Company Report
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GFH Financial Group

Balance sheet has de-risked further, with RWAs down 12% y/y, and higher provision buffers

- **EPS increased by 7.8% y/y in Q4 on the back of 15.3% higher revenue (FY 22 10.8% y/y), aided by the proprietary and co-investment segment (2.8x), the commercial banking segment (+54% y/y) and treasury portfolio (+42% y/y), more than offsetting higher OpEx (+36%) and CoF (+41%).**
- **Asset quality improved with stage 2 and 3 loans falling from 18.2% and 8.3% YE 21 to 9.6% and 4.6% YE 22, respectively, while coverage of stage 2 and 3 improved from 2.8% and 38.6% YE 21A, respectively, to 8.4% and 49.4%.**
- **Assets increased 21% y/y, AuM by 17.3% y/y to USD 17.6bn, and RoE was 9%.**
- **Maintain BUY as current valuation is not pricing in better earnings resilience, improved return generation as GFH continues to reduce its real estate exposure and its growing AuM base (market cap/AuM of 5.3%).**

EPS growth reached 7.8% y/y in Q4 (vs. 8.2% in Q3, 4.9% in Q2 and 0.1% in Q1) because of a broad-based improvement in CB, proprietary and co-investments, and treasury. Q4 earnings were supported by higher i) income from the commercial banking segment, up by 54% y/y, on the back of a growing balance sheet with asset base up by 22% mainly through expanding investments in sukuk (+62%), ii) direct investment income and iii) treasury income, up by 42% y/y. Nevertheless, this was partially offset by higher finance expense as 73% re-prices at higher rates and OpEx, up by 41% and 6%, respectively.

FY 22 profit growth advanced by 5.5%, as stronger performance in IB, CB and direct investments, was partially offset by weaker treasury income (-10%), impacted by the rate hikes, lower other income (-60%), higher OpEx (+11%) and finance expenses (+41%). We expect further EPS and RoE improvement on i) the commercial banking (higher NIMs), ii) the investment banking (healthy project pipeline as GFH targets the healthcare and logistics sectors in KSA), and iii) stabilization in treasury income as pace of rate hikes slows. Income from proprietary and co-investments remains a volatile source of income, impacted by the sales of investments. We pencil in a topline growth of 53% in FY 23e.

Expanding asset base (+21% y/y) through growing treasury portfolio and financing book. Asset growth was 21% y/y and 8% q/q, mainly through i) higher sovereign exposure with treasury portfolio up by 34%, ii) increased proprietary investment book (mostly the Sukuk of Infracorp of USD 690m), iii) larger financing book, expanding by 9.5% y/y mainly through Ijarah assets (+30%). Following the Infracorp transaction through which GFH disposed 60% of its stake and transferred the majority of its real estate assets, equity investments surged by 6x y/y on the balance sheet while real estate investments fell by 32% y/y. The Group managed to grow its AuM by 17.3%, from USD 15bn in FY 21 to USD 17.6bn.

Balance sheet has been de-risked, but remains dependent on funding from FIs. Asset base expansion was mainly funded through higher placements from financial institutions (reaching USD 3.8bn, up from USD 2.3bn), up by 66% y/y, with some support from placements from non-financial institutions/ individual and term financing (in total c.USD 1.1bn), up by 38% and 11%, respectively. Net debt to equity ratio currently stands at 1.09x. GFH's RE exposure should continue to fall, with the remaining 40% of its stake in Infracorp likely to be offloaded in H2 24. GFH targets growing its AuM base from USD 17.6bn at YE 22A to USD 25bn through organic/inorganic growth.

BUY USD 0.37

Banks / BAHRAIN

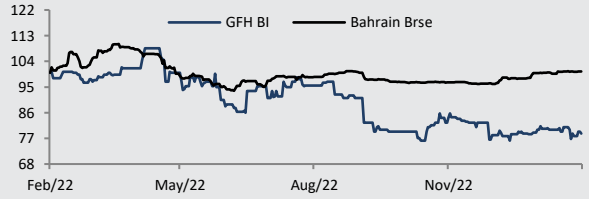
Bloomberg code	GFH BI
Market index	Bahrain Brse
Target Price	0.37
Upside (%)	48.5

Market data 3/20/2023

Last closing price	0.25
52 Week range	0.2-0.3
Market cap (USD m)	943
Average Daily Traded Value (USD m)	0.3
Free float (%)	82%

Year-end (local m)	2021	2022	2023e	2024e
Revenues	262	237	280	314
Pre-provisioning profit	128	89	134	162
EPS	0.02	0.02	0.03	0.03
P/E (x) (mkt price)	11.4	10.6	9.4	7.6
BVPS	0.3	0.3	0.3	0.3
Tangible BVPS	0.3	0.3	0.3	0.3
P/B (x) (mkt price)	1.0	1.0	0.9	0.9
P/TBVPS (x) (mkt price)	1.0	1.0	0.9	0.9
DPS	0.01	0.02	0.02	0.02
Div. yield (%)	4.8	6.4	6.4	7.2
RoAA (%)	1.1	1.0	1.0	1.2
RoRWA (%)	1.0	1.2	1.4	1.7
RoATE (%)	9.0	9.2	10.0	11.8
RoEcC (%)	8.0	9.7	11.0	13.0
RAROC (%)	8.7	9.4	11.3	13.3
Net LtD ratio (%)	87.9	106.7	88.8	88.6
Risk Weighted Assets (bn)	8.3	7.3	7.1	7.5
Core Equity T1 ratio (%)	12.1	13.9	16.2	16.1
Tier 1 capital ratio (%)	12.9	14.0	16.3	16.2
Total capital ratio (%)	13.5	14.7	17.0	16.9
NPL ratio (%)	7.1	3.5	7.0	7.0
Coverage ratio (%)	73.2	124.4	64.1	66.9
Number of shares	3,833	3,833	3,833	3,833

Price Performance



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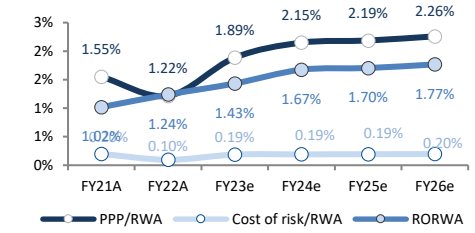
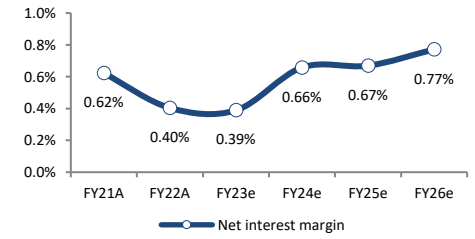
Abacus *Arqaam Capital Fundamental Data*

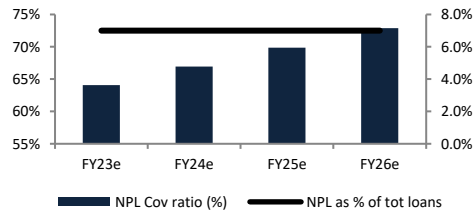
Profitability



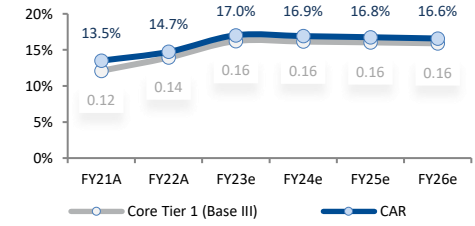
NIM



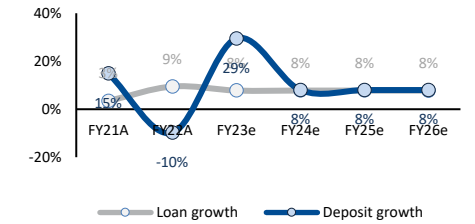
Credit Quality



Capital Ratios



Growth



GFH Financial Group

Year-end	2021	2022	2023e	2024e	2025e	2026e
Performance analysis						
Net Interest Margin (%)	0.62	0.40	0.39	0.66	0.67	0.77
Asset yield (%)	4.13	4.38	5.00	5.00	5.05	5.20
Cost of Funds (%)	1.44	1.38	1.65	1.72	1.78	1.85
Risk Adjusted Margins (%)	(0.23)	0.08	(0.11)	0.20	0.23	0.34
Cost / Income (%)	51.0	62.5	52.2	48.3	47.1	45.5
Net Interest Income / total income (%)	4.6	3.7	3.7	6.6	7.1	8.5
Fees & Commissions / operating income (%)	1.8	3.9	3.6	3.6	3.7	3.8
Trading gains / operating income (%)	62.9	75.1	76.6	74.0	72.7	70.6
RoATE (%)	9.0	9.2	10.0	11.8	12.0	12.5
Pre-prov. RoATE (%)	10.4	9.8	11.1	12.7	13.0	13.5
RoAA (%)	1.1	1.0	1.0	1.2	1.2	1.2
Revenue / RWA (%)	3.17	3.25	3.95	4.16	4.13	4.14
Operating Costs / RWA (%)	1.62	2.03	2.06	2.01	1.95	1.88
PPP / RWA (%)	1.55	1.22	1.89	2.15	2.19	2.26
Cost of Risk / RWA (%)	0.20	0.10	0.19	0.19	0.19	0.20
RoRWA (%)	1.02	1.24	1.43	1.67	1.70	1.77
RoRWA (%) (adj. for gross-up of associates)	1.02	1.24	1.43	1.67	1.70	1.77

Year-end	2021	2022	2023e	2024e	2025e	2026e
Asset Quality						
Provisions charge / avg. gross loans (%)	1.2	0.5	0.9	0.9	0.9	0.9
Past due not impaired / gross loans (%)	4.1	4.8	4.0	4.2	4.3	4.5
NPL / gross loans (%)	7.1	3.5	7.0	7.0	7.0	7.0
NPL coverage ratio (%)	73.2	124.4	64.1	66.9	69.9	72.9
Provisions / avg. gross loans (%)	4.1	4.8	4.0	4.2	4.3	4.5
Provisions charge / operating income (%)	12.8	7.8	9.9	8.8	8.8	8.7

Year-end	2021	2022	2023e	2024e	2025e	2026e
Funding and Liquidity						
Net Loans / Deposits (%)	87.9	106.7	88.8	88.6	88.5	88.3
Cash and interbank / assets (%)	8.9	8.8	11.7	8.5	5.5	2.8
Deposits / liabilities (%)	21.6	15.5	18.5	18.5	18.4	18.4

Year-end	2021	2022	2023e	2024e	2025e	2026e
Capital and leverage ratios						
Core Tier 1 ratio (Basel III) (%)	12.1	13.9	16.2	16.1	16.0	15.9
Tier 1 ratio (%)	12.9	14.0	16.3	16.2	16.1	16.0
Total capital ratio (%)	13.5	14.7	17.0	16.9	16.8	16.6
Tangible equity / assets (%)	14.5	11.0	10.6	10.5	10.3	10.1
RWA / assets (%)	102.3	74.6	67.4	66.2	65.2	64.2

Year-end	2021	2022	2023e	2024e	2025e	2026e
Growth						
Revenues (%)	38.9	(9.6)	18.5	11.9	5.6	6.7
Cost (%)	18.9	10.8	(1.1)	3.5	3.0	3.0
Pre-Provision Operating Profit Growth (%)	68.4	(30.9)	51.2	21.0	8.1	9.9
Provisions (%)	78.8	(57.7)	91.2	8.0	8.0	8.0
Net Profit (%)	86.8	7.2	12.8	24.1	8.2	10.3
Assets (%)	22.7	20.7	8.0	8.0	8.0	8.0
Net Loans (%)	3.5	9.5	7.8	7.8	7.8	7.8
Deposits (%)	14.9	(9.8)	29.5	8.0	8.0	8.0
Risk Weighted Assets (%)	-	(11.9)	(2.5)	6.2	6.3	6.4

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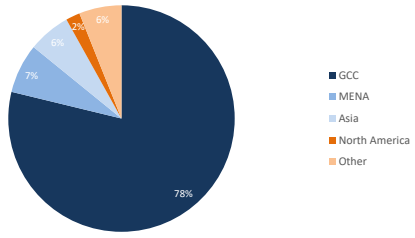
Abacus *Arqaam Capital Fundamental Data*

Company Profile

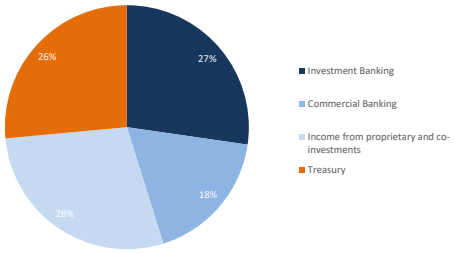
GFH is a Bahrain-domiciled Sharia-compliant financial group that is focused on investment banking, treasury activities, commercial and retail banking in Bahrain via Khaleeji Commercial Bank BSC (KHCB) and proprietary investments.

S&P raised the credit rating from B- to B with a stable outlook, reflecting the revenue resilience and improvement in RoE.
Infracorp launched a USD 900m green bond on the LSE.
GFH is listed on four stock exchanges.

Geographical breakdown



Revenue Breakdown



Management	
CEO	Hisham Ahmed Al Rayes
CFO	Suryanarayanan Hariharan
COO	Salah Abdulla Sharif

Major Shareholders	
Keypoint Trust	10.00%
AL RAGHD & AL MANAR REAL ESTATE	9.79%

GFH Financial Group

Year-end	2021	2022	2023e	2024e	2025e	2026e
Income statement (USDmn)						
Interest income	79	95	132	158	178	204
Interest expense	67	86	122	137	154	173
Net Interest Income	**12**	**9**	**10**	**21**	**24**	**30**
Fee income	5	9	10	11	12	13
Net investment income	55	58	95	103	102	99
Other operating income	191	161	164	179	194	210
Total operating income	**262**	**237**	**280**	**314**	**331**	**353**
Total operating expenses	134	148	146	151	156	161
Pre-provision operating profit	**128**	**89**	**134**	**162**	**175**	**193**
Net provisions	16	7	13	14	15	17
Other provisions / impairment	19	(4)	12	13	14	16
Operating profit	**93**	**85**	**108**	**134**	**145**	**160**
Associates	-	12	-	-	-	-
Pre-tax profit	**93**	**98**	**108**	**134**	**145**	**160**
Taxation	-	-	-	-	-	-
Net profit	**93**	**98**	**108**	**134**	**145**	**160**
Minorities	8	7	6	8	9	10
Others	-	-	-	-	-	-
Attributable net profit	**84**	**90**	**102**	**126**	**137**	**151**
Diluted EPS	0.02	0.02	0.03	0.03	0.04	0.04
DPS	0.01	0.02	0.02	0.02	0.02	0.02
BVPS	0.25	0.26	0.27	0.29	0.31	0.32
Tangible BVPS	0.25	0.26	0.27	0.29	0.31	0.32

Year-end	2021	2022	2023e	2024e	2025e	2026e
Balance sheet (USDmn)						
Gross loans and advances	**1,382**	**1,500**	**1,620**	**1,749**	**1,889**	**2,040**
Less: loan loss provisions	71	64	73	82	92	104
Net loans and advances	1,311	1,435	1,547	1,667	1,797	1,936
Cash and central bank	722	858	1,440	1,668	1,914	2,180
Due from banks	-	-	-	-	-	-
Investment, net	5,379	6,644	6,848	7,293	7,773	8,292
Fixed assets, net	140	233	74	74	74	74
Other assets	531	590	632	683	738	797
Total assets	**8,084**	**9,760**	**10,541**	**11,384**	**12,295**	**13,279**
Customer deposits	1,491	1,345	1,741	1,881	2,031	2,194
Due to banks	-	-	205	698	1,232	1,813
Debt	3,863	5,733	5,733	5,733	5,733	5,733
Other liabilities	1,561	1,611	1,740	1,879	2,029	2,192
Total liabilities	**6,916**	**8,689**	**9,419**	**10,191**	**11,026**	**11,931**
Total equity	**1,168**	**1,071**	**1,122**	**1,194**	**1,269**	**1,348**
Risk Weighted Assets (bn)	8	7	7	8	8	9
Average Interest-Earning Assets	1,919	2,163	2,640	3,161	3,523	3,914
Average Interest-Bearing Liabilities	4,691	6,216	7,379	7,996	8,654	9,368
Common shareholders	963	997	1,037	1,103	1,171	1,241
Core Equity Tier 1 (Basel III)	1,001	1,016	1,152	1,218	1,286	1,356
Tier 1 capital	1,064	1,020	1,157	1,222	1,290	1,361

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Asset quality improved significantly. Stage 1, 2, and 3 loans make up 85.8%, 9.6%, and 4.6%, respectively, compared to 73.5%, 18.2%, and 8.3%, respectively, at YE 21A. Stage 1, 2, and 3 loans coverage stand at 1.4%, 8.4%, and 49.4%, respectively, compared to 2.0% 2.8%, 38.6%, respectively, as of YE 21A. We still identify a slight provision deficit of USD 7.5m vs. our standard stress test of 1% coverage on stage 1 loans, 12% on stage 2, and 60% on stage 3. However, the collateral is substantial, with average collateral coverage ratio on secured facilities at 149.7%. Furthermore, the financing book is well diversified with exposure spread across segments: 31% RE, 24% Others, 15% Manufacturing, 15% Construction, and 14% trading.

Optimal capital level and liquidity position. GFH operates at optimal capital levels, with T1 and CAR of 14.0%(+1.22 ppt y/y) and 14.73% (+1.14 ppt y/y), respectively, supported by declining RWA down by 12% to USD 7.3bn. Leverage is reasonable at an asset/equity ratio of 9.8x, while gross loan/equity is low at 1.5x. NSFR improved to 111% (cs. 101% YE 21A), while average LCR slipped from 221% YE 21A to 134%. It has limited fungibility from KHCB to the rest of the bank, with average liquidity of 52% of assets. GFH's LT issuer credit rating was raised by S&P Global Ratings to 'B' from 'B-', with a stable outlook.

The current valuation is not pricing in better earnings resilience. The stock trades at 0.9x P/tNAV 23e, not recognizing the de-risking of the company as GFH continues to reduce its legacy RE exposure, the enhanced focus on RoE, the improved revenue mix, and the limited intangibles on the bank's balance sheet. The valuation of real estate is largely at cost, and we identify a USD 218m mark-to-market gain on the property investment book (11% of our FV) that is not reflected in shareholders' equity (3% of RWAs FY 22), albeit largely comprising land assets (note 9 FS).

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Exhibit 1: Earnings estimate change table (USD m)

	FY 23e			FY 24e			FY 25e		
USD m	**New**	**Old**	**Δ**	**New**	**Old**	**Δ**	**New**	**Old**	**Δ**
Net interest income	10	-166	-106.2%	21	-173	-112.0%	24	-279	-108.4%
Fee income	10	6	73.0%	11	6	73.0%	12	12	0.0%
Investment income	95	231	-58.7%	103	250	-58.7%	102	445	-77.2%
Non-interest income	270	446	-39.5%	293	484	-39.5%	308	651	-52.8%
Total income	**280**	**280**	**0.0%**	**314**	**311**	**1.0%**	**331**	**372**	**-11.0%**
Opex	146	141	3.9%	151	145	4.5%	156	156	-0.3%
Operating income	**134**	**139**	**-3.9%**	**162**	**166**	**-2.1%**	**175**	**216**	**-18.7%**
Loan loss provision	13	13	0.4%	14	14	0.4%	15	15	0.0%
Net income reported	**102**	**107**	**-5.2%**	**126**	**136**	**-7.3%**	**137**	**175**	**-21.7%**
Net income adjusted	**102**	**107**	**-5.2%**	**126**	**136**	**-7.3%**	**137**	**175**	**-21.7%**
Ratios									
NIM	0.39%	-4.34%	4.73%	0.66%	-4.11%	4.77%	0.67%	-7.93%	8.60%
Cost/income	52.2%	50.3%	2.0%	48.3%	46.7%	1.6%	47.1%	42.0%	5.1%
LLP	0.85%	0.85%	0.0%	0.85%	0.85%	0.0%	0.85%	0.85%	0.0%
NPL	7.00%	7.00%	0.0%	7.00%	7.00%	0.0%	7.00%	7.00%	0.0%
Coverage	64.1%	77.0%	-12.9%	66.9%	78.9%	-11.9%	69.9%	69.9%	0.0%
Growth									
Assets	8%	8%	0.0%	8%	8%	0.0%	8%	8%	0.0%
Loan	8%	8%	0.0%	8%	8%	0.0%	8%	8%	0.0%
Deposit	29%	8%	21.5%	8%	8%	0.0%	8%	8%	0.0%
SAR									
EPS	0.03	0.03	-5.2%	0.03	0.04	-7.3%	0.04	0.05	-21.7%
TP	**0.37**	**0.42**	**-12.5%**						

Source: Company Data, Arqaam Capital Research

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Exhibit 2: Valuation Table: (USD m)

Year-end	2016	2017	2018	2019	2020	2021	2022	2023e	2024e	2025e	2026e	2027e	perp	subtotal
1. DCF														
Net profit	217	107	114	66	45	84	90	102	126	137	151	174	181	
Other adjustments (comprehensive income and GW amortization)	--	--	--	--	--	--	--	--	--	--	--	--	--	
Minus: excess return excess capital	18	16	17	10	7	5	5	8	9	9	9	10	11	
Risk free rate	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	
Tax shelter	--	--	--	--	--	--	--	--	--	--	--	--	--	
Adjusted net profit	199	91	97	56	38	79	85	93	117	127	141	164	170	
Capital requirements	516	1,007	964	1,000	993	992	874	852	905	962	1,023	1,089	1,133	
RoEcC	38.5%	9.1%	10.1%	5.6%	3.8%	8.0%	9.7%	11.0%	13.0%	13.3%	13.8%	15.0%	15.0%	
Cost of capital	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	
Capital charge	67	131	125	130	129	129	114	111	118	125	133	142	147	
Economic profit	132	(40)	(28)	(74)	(91)	(50)	(29)	(17)	(0)	2	8	22	23	
Discount factor	--	--	--	--	--	--	--	1.00	0.88	0.78	0.69	0.61	0.54	
NPV of Economic Profit	--	--	--	--	--	--	--	(17)	(0)	2	6	13	12	
DCF EVA Forecast period														4
Perpetual growth rate (nominal GDP)													4.0%	
Terminal Value													253	
Terminal value discounted														138
Required Capital														874
Value of the bank operations														**1,015**
2. Capital surplus/deficit														
Available capital:														
Shareholders equity	908	1,150	1,059	1,005	913	963	997	1,037	1,103	1,171	1,241	1,327		
Minorities	214	346	364	288	273	205	75	84	91	98	106	115		
Less Goodwill & intangibles	(55)	--	--	--	--	--	--	--	--	--	--	--		
Less non equity elements reported shareholders equity														
Less Dividends (if included in reported equity)	(89)	(85)	(32)	(33)	(18)	(46)	(61)	(61)	(69)	(80)	(88)	(99)		
Tangible equity	978	1,411	1,391	1,260	1,168	1,122	1,010	1,061	1,125	1,189	1,260	1,343		
Capital needs														
RWAs (Basel III)	4,299	8,388	8,031	8,330	8,272	8,268	7,285	7,103	7,542	8,015	8,526	9,078		
Equity as % RWA	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%		
Financial stakes	--	--	--	--	--	--	--	--	--	--	--	--		
Capital Requirements	516	1,007	964	1,000	993	992	874	852	905	962	1,023	1,089		
Surplus capital	**462**	**404**	**427**	**260**	**175**	**130**	**136**	**209**	**220**	**227**	**237**	**253**		**136**
3. Other adjustments														
Real Estate hidden value														218
Underprovisionning vs. arqaam acid test (conservative)														(8)
Total adjustments														**211**
4. Dividends														**61**
Total Fair Value														**1,423**
Fully diluted number of shares														3,833
Fair value per share														**0.37**
Current share price														**0.25**
Upside														**48.5%**
Implied P/E (x)	6.6	13.3	12.5	21.5	31.6	16.9	15.8	14.0	11.3	10.4	9.4	8.2		
Implied P/tNAV (x)	1.7	1.2	1.3	1.4	1.6	1.5	1.4	1.4	1.3	1.2	1.1	1.1		

Source: Company Data, Arqaam Capital Research

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