



CMP/SEP/2019/0020

29th September 2019

Mr. Hassan Al Serkal

EVP, COO – Head of Operations Division, Market Operations Division

Dubai Financial Market

P.O Box 9700

Dubai - United Arab Emirates

Dear Mr. Al Serkal,

Subject: CI Ratings Affirms GFH's Rating at 'BB' with a Stable Outlook

Capital Intelligence Ratings (“CI Ratings”), the international credit rating agency, has affirmed its Long-Term Foreign Currency Rating (LTFCR) and Short-Term Foreign Currency Rating (ST FCR) for GFH at ‘BB’ and ‘B’, respectively, with Outlook for the ratings at Stable.

The ratings affirmation was once again supported by strong and increased liquidity reported by the Group and underpinned by an improved funding profile in line with GFH’s strategy to diversify its business and income generating investments and activities. According to the report, increased liquidity is being driven by improved confidence in GFH, which saw sustained growth in money market funds. Also supporting the ratings is GFH’s sound leverage along with satisfactory debt service capacity, and the strong profitability at both the operating and net levels. An additional factor cited as contributing to the ratings is the Group’s sound capital adequacy and improved internal capital generation rate.

The report also highlighted GFH’s continuous progress on its key strategic objective to transform itself from an investment bank into a financial group, notwithstanding the challenging operating conditions in the region.

Management’s Opinion on the Assigned Rating:

CI Rating’s affirmation of GFH’s ratings reflects the continued recognition of the strong and steady progress GFH is delivering across its businesses. The bank will continue diversifying its business and securing strong income generation for the benefit of its shareholders and investors. The management is looking forward to keep building on this momentum and to delivering even stronger results and performance in 2019 and beyond.

Yours Sincerely,

A handwritten signature in blue ink, appearing to read 'Nabeel Mirza', enclosed within a blue oval scribble.

Nabeel Mirza

Head of Compliance

Ref: BH02818CRA00-1

26th September 2019

GFH Financial Group's Ratings Affirmed

Capital Intelligence Ratings (CI Ratings or CI), the international credit rating agency, today announced that it has affirmed GFH Financial Group's (GFH) Long-Term Foreign Currency Rating (LT FCR) and Short-Term Foreign Currency Rating (ST FCR) at 'BB' and 'B', respectively. The Outlook for the ratings is Stable. The ratings are supported by good and increased liquidity underpinned by an improved funding profile. The latter reflects the significant increase in funds mobilized in the money market primarily from individuals, financial and non-financial institutions in the region. Also supporting the ratings is GFH's sound leverage along with satisfactory debt service capacity, and the strong profitability at both the operating and net levels, although this has been boosted by significant non-recurring items in recent years. An additional factor supporting the ratings is the group's sound capital adequacy and improved internal capital generation rate. The major rating constraints are increased Bahrain sovereign credit risk and the high concentration of assets in the real estate sector. Additional factors constraining the ratings are the challenging domestic and regional economic environment coupled with increased geopolitical tension, and the relatively weak financing asset quality at subsidiary Khaleeji Commercial Bank (KHCB) in Bahrain.

GFH continues to make progress on its key strategic objective to transform itself from an Islamic investment bank into a fully integrated Sharia'a compliant financial group, notwithstanding the difficult operating conditions in Bahrain and the broader region. As GFH diversifies its business model we expect this to mitigate the effect of its high legacy exposure to real estate development assets and, concurrently, reduce the earnings volatility attributed to investment banking. Crucially, the group has focused on strengthening balance sheet liquidity by decisively focusing on expanding treasury and money market activities. This is being driven by improved confidence in GFH, which saw money market funds sustain strong growth during H1 2019. In turn, the contribution of money market funds to total funding has increased in both percentage and absolute terms.

We consider this factor together with improved liquidity to be a credit strength. There is however concentration by client – as is the case with almost all GCC banks – with this being partially a function of its wholesale bank status (GFH itself cannot accept retail deposits, although the subsidiary KHCB in Bahrain does). At the same time, GFH has continued to successfully pay down debt and reduce utilisation of more sensitive market-based sources of funding.

Alongside GFH's improved debt service capacity – and increased money market funding base – the proportion of term debt in total liabilities has declined to a low level. Leverage at the consolidated level remained sound despite increasing as a result of larger volumes of money market funds. That said, the utilisation of a leverage ratio at the consolidated level is distorted to some degree by the balance sheet of KHCB, a retail deposit taking institution. The surplus funds generated by GFH have been deployed into liquid Sukuk issued by Central Bank of Bahrain (CBB), amongst others. Sukuk holdings have in turn helped improve the group's liquidity position in recent periods.

GFH's capital adequacy remained sound with this factor also supporting the ratings. Key capital ratios remained well above CBB minimum regulatory requirements, despite retreating moderately in large part due to a decline in regulatory capital. The latter related to an increase in treasury shares as well as the effect of foreign currency translation loss and reduced minority interest. The contribution of high quality loss-absorbing funds to regulatory capital was considerable as evidenced by the high CET 1 ratio of 15.86%. The Basel III leverage ratio was also strong. GFH's capital flexibility is satisfactory thanks to good bottom-line profitability, although the rate of internal capital generation is ultimately dictated by dividend policy. A lower dividend payout in respect of 2018 earnings benefited the internal capital generation rate. The nature of GFH's business model and in particular the significant asset concentrations means that a sound capital base is crucial.

The asset base continues to demonstrate high concentration by sector, geography and individual investment. This factor is a significant rating constraint in our view. The high exposure to real estate

development and properties is largely a legacy of GFH's former business model (pre-global financial crisis). Development properties represent real estate under development and for sale mostly in Bahrain, UAE, North Africa and India. With GFH firmly in control of these projects, the Group does not rule out an opportunistic sale of these assets. However, the current strategy is to proceed with the development of the projects but with minimum injections of additional cash, by partnering with reputable contractors to develop the land bank in exchange for a revenue share. The exit strategy for the projects could take place in the form of strategic sell outs, sale of underlying assets or initial public offerings. Two single projects (one each in Bahrain and India) represented a significant share of total capital. A majority of assets are in Bahrain where sovereign risk has increased over the last few years.

KHCB's financing asset quality and net profitability have deteriorated partially due to prevailing difficult economic conditions in Bahrain and, more recently, the adoption of IFRS 9 in 2018. The increase in the NPF ratio is partially mitigated by KHCB's relatively low share of financings in total assets. Operating profitability, capital adequacy and liquidity however remained sound. KHCB provides significant diversification benefits to the Group's overall risk profile.

GFH's operating and net profitability is good relative to the rating level, notwithstanding the exceptional nature of items in recent years. Income generation will also more than likely remain dependent on deal flow to a significant degree over the short to medium term in CI's view. That said, GFH's operating profitability continues to bestow satisfactory risk absorption capacity and is capable of withstanding additional provision charges that could arise. Notwithstanding the setback in KHCB's bottom line profitability, the entity continues to generate a steady revenue stream thus negating the effect of earnings volatility to some degree at group level. Revenue however is skewed towards non-financing income, reflecting the limited profit-earning assets within the asset mix and, conversely, high exposure to real estate development and properties. Effective cost containment has preserved the cost-to-income ratio at a satisfactory level.

CREDIT RATINGS

Corporate Ratings		
Long-Term	Short-Term	Outlook
BB	B	Stable

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About the Ratings

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