
***2nd Islamic Venture Capital &
Private Equity Conference 2009***

**The Role Of Islamic Private Equity
In The New World Order**

21st May, 2009

PE Landscape In The New World Order

- ◎ **LBO type deals are dead. Up to 40% of LBO debts will default in the next 3 years.**
- ◎ **Without debt financing, deal sizes are getting smaller & returns are correspondingly lower.**
- ◎ **IPO as an exit strategy in Asia is no longer viable, for now.**
- ◎ **PE managers need to shift their focus to new themes**
 - **Special situations**
 - **Distressed debts**
 - **Infrastructure plays like power, water etc.**
 - **Mezzanine financing**
 - **Natural resources**

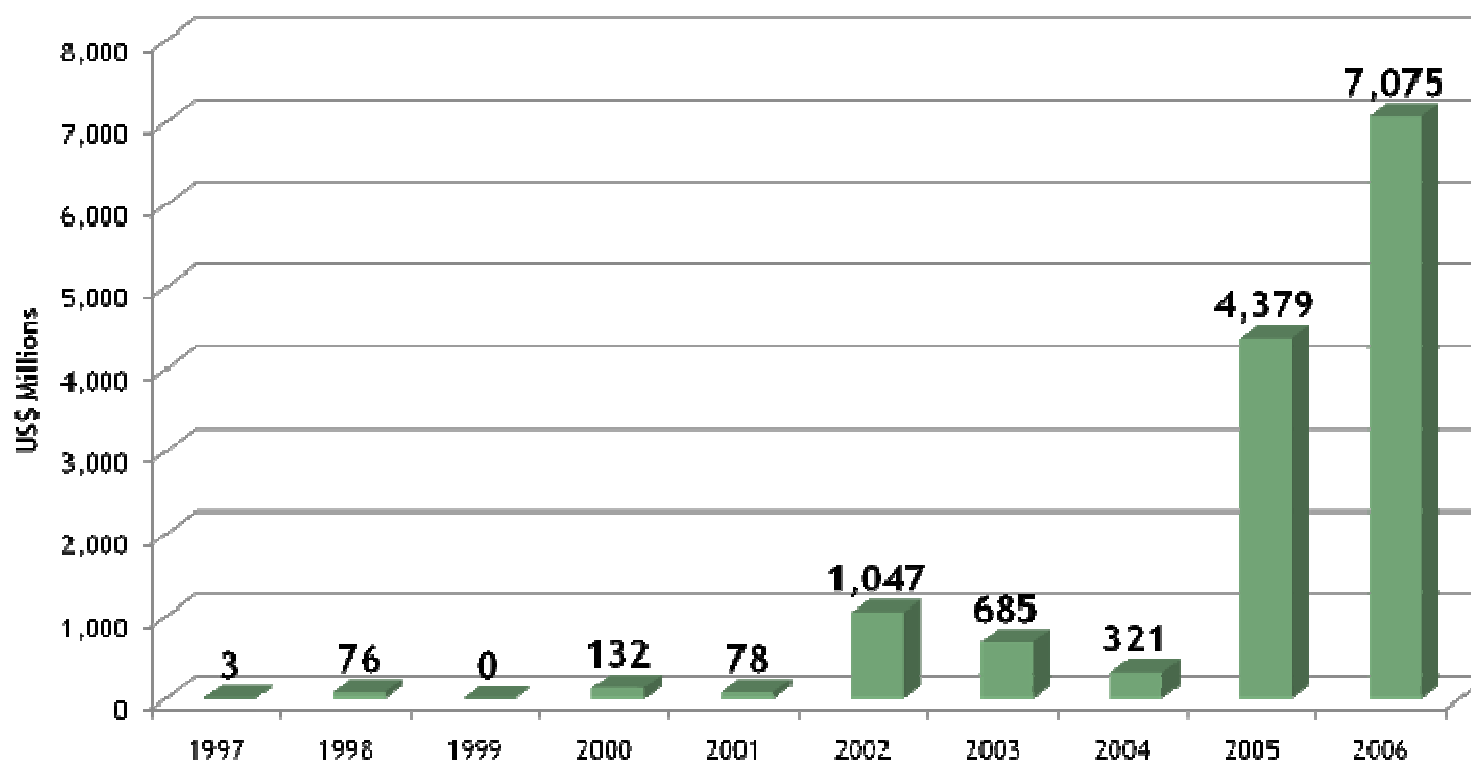
Why Is Islamic PE Relevant?

- ◎ **In the chase for higher returns, especially LBO and MBO transactions, conventional PE has to depend increasingly on debt and financial engineering.**
- ◎ **Private Equity, due to its natural fit with Shariah principles, is an ideal asset class suitable not only for Islamic investors but those who share the following investment principles:**
 - **Profit and Risk sharing**
 - **Active participation in business**
 - **Invest in bona fide business and not purely highly structured financial instruments**
 - **Low debt or gearing ratio**

Islamic Private Equity Investments

- ◉ **Originally, few asset classes were deemed Shariah-compliant:**
 - Real estate
 - Trade finance
 - Commercial leasing
- ◉ **Due to the inherent risk-sharing aspects of PE and natural fit with Shariah principles, Private Equity can be viewed as Shariah-compliant, if properly structured.**
- ◉ **As an alternative investment class, Islamic Private Equity investments can be easily structured, whether in the form of ijara, murabaha or musharaka.**

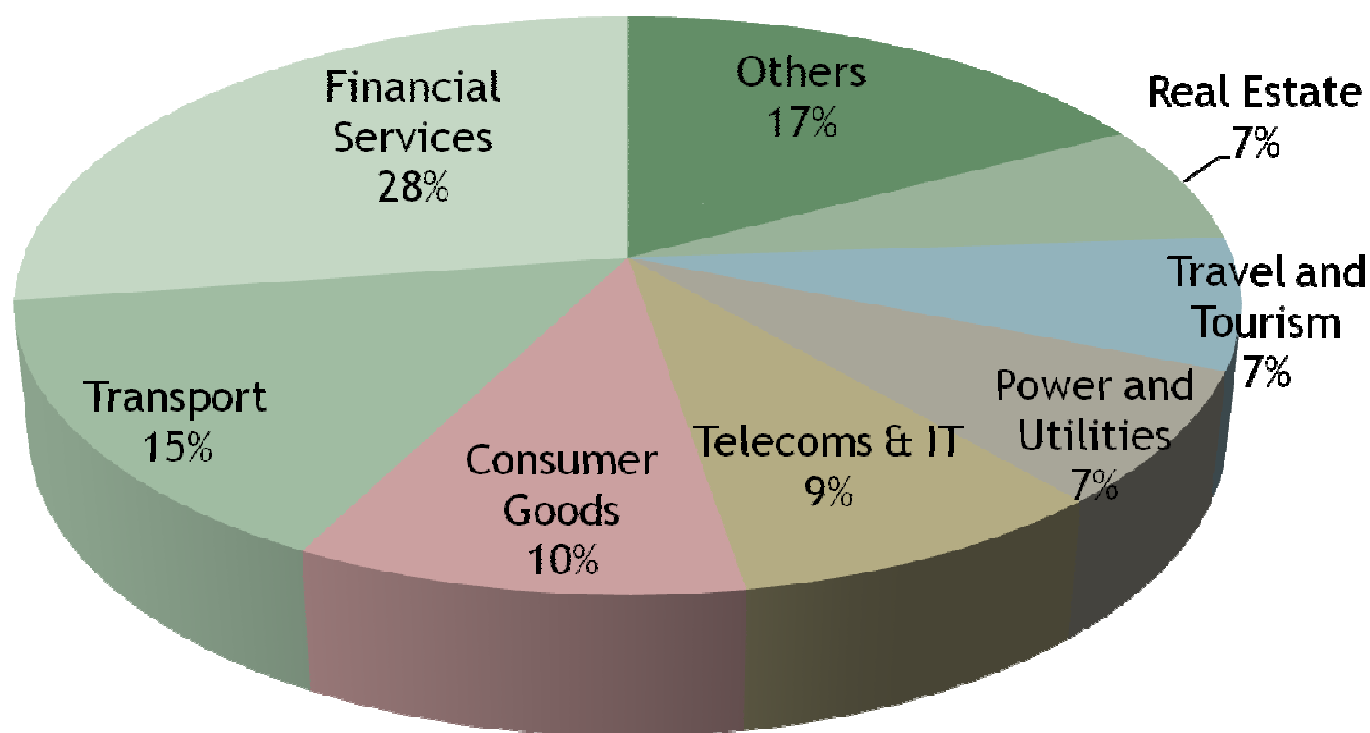
MENA Region PE Funds Raised, 1997-2006



Source: Zawya/KPMG

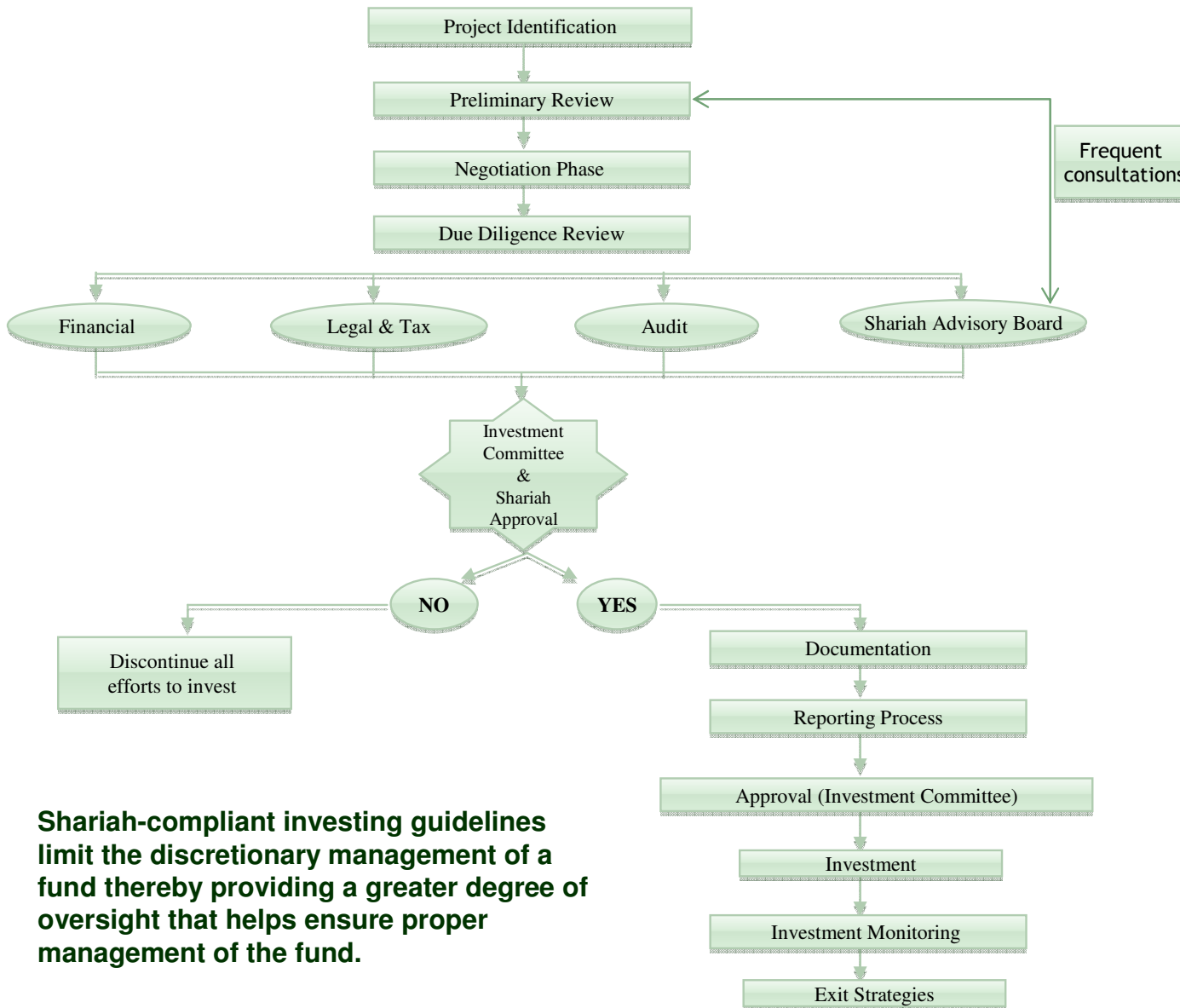
Sector Focus Of Islamic PE, 1997-2006

Sector Focus of Islamic PE Investment, 1997-2006



Source: Zawya/KPMG 2006

Shariah-Compliant Investment Process



Shariah-compliant investing guidelines limit the discretionary management of a fund thereby providing a greater degree of oversight that helps ensure proper management of the fund.

Islamic PE Investment Principles

◎ **Equal Treatment Of Shareholders**

- All shareholders share risks and rewards through partnership.
- Shares of all shareholders should be decided without any ambiguity.
- Ratio of distribution of profit and loss must be agreed upon at the time of execution of the agreement.

◎ **Maximizing Return**

- Islamic PE has the same core objective as conventional PE i.e. maximize return through value creation and investing in asset-backed or economic activity-based transactions.

Islamic PE Investment Principles

◎ Prudent Use Of Leverage

- There are no LBO type deals in shariah-compliant PE investing.
- Deals that depend heavily on debt financing are prohibited.
- Typical Shariah PE only allows a maximum of 33% debt ratio.
- This constraint is applied for ensuring that the company is capitalized in a Shariah-acceptable manner and with the expectation to eliminate debt in the future.
- This concept fits perfectly with the current worrying credit markets situation.

Elimination Of Risks Due To Leveraging

- ◎ **As Shariah investment principles prohibit extreme levels of gearing, it eliminates the risk of LBO deals financed through extremely risky and unhealthy levels of debt.**

- ◎ **Failures caused by LBO type deals:**
 - **Amstar Corp.**
 - **Evenflo & Spalding Holdings Corp.**
 - **Flagstar Companies Inc.**
 - **R.H. Macy & Co.**
 - **Northwest Airlines Inc.**
 - **Northwest Industries Inc.**
 - **Ohio Mattress Co.**

Target Sectors

- ◎ **There are a number of target sectors that lend themselves more readily to Shariah-compliant investments:**
 - Healthcare
 - Education
 - Real estate & property
 - Infrastructure assets
 - Agricultural & plantation assets
 - Consumer & lifestyle products
 - Food & beverage
 - Manufacturing
 - Retail & distribution

- ◎ **Emerging markets are suitable for Shariah-compliant PE investing.**

Challenges Faced By Islamic PE

- ◎ **There is a real need for Shariah-compliant financial R&D:**
 - Shariah-compliant finance competes directly with conventional finance. It relies heavily on conventional financial models & approach.
 - Risk & Reward in conventional finance is deeply rooted in interest rates (cost of money) which is the prime tool for global monetary policies.

$$R^e = R^f + [\beta * (R^m - R^f)]$$

- ◎ **Islamic finance needs to be progressive as new investment opportunities arise e.g., investing in infrastructure assets which require more innovative debt structures.**

Conclusion

- ◎ **Islamic finance will expand the universe of investment opportunities and could potentially have other spin-off benefits such as:**
 - **Shariah-compliant fund of funds**
 - **Financial R&D for Shariah-compliant finance could potentially lead to a new paradigm in global finance by introducing innovative risk & reward pricing mechanisms that does not rely on interest rates.**
 - **With proper allocation of risk and reward, Shariah-compliant finance need not be a competitor to conventional finance but a true alternative to conventional finance.**