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# New Funding Opportunities For Telcos? Islamic Finance Dials Into The Telecom Market With A New Airtime Facility

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The recent announcement by Etihad Etisalat ("Mobily"), the Saudi Arabian telecom operator, of its 2.875 billion dollar Islamic financing was a first on a number of fronts. For Mobily, the achievements were clear; the amount of available funding and the pricing were unprecedented. As pointed out in its press release, it was the largest ever Islamic syndicated loan and the lowest rate of Islamic financing ever granted to a telecom operator in the Middle East and Africa. For the financial institutions and lawyers involved in Islamic and telecom finance, the transaction contained a further unique feature. A new Islamic finance instrument specifically designed for telecom operators, the airtime facility, allows Mobily to sell minutes of airtime to an airtime facility agent acting on behalf of investors. Mobily then acts as the agent of the investors and sells the airtime to its customers for a profit. Mobily is able to obtain the funds that it needs for its business through the sale of a large amount of minutes up front. The investors make a return on their investment similar to what they might make through a conventional loan through the subsequent distribution of those minutes over the life of the financing, but the profit element comes from a sale transaction, not interest.

## Use Of Airtime As The Asset Compared To Other Options

The use of "airtime" as the asset being financed was the break through that allowed the Mobily financing to go forward. Many of the more common Islamic financing techniques involve the use of an underlying tangible asset as the basis of the financing. The value of the relevant assets should be appropriate for the amount of the financing. For this reason, the nature of a company's assets are a key starting point in determining the availability of a given Islamic product. In project financings, for example, the *istisna/ijara* combination is often used. The project company and an SPV enter into an *istisna* (a form of procurement agreement) under which the project company agrees to procure the construction and delivery of certain assets to an SPV by a certain date. The SPV then leases those assets back to the project company under rental arrangements in a forward lease (*ijara*) broadly equivalent to what the project company would pay in principal and interest under a loan agreement. The *istisna ijara* combination works well in connection with the financing of large immovable project assets, such as those used in sectors like petrochemicals,

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aluminum and LNG, or even moveable assets like ships and airplanes. The Islamic investors will often finance specific tangible assets in the deal as part of a larger project financing involving non Islamic tranches of debt alongside the Islamic.

With a telecom operator, two of the most important and valuable assets are the licence and the network infrastructure. Both present difficult challenges as the basis for an Islamic financing. Transferring the licence, often the most valuable asset on the company's books, is generally subject to regulatory approval. In order to qualify to obtain the licence, operators frequently must fulfill certain qualitative and quantitative criteria (for example, minimum numbers of subscribers in other operations, financial criteria, etc.). A special purpose vehicle (SPV) set up by the financing parties and owned by their agent is unlikely to fit well into the regulatory requirements applicable to holders of the licence. Apart from the regulatory hurdles, getting the scholars comfortable with the use of the licence as the basis for a Shariah compliant financing will prove an uphill battle. A simple sale and leaseback of the licence will be unacceptable to many scholars. In general, intangible assets such as a licence don't fit easily into traditional Islamic financing structures.

Infrastructure equipment certainly lends itself more easily to Islamic financing techniques than the licence. *Murabaha* structures are frequently used for the purpose of trade finance and have in the past been used to finance network equipment. Under a *Murabaha*, the Islamic investors purchase the asset from the supplier and then sell it to the company at a marked up price on a deferred payment plan, with economics that broadly mirror those of a conventional loan. As the Islamic investors actually hold title to the asset (if even for a brief moment), the mark up is seen as profit from a sale transaction rather than interest or "*riba*". In addition to *Murabahas*, it is certainly possible that an *istisna ijara* structure could be used to finance network equipment (although the author is not aware of this being done before). Regulatory and liability issues would need to be carefully considered since a good part of the network would be owned by an SPV.

Finally, the list of available Islamic finance products available to telecom operators would not be complete without mentioning the *Tawarruq* or reverse *Murabaha*. In a *Tawarruq*, the Islamic banks purchase an asset, often a commodity, which is sold to the company on a deferred payment plan (much like the traditional *Murabaha*). The company then sells the commodity to the spot market for instant funds. This form of Islamic finance can be used in almost any business since the assets which are bought and sold are not those which will actually be used by the company.

### Advantages Of Airtime

Achieving a Shariah compliant financing was a top priority for Mobily and none of the above Islamic finance products met its medium term financing needs. Firstly, one of the primary purposes of the Mobily financing was to refinance short term debt (including license acquisition costs). The value of the network equipment in itself would have simply not have been enough to form the basis of the financing given the amount required. In addition, given that the majority of the funds raised were for the purpose of a refinancing, an equipment based *Murabaha* would simply not have been available. The *Tawarruq* structure had been used for some of Mobily's short term debt (as had equipment based *Murabahas*) but was not found to be suitable as a medium term solution.

The use of airtime as the underlying asset dramatically expanded the financeable asset base and therefore the amount of the financing that could be made available on a medium term basis. Forecast airtime sales far exceed the financing requirements of the company, allowing the size of the facility to be determined by the company's financial needs and ability to support debt rather than being limited by the value of particular assets. In this way it combined all the advantages of a *Tawarruq* while at the same time still using the company's own assets as the basis for the financing. Airtime appealed to the scholars. It was commercially understandable, involving the sale and distribution of the company's main product. It

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did not suffer from the appearance of artificiality that affected other possible structures (especially those involving the license). From an accounting point of view, where substance prevails over form, it could still be treated as a financing transaction.

**Transaction Documentation**

The financing was documented with the following principal agreements: a master sale and purchase agreement; a distribution and support agreement, an investment agency agreement and a sale undertaking. As the transaction involved Islamic facilities other than the airtime facility, a common terms agreement set forth the representations and warranties, covenants and events of default common to all facilities.

**Master Sale and Purchase Agreement**

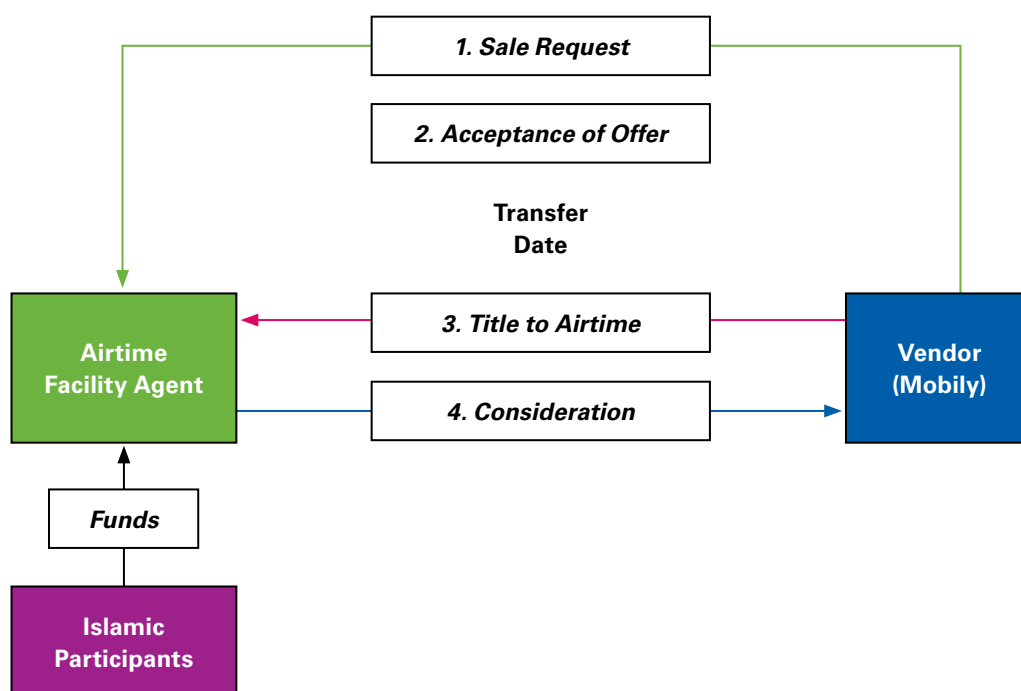
The Master Sale and Purchase Agreement was entered into between the airtime facility agent and the company as vendor.

Under the Master Sale and Purchase Agreement, the company may offer to sell to the airtime facility agent (acting on behalf of the airtime facility participants) an amount of airtime (represented in a number of minutes) on its network together with distribution services in connection with such transferred airtime. Together with other conditions to funding, (i.e. drawdown) that are common to conventional loan agreements, the offer of airtime is subject to the conditions precedent set out in the common terms agreement as well as to limitations on the amount of available airtime that may be sold to the airtime facility agent.

If the conditions referred to above are met, the airtime facility agent is required to accept the offer and purchase the airtime for an amount calculated by multiplying the airtime offered by the company by a base currency unit (in this case one (1) Saudi Riyal). This amount is payable to the company on a transfer date specified in the offer to sell the airtime. On the transfer date, the company transfers title to the airtime to the airtime facility agent.

The basic mechanics are captured in the diagram below.

**Master Sale and Purchase Agreement—Sale Request and Transfer of Airtime**



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In addition to the representations and warranties typical in a conventional loan financing, the company makes certain representations and warranties to the airtime facility agent as to its ability to act as a distribution agent in respect of the airtime transferred to the airtime facility agent and acknowledges that the airtime facility agent has agreed to purchase the airtime (on behalf of the airtime facility participants) from the company in reliance on the fact that distribution services are to be provided together with the airtime and that the airtime facility agent and the airtime facility participants will sustain losses to the extent that the company fails to provide distribution services.

The Master Sale and Purchase Agreement also provides mechanisms for the reduction of available airtime which the company is entitled to offer to sell to the airtime facility agent following a cancellation in relation to a single airtime facility participant and cancellation of the commitments of all the airtime facility participants. In addition, the agreement also contains a mechanism so that on the occurrence of an enforcement event (prior to amounts being repaid as required distribution revenue pursuant to the Distribution and Support Agreement) the airtime facility agent may obtain a refund for airtime consideration paid as well as liquidated damages.

### **Distribution and Support Agreement**

The Distribution and Support Agreement is entered into between the airtime facility agent and the company as distribution agent.

Under this agreement, the airtime facility agent appoints Mobily as its agent to carry out and perform the following distribution services for the term of the facility:

- (i) the sale and distribution in each quarterly period following the end of the availability period—a “distribution period”—of a pre-agreed amount of airtime purchased by the airtime facility agent pursuant to the Master Sale and Purchase Agreement and distributed pursuant to a distribution schedule. The company is required to earn a minimum revenue from the sale and distribution of such airtime during each distribution period—the “required distribution revenue”. The required distribution revenue for each distribution period consists of a profit element calculated by reference to a margin and a reference rate (LIBOR/SIBOR) and on certain dates a base value component (being a percentage of the aggregate airtime consideration paid by the airtime facility agent pursuant to the Master Sale and Purchase Agreement); and
- (ii) obtaining and maintaining all necessary rights, powers, authorities, skill and equipment to perform the services referred to above.

On the commencement of each distribution period, the airtime facility agent notifies the company of the required distribution revenue for such period and, on the final day of each distribution period, the company is required to pay the airtime facility agent the required distribution revenue.

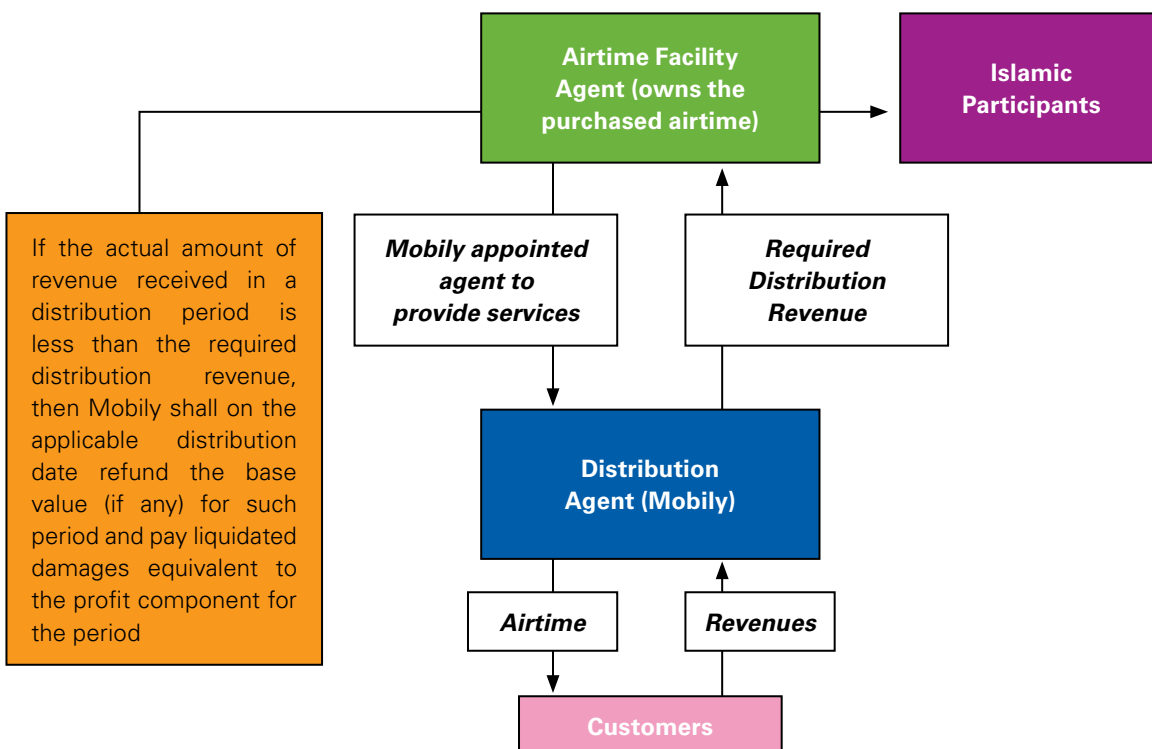
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The company undertakes to the airtime facility agent (acting on behalf of the airtime facility participants) that it will realise a minimum return from the sale of airtime. Accordingly, if the actual amount of revenue received in a distribution period is less than the required distribution revenue, then the company shall on the applicable distribution date refund the base value (if any) for such period and pay liquidated damages equivalent to the profit component for such period.

As the initial distribution schedule is based upon the assumption that the maximum amount of airtime will be purchased under the Master Sale and Purchase Agreement, the Distribution and Support Agreement contains mechanics for the distribution schedule to be updated in a number of circumstances. These include updates to take account of the aggregate amount of airtime actually purchased, the company electing to repurchase (prepay) an amount of airtime and refunds to a single airtime facility participant. The Distribution and Support Agreement also contains mechanics so that the company shall refund amounts of base value outstanding together with any profit element (as

The basic mechanics are captured in the diagram below.

**Distribution and Support Agreement—Sale of Airtime in a Distribution Period**



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liquidated damages) following an enforcement event. It also allows for refunds to a single airtime facility participant (in the case of, for example, illegality).

### **Airtime Investment Agency Agreement**

The relationship between the airtime facility agent and the airtime facility participants is governed by the Airtime Investment Agency Agreement, which also includes mechanics for the airtime facility participants to make contributions towards the purchase of airtime, payments by the airtime facility agent and transfers by the airtime facility participants of their participations. It also contains the mechanisms whereby the company may elect to cancel or repurchase airtime.

### **Sale Undertaking**

The Sale Undertaking documents the mechanics pursuant to which the company repurchases airtime following its election to prepay the airtime facility.

### **Future Use**

No doubt the Saudi Arabian context of the Mobily financing gave added impetus to the development of a Shariah compliant structure that could meet the precise financing needs of the company. Yet with

some 22 percent of the world's population Muslim and the strong cultural desire to see the Islamic financing sector develop, the likelihood of other telecom operators finding a use for this structure seems strong. The acceptance by the scholars of airtime as an asset for the purposes of a Shariah compliant financing gives telecom operators access to a new pool of potential capital by allowing dedicated Islamic banks to invest in their business. The amount of the available funding will not be restricted by the valuation of a particular asset, but be based upon the financing needs and credit considerations of the relevant company. Whether a greenfield financing or a refinancing, the airtime facility structure should prove a welcome addition to the available financing options open to telecom operators.

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