



CMP/SEP/2014/0002
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Mr. Hassan Al Serkal
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Dear Mr. Al Serkal,

Subject: Elaboration on Credit Rating

Gulf Finance House (GFH) would like to share further details with its shareholders on the recent upgrade in credit rating assigned by Capital Intelligence (CI), the international credit rating agency.

Capital Intelligence (CI) in its announcement declared the following, while raising GFH's Long-Term Rating to 'BB' from 'BB-' and affirmed the Short-Term Rating at 'B'. The Outlook for GFH's ratings reverts to 'Stable' from 'Positive' following the rating action.

"Gulf Finance House (GFH), in common with other Islamic and conventional investment companies in the Gulf Cooperation Council (GCC) region, had suffered a major setback in credit metrics and operations following the domestic and regional financial crisis in 2009. As well as experiencing a dramatic worsening of asset quality, the Company was also hit by a severe liquidity squeeze which forced debt restructuring with lenders and suspension of new investment. GFH has since successfully paid down debt and rebuilt its capital base. Concurrently, leverage has improved noticeably due to the twin effect of debt repayment and successive increases in equity over the past three years. Indeed, the success of the capital increase (under the convertible Murabaha programme), amid ongoing challenging market conditions, underscores the high degree of investor demand for Shari'a compliant products, as well as rather strong shareholder support.."

Although GFH continues to diversify its sources of funding its liquidity remained tight at end 2013, despite the moderate improvement in key ratios. The low liquidity reflects the limited holdings of cash and bank balances in combination with the significant stock of unquoted investment securities. Encouragingly, GFH's liquidity metrics improved in the current quarter following the successful USD100mn refinancing with a major regional lender. This has extended debt maturities and enhanced its debt service capacity. As regards the considerable holdings of unquoted investments in the infrastructure sector, GFH's strategy is to exit these investments principally by means of strategic sell outs, sale of underlying assets or through initial public offerings. However, this is likely to be a drawn out process given the soft market conditions. GFH continues to have high sector concentration risk in infrastructure and real estate, although this is partly a legacy of its former business model. The current business model will avoid greenfield higher risk large projects and instead focus on diversifying assets and revenues across sectors and geography.



Notwithstanding GFH's return to net profit in 2012, profitability remains an area of relative weakness, underscoring its limited income generating capacity. Total income slipped further in 2013, dragging down the modest return on average assets (ROAA), despite a further decline in total operating costs. Net profit and total income recovered in H1 of the current year, but this was on the back of a sizeable non-recurring item. Earnings volatility is inherent in GFH's business model given the reliance on deal flow and limited recurring revenue streams. Currently, the large portfolio of underperforming investments also has a negative effect on profitability. Management projections for the near to medium-term envisage a sustained recovery in profitability boosted by income from investment in profitable commercial and asset management companies. The expected improvement in profitability and cash flow will strengthen GFH's liquidity and support debt servicing. In that regard, the marked reduction in leverage in recent years is a major positive credit factor.

In view of the recent successful refinancing and moderately improved liquidity position CI raises GFH's Long-Term Rating to 'BB' from 'BB-'. The extended debt repayment period, as well as the significant reduction in leverage, supports the rating. Although net profit has remained in positive territory GFH's earnings profile is characterised by volatility given the reliance on deal flow, very limited recurring revenue streams and sizeable portfolio of underperforming investment securities.

The Short-Term Rating is affirmed at 'B'. The Outlook for the ratings, which had been 'Positive', reverts to 'Stable' following the upgrade. The factors constraining GFH's ratings are the forced debt restructuring a few years ago, encumbered asset base, and the small balance sheet coupled with single name and sector concentrations. Also constraining the ratings is the still challenging investment environment..

The successive injections of capital in recent years under the first convertible Murabaha programme, in combination with debt repayment, have clearly reduced GFH's previously high leverage. The additional increase in equity in H1 2014 coupled with the recent successful refinancing are expected to sustain leverage at the current sound level, improve liquidity further and reduce finance costs over the near term. However, income generation is projected to remain modest and subject to volatility given the ongoing dependence on deal flow and limited recurring income. Going forward, the Company seeks to invest the proceeds generated from the new convertible Murabaha programme into cash generating operating businesses which should produce sustainable revenue streams and returns. While sources of funding are currently adequate, GFH's financial flexibility remains rather limited, notwithstanding the recent improvement, due to the significant proportion of assets pledged as security to lenders".

- **Long-term Rating:**

BB, a *Speculative Grade*, refers to speculative credit quality. Capacity for timely fulfillment of financial obligations is vulnerable to adverse changes in internal or external circumstances. Financial and/or non-financial factors do not provide significant safeguard and the possibility of investment risk may develop.

- **Short-term Rating:**

B, a *Speculative Grade*, refers to an adequate capacity for timely repayment that could be seriously affected by unexpected adversities.

Note: The (-) or the (+) is added to the rating based on the discretion of the rating agency. This symbolizes the weightage of the rating granted.



Management opinion on the assigned Credit Rating:

The management of the Bank feels that the upgrade in the rating is a further acknowledgement by the market and a vote of confidence in their strategy and the strong progress the Bank continues to make both financially as well as operationally. It is an important validation which indicates that the Bank is on the right track and continues to have the support of the market and its shareholders. The upgrade in rating will further strengthen market confidence in the Bank and allow for better business opportunities in the future.

Yours Sincerely,

Nabeel Mirza
Compliance Director & MLRO