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**Fitch Affirms Investcorp's Ratings At 'BB'; Outlook Positive**

Fitch Ratings has affirmed Investcorp Bank B.S.C.'s (Investcorp) Long-Term Issuer Default Rating (IDR) at 'BB' and Viability Rating at 'bb'. The Rating Outlook remains Positive. A full list of ratings is provided at the end of this release.

KEY RATING DRIVERS - VIABILITY RATING, IDRs, SUPPORT RATING, SUPPORT RATING FLOOR AND SENIOR UNSECURED DEBT

The rating affirmations reflect the company's strong client franchise and high degree of brand name recognition in the Gulf, supported by its solid investment track record and long-term relationships in the region. The ratings also reflect Investcorp's funding strategy, which incorporates the use of long-dated debt to fund its co-investment portfolio. Fitch believes this strategy reduces the impact of refinancing and liquidity risk inherent in Investcorp's business model of originating and syndicating alternative investments. At the same time, Investcorp's regulatory framework as a bank and designation as a domestic systemically important bank (D-SIB) by the Central Bank of Bahrain, add additional levels of risk management, capital and liquidity requirements that other alternative investment managers (IMs) are not subject to.

Rating constraints include the following:

- Meaningful balance sheet co-investments in private equity, hedge funds, real estate and collateralized loan obligations (CLOs), which are subject to valuation volatility;
- Increased potential earnings volatility and placement risk relative to peers, given that transactions are primarily originated and placed with investors on a deal-by-deal basis as opposed to raising dedicated funds with a pre-determined investment period;
- Fitch also notes potential growth/execution risks associated with Investcorp's strategy to more than double assets under management (AUM) to \$50 billion in the medium term though both organic and inorganic growth.

The Positive Rating Outlook primarily reflects the potential franchise and earnings benefits that may accrue to Investcorp as a result of the strategic partnership with Mubadala Development Co. (Mubadala), a sovereign-wealth fund of Abu Dhabi. In March 2017, Mubadala completed its 20% stake purchase of Investcorp, which follows Investcorp's 9.99% ownership stake sale to another Gulf-based institution in 2015. Fitch views these transactions positively, as they may give Investcorp additional credibility with, and expanded access to, potential Gulf-based investors as well as a potentially more stable equity base.

In March 2017, Investcorp closed its acquisition of the debt and CLO management business of UK-based 3i Group PLC (3i) for \$316 million and renamed the business Investcorp Credit Management (ICM). The deal added \$10.8 billion in AUM, expanded Investcorp's product offering into credit and is expected to add approximately \$50 million, annually, in stable management fee revenue to the firm. The deal was funded entirely through cash on the balance sheet, which Fitch viewed favorably. Still, the acquired co-investment assets and on-going CLO risk retention requirements do increase Investcorp's balance sheet risk exposure.

As part of its growth strategy, Investcorp has increased its fundraising capabilities with the addition of client-facing resources to help drive fundraising in the Gulf and, more recently, in Europe and Asia. However, in FY17, fundraising largely kept pace with distributions and redemptions. At June, 30 2017, AUM (excluding \$10.8 billion from the acquired 3i business) had declined approximately \$300 million, to \$10.5 billion, year over year driven by net redemptions in hedge funds, partially offset by increased real estate AUM and flat private equity AUM. Fitch believes organic AUM growth over the Outlook Horizon would indicate benefits accruing to the firm from its influential strategic shareholders and fundraising initiatives.

In FY17, Investcorp's Fitch-estimated fee-related EBITDA (FEBITDA) margin, which excludes more volatile performance fees, improved to 32% (from 30% in FY16) which is at the low

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end of Fitch's 'a' category quantitative benchmark range of 30% to 50% for alternative investment managers. Fitch notes that a significant portion of Investcorp's fee-earnings are based on activity fees earned from transactional activities including initial acquisition, add-ons, subsequent placement, and eventual investment exit. Activity fees are dependent on the firm's ability to transact in the marketplace and can be volatile.

Given Investcorp's banking status, Fitch used the 'Global Bank Rating Criteria' dated Nov. 25, 2016 to help inform its assessment of certain aspects of Investcorp's credit profile, such as operating environment (and in particular, the regulatory framework), capitalization and leverage, and funding and liquidity.

For the fiscal-year ended June 30, 2017 (FYE17) Fitch believes Investcorp maintained good liquidity, capitalization and funding profiles. At FYE17, balance sheet cash and other liquid assets of \$562 million (up from \$410 million a year prior) was more than sufficient to cover all outstanding debt maturing through December 2021. In addition, Investcorp had \$426 million of undrawn capacity on committed revolving facilities at FYE17.

Capital levels remained strong with a reported Total Capital Ratio of 31.7% at FYE17; well in excess of the Central Bank of Bahrain's minimum requirement of 12.5%. Leverage, as measured by Fitch Core Capital (FCC) / FCC-Adjusted Risk-Weighted Assets, was 24.9% at FYE17, within Fitch's 'a' category quantitative benchmark range of >19% for banks with a 'bbb' rated operating environment.

For funding, Investcorp relies on a mix of secured and unsecured wholesale funding sources, supplemented with deposit funding given its status as a bank. At FYE17, the company remained within its targeted co-investment to long-term capital (long-term debt, deferred fees and total equity) ratio of 1.0x or lower, at a ratio of 0.7x, which Fitch views as appropriate. At FYE17, balance sheet co-investments increased to \$1.1 billion (from \$1.0 billion a year prior) with an increase in

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CLO retention exposure from ICM more than offsetting lower hedge fund co-investments.

Interest coverage as measured by Adjusted EBITDA (which excludes asset based income) over interest expense was 2.7x for the trailing twelve months ended June 30, 2017 (FY17) which Fitch considers adequate for the rating category.

Investcorp's 'BB' Long-Term IDR is equalized with its 'bb' Viability Rating based on Fitch's view of limited likelihood of sovereign support. This is reflected in the Support Rating of '5' and the Support Rating Floor of 'No Floor'. The Support Rating of '5' and the Support Rating Floor of 'No Floor' reflect Fitch's view that there is no reasonable assumption that sovereign support will be forthcoming to Investcorp given the lack of a support track record and the fact that much of Investcorp's activities are conducted outside of Bahrain.

The affirmation of Investcorp's 'B' Short-Term IDR maintains the mapping relationship between long-term and short-term IDRs as outlined in Fitch's Global Bank Rating Criteria.

The senior unsecured debt rating is equalized with Investcorp's Long-Term IDR reflecting the expectation for average recovery prospects for the debt class.

#### RATING SENSITIVITIES - IDRs, VIABILITY RATINGS, AND SENIOR UNSECURED DEBT

Fitch believes Investcorp's ratings upside is likely limited to the 'BB' category over the intermediate term due to the potential earnings volatility associated with the company's business model and balance sheet co-investment exposure. The company's deal-by-deal business model could be a profitability constraint in a period of investment origination and/or placement activity weakness, while elevated co-investment exposure introduces balance sheet risk in the event of investment losses. Post-origination placement may also introduce balance sheet risk in the event Investcorp is unable to place originated investments with clients.

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Fitch views a one-notch upgrade as achievable over the 12 to 24 month Outlook horizon provided that Investcorp is able to leverage its strategic partnerships and expanded fundraising platform to grow AUM organically, while maintaining its strong capitalization, co-investment funding and liquidity positions. An increase in the proportion of recurring management fee income (which represented 32% of total revenues in FY17) and strengthened interest coverage would also be viewed positively.

If Investcorp is unable to demonstrate material accretive benefits to AUM growth and fee income resulting from the strategic Mubadala investment or the expanded fundraising platform over the Outlook Horizon, the Outlook could be revised to Stable.

Should Investcorp be unable to generate sufficient fee earnings to cover interest expense, experience material AUM declines in core private equity, real estate and CLO businesses or experience integration issues associated with recent acquisitions, the ratings could be negatively impacted. Materially increased balance sheet co-investment not funded by equity, increased leverage appetite, or reduced liquidity resources would also be viewed negatively.

The senior unsecured debt rating is equalized with Investcorp's IDRs and therefore, would be expected to move in tandem with any changes to Investcorp's IDRs. Although not envisioned by Fitch, were Investcorp to experience an increase in secured debt as a percentage of total debt, this could result in the unsecured debt rating being notched below Investcorp's Long-Term IDR.

#### SUPPORT RATING AND SUPPORT RATING FLOOR

Investcorp's Support Rating and Support Rating Floor are sensitive to changes in Fitch's assumptions regarding the likelihood of extraordinary sovereign support to be extended to Investcorp, which Fitch views as unlikely.

Fitch has affirmed the following ratings:

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Investcorp Bank B.S.C.  
--Long-Term IDR at 'BB';  
--Short-Term IDR at 'B';  
--Viability Rating at 'bb';  
--Support Rating at '5';  
--Support Rating Floor at 'NF'.

Investcorp S.A.  
--Long-Term IDR at 'BB';  
--Short-Term IDR at 'B';  
--Senior unsecured debt at 'BB'.

Investcorp Capital Ltd.  
--Long-Term IDR at 'BB';  
--Short-Term IDR at 'B';  
--Senior unsecured debt at 'BB'.

The Rating Outlook is Positive.

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