution for Social Security, 9% by the Islamic Development Bank, 18% by General Directorate for Foundations and 2% by other shareholders. Kuveyt Turk is strategically important to Kuwait Finance House given the parent's committed focus on Turkey, Kuveyt Turk's size relative to the group (around 20% of group assets) and its close integration with the parent. We find current yields on their senior unsecured Sukuk attractive on a relative basis and is a good value play.
SECO	Saudi Electricity Company (SECO), the Gulf's largest utility by market value. The company is 81.24 % owned by the government, both directly (74.31 percent) and through Saudi Aramco (6.93 percent) with the remaining free float on the Saudi stock market. The core role for SECO is electricity generation and distribution. SECO is a fundamental component of the development of the KSA economy and benefits from governmental support for its capital expenditure programme. SECO is strategically important for the kingdom and plays a crucial role in meeting Saudi Arabia's power needs.
Hazine Mustesarligi (Sovereign)	Turkey's western boundaries are in Europe and eastern boundaries are in Asia. Turkey has a very strategic location in the Eastern Mediterranean and has control over the entrance to the Black Sea. Turkey is relatively wealthy for a BB rated name (Brazil, Russia, South Africa) . Government borrowing is roughly in line with its BB peers with a deficit of 2% of GDP in 2018, but total debt at just 29% of GDP is significantly lower than the median for its BB peer group which is closer to 50%. The recent Sukuk issuance was a great success on the back of attractive pricing and was well received. On a relative value basis, these short dated Sukuk offer good value, in our view.
DIB Sukuk	Dubai Islamic Bank (DIB) is the oldest Islamic bank in the world and the largest in the UAE by total. The Government of Dubai has been DIB's largest stakeholder since 1998 with a 29% stake. The UAE Federal Pension fund has a 3% ownership; while the remaining 68% is open to public ownership. Dubai Islamic Bank is well positioned to benefit from the improved outlook for the UAE economy and is well capitalized. DIB has a strong and healthy loan book when compared to the rest of the Dubai based banks. The perpetual Sukuk offers decent return for its structure and we expect the spreads on such subordinated Sukuk to compress from current levels.
ABG Sukuk	Al Baraka Banking Group B.S.C. (ABG) is licensed as an Islamic wholesale bank by the Central Bank of Bahrain and is listed on Bahrain Bourse and Nasdaq Dubai. It is a leading international Islamic banking group providing its unique services in countries with a population totaling around one billion. The Group has a wide geographical presence in the form of subsidiary banking units and representative offices in 17 countries, which in turn provide their services through over 695 branches. The perpetual Sukuk is unrated. When compared to the rest of the GCC region's hybrid instruments, the Sukuk offers value.
Mumtalakat	Bahrain's investment arm for the Kingdom's non-oil and gas strategic assets, Mumtalakat's vision is to grow the wealth of the country. Established in 2006, Mumtalakat has operated with the commercial discipline and rigour of the private sector. Its investment strategy is to create a diversified and balanced portfolio. Fully owned by the Government of Bahrain, it is recognised by the international community for its continued commitment to transparency and corporate governance.

COMPANY	ISSUER DESCRIPTION / RATIONALE
NMC Health Care	The Group is one of the world's top 10 healthcare operators by market value and is a member of the FTSE 100 index. The Group currently owns and manages 188 facilities across 17 countries, with a presence in the GCC region (the UAE, Saudi Arabia and Oman), Europe (Denmark, Italy, Sweden, Latvia, the United Kingdom and Spain), South America (Brazil and Columbia) and Africa (Kenya) through its owned facilities and five more countries (Kuwait, Slovakia, Egypt, Jordan and Yemen) through its managed facilities. Attractive yield for its strong business strategy model and outlook.
CBB INTL Sukuk (Bahrain Sovereign)	Bahrain's debt-to-GDP ratio has increased the most since 2008 placing public debt dynamics on an uncomfortable trajectory. The public debt has increased by 78pp of GDP over a decade, much higher than Greece and Ukraine. Still, structural reforms have remained modest, despite the rapid deterioration in debt metrics. That deterioration was exacerbated by an increasing reliance on external debt issuance as the oil price correction hit hard-currency revenues. Yet, Bahrain's return to external borrowing highlights increasing strains on tapping international debt markets, which we believe is likely to accelerate formal GCC financial support, notably from Saudi Arabia. We believe the authorities will remain strongly committed to the peg, which ultimately will accelerate GCC financial support in coming months, in our view. Bahrain has greatly benefitted from assumption of implied GCC support, which has compressed its sovereign borrowing premium compared with EM peers.
Emirates REIT	Emirates REIT is a UAE based real estate and investment trust. Emirates REIT Sukuk is the issuer and trustee of Sukuk certificates. Emirates REIT raised USD 400mn via an Islamic bond with a fixed profit rate of 5.125% and matures on the 12 December 2022. The Sukuk is rated BB+ by Fitch. Emirates REIT owns 10 properties in Dubai with a leasable area of 2.2mn square feet (sqf). Its properties are a combination of commercial and education assets, striking a balance between rental income growth and stability. The average lease maturity for commercial assets is short at one to three years, depending on the unit type.
Mazoon	Mazoon was registered on the commercial register at the MOCI on 2 February 2003 and commenced its operations on 1 May 2005 (the Transfer Date) following the implementation of a decision of the Ministry of National Economy (the Transfer Scheme) issued pursuant to the Sector Law. Mazoon is indirectly 100%, Owned by the Government and accordingly benefits from direct and indirect support mandated by law. Since the electricity distribution business is a "natural monopoly" as a result of the high fixed costs of distribution infrastructure, only one operator is economically viable in any particular territory.
Oman Sovereign	Oman's fiscal and external deficits remain large, requiring external financing including the frequent return to capital bond markets. We expect the government will remain committed to the path of gradual fiscal consolidation through a combination of expenditure and revenue measures. Gross general government debt is expected to move closer to 50% of GDP this year. Oman's Sovereign ratings have been under pressure and current yields reflect the weak macro backdrop. On a ratings-adjusted basis, the debt offered is compelling, and we do price-in to our models that in the event of the Sultanate of Oman going through a challenging period of stress, the GCC states would extend their full financial support to alleviate the situation
ICD Sukuk	ICD's investment portfolio represents a cross-section of Dubai's most recognized and significant companies in sectors which the Government has deemed to be strategic for the continued development and growth of Dubai and the UAE. ICD has strategic investments in Finance & Investment, Transportation, Energy & Industrial, Real Estate & Leisure and Retail. The debt offers a good carry for a Government owned establishment.

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