Investcorp Bank B.S.C.

Full Rating Report

Ratings

Investcorp Bank B.S.C.

Long-Term IDR	BB
Short-Term IDR	B
Viability Rating	bb
Support Rating	5
Support Rating Floor	NF

Investcorp S.A.

Long-Term IDR	BB
Short-Term IDR	B
Senior Unsecured Debt	BB

Investcorp Capital Ltd.

Long-Term IDR	BB
Short-Term IDR	B
Senior Unsecured Debt	BB

Rating Outlook

Stable

Financial Data

Investcorp Bank B.S.C.

	2015	2014
Total Assets ($m)	2,161	2,304
Total Equity ($m)	882	918
Debt ($m)	763	882
Net Income ($m)	116.7	103.1
ROAA (%)	5.2	4.3
ROAE (%)	12.4	10.0
FCC/RWA (%)	20.5	17.0

Related Research

2016 Outlook: Investment Managers (Rated Managers Well-Positioned to Weather Headwinds) (December 2015)

U.S. Alternative Investment Managers: An Industry Update (November 2015)

Investment Managers: Rating Attribute Analysis (November 2014)

Analysts

Michael Dodge
+1 212 908-0379
michael.dodge@fitchratings.com

David Pierce
+44 203 530 1014
david.pierce@fitchratings.com

Key Rating Drivers

Strong Gulf Franchise: The ratings of Investcorp B.S.C. (Investcorp) and its subsidiaries reflect the company's strong client franchise in the Gulf region; established track record as a private equity, hedge fund (HF) and commercial real estate investment manager; strong capital levels; and improved funding and liquidity. Rating constraints include meaningful balance sheet co-investment exposure, the inherent earnings volatility of the business model and resulting potential pressure on fixed-charge coverage.

Solid Financial Profile: Use of long-dated debt and secured financing for co-investments reduces Investcorp's refinancing and liquidity risk. At YE15, the company was in line with its targeted co-investment to long-term capital ratio of 1.0x or lower, such that the entire balance sheet co-investment portfolio is funded through long-term financing. Capital levels remain strong relative to existing ratings and are well in excess of the Central Bank of Bahrain's minimum requirement.

Significant Co-Investment Exposure: The company's co-investment exposure was reduced in FY15 but remains high, particularly with respect to private equity, and may result in increased long-term balance sheet risk resulting from investment losses and erosion in the company's capital position. If the company is unable to place investments with clients post-origination, balance sheet exposure could increase. In FY15, balance sheet co-investments were $1.2bn, or 57% of assets and 140% of equity.

Inherent Earnings Volatility: The company invests primarily on a deal-by-deal basis and generates a high proportion of income from activity fees that are based on the amount of capital deployed and the associated level of placement volumes. In a period of reduced investment origination and/or placement activity weakness, profitability and fixed-charge coverage would be constrained.

Equity Sale Transaction a Positive: Investcorp sold a 9.9% stake in itself to a Gulf-based institutional shareholder in September 2015. The transaction provides a potentially more stable equity base and, together with retained earnings, funded a buyback of 42% of preference shares, which improved fixed-charge coverage. Adjusted EBITDA coverage including preferred dividends improved but remained low at 1.4x for FY15. Excluding preferred dividends, coverage was 2.2x.

Rating Sensitivities

Recurring Management Fees Positive: Ratings could be positively influenced by a material increase in the proportion of recurring management fee income, improved leverage and liquidity metrics and declines in co-investments as a proportion of equity.

Weaker Fixed-Charge Coverage Negative: Negative rating actions could result if Investcorp is unable to generate sufficient earnings to cover fixed charges or experiences material declines in assets under management (AUM). An increase in balance sheet co-investments as a proportion of equity and/or an inability to appropriately fund co-investments with long-term capital could also pressure ratings. Were pressures in the oil and gas sector to translate into materially reduced Middle Eastern investor appetite for Investcorp's offerings, this would be viewed negatively.

Operating Environment

Sovereign Rating

In December 2015, Fitch Ratings revised Bahrain's Outlook to Negative from Stable and affirmed its long-term Foreign and Local Currency IDRs at 'BBB–' and 'BBB', respectively. The revision of the Rating Outlook to Negative from Stable reflected Fitch's lower oil price forecasts outweighing the effects of policy response on Bahrain's fiscal position. Fitch forecasts a wider double-digit deficit of 12.5% of GDP in 2015 and 10.7% of GDP in 2016, remaining in high single digits by 2017, up from 5.5% of GDP in 2014. The ratings affirmations reflect Bahrain's real growth that has been resilient to lower oil prices, a strong external balance sheet, continued exhibited financing flexibility and favorable business environment with a strong regulatory framework and local skill base, combined with low costs, supporting its financial sector.

According to Fitch's "Global Non-Bank Financial Institutions Rating Criteria," dated April 2015, available on its website at www.fitchratings.com, globally diversified investment managers and alternative funds have increased potential for rating differentiation relative to their primary jurisdiction if the funds they manage, the assets they invest in and the investors they service are in more favorable operating environments.

Investcorp performs its activities on an integrated worldwide basis and makes investments in companies based in the U.S, Europe and the Middle East and North Africa (MENA), including Turkey. The company's clients and trading partners also operate in the international marketplace, and neither their domicile nor the geographical location of a transaction is necessarily related to the country in which the asset or liability is financed. Over 90% of Investcorp's assets are held in subsidiaries domiciled in the Cayman Islands, with most of the company's activities conducted in the United States and Europe.

Economic and Business Environment

Fitch's rating outlook for the alternative investment management industry is stable, as overall issuer fundamentals are expected to remain solid in 2016 given the locked-in nature of the majority of the fee stream. Management fees could decline if market valuations remain strong and new investment slows, but, in that case, exit activity would likely remain elevated, allowing for continued incentive income generation, which would allow alternative investment managers to add to cash coffers, particularly for those with lower average payout ratios. However, if markets become more dislocated, realization activity is likely to slow, but Fitch would expect to observe an increase in investment activity, which would yield management fee growth, higher transaction fees and FEBITDA expansion, as shadow AUM in the sector is significant.

That said, the absolute volatility of incentive income may be altered as compared with the pre-financial crisis given the increased diversity of alternative investment manager platforms. While Fitch would continue to expect realized incentive income to decline materially when market valuations are falling, some fund strategies may benefit from that market scenario (i.e. hedge funds and/or distressed credit funds), yielding a baseline incentive earnings stream for some firms, regardless of the market environment.

The hedge fund industry had a challenging 2015 and start to 2016. A series of markets events across the globe hit many markets traded by hedge funds and caused weak returns of negative 1.12% for 2015 and negative 0.67% for 1Q16, represented by the HFRI Fund Weighted Composite Index. Despite weak performance, the industry added $71.5bn in new capital inflows in 2015, reaching approximately $3.2tn in AUM, which highlights investors' continued demand for uncorrelated returns hedge funds seek to achieve. However, continued underperformance could lead to accelerated AUM outflows in 2016, particularly from underperforming strategies.

Related Criteria

Global Non-Bank Financial Institutions Rating Criteria (April 2015)

Financial Market Development

The U.S. and Europe have the broadest, deepest and most liquid capital markets in the world. Funding availability for private equity transactions has remained strong and attractive, particularly in the low interest rate environment, despite new leveraged lending guidelines from regulators. Bahrain's financial sector is also well developed and diversified, consisting of a wide range of conventional and Islamic financial institutions and markets. Bahrain is home to the largest concentration of Islamic financial institutions in the world and continues to be a financial hub for economic activity with high levels of trade and investment bolstered by a competitive and efficient regulatory environment.

Regulatory Framework

Investcorp is domiciled in Bahrain as a wholesale bank and operates under the regulatory oversight of the Central Bank of Bahrain (CBB). CBB has functioned as the single regulator for Bahrain's financial system since 2002 and has installed a comprehensive reporting framework for the specific needs of Islamic banking and insurance. In August 2014, CBB designated Investcorp as a domestic systemically important bank (DSIB). However, the support rating floor of "No Floor" reflects 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.

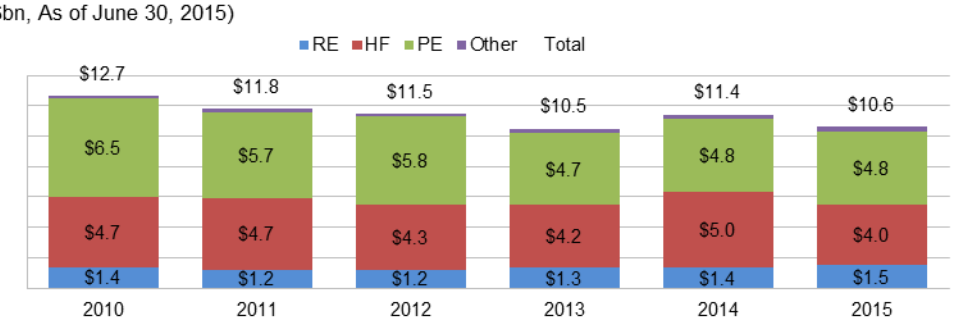
Increased regulatory scrutiny in the alternative investment manager space has elevated the barriers to entry with reporting and regulatory burdens, which Fitch believes benefits larger established firms like Investcorp.

Company Profile

Franchise

Since its founding in 1982, Investcorp has defined itself as an investment intermediary to channel the wealth of its Arabian Gulf clients into investments in the U.S. and Europe. The company's focus has continued to be on serving the needs of its clients from the six Gulf Cooperation Council countries — Bahrain, Kuwait, Qatar, Saudi Arabia, Oman and the United Arab Emirates — where there is demand for international alternative investment products. The company seeks to differentiate itself from other asset managers by appealing to investors' preference for investment discretion and offering investments on a deal-by-deal basis without a dedicated fund structure; investments are initially underwritten by the company with a significant portion earmarked for placement with investors.

Assets Under Management
($bn, As of June 30, 2015)



Source: Company filings.

Business Model

As of fiscal year-end June 30, 2015 (FYE15), Investcorp had approximately $10.6Bn of AUM and operated globally across three lines of business including Corporate Investments (private equity), hedge funds and real estate. Investcorp has offices in the Kingdom of Bahrain, New York, London, the Kingdom of Saudi Arabia, Doha and Abu Dhabi.

The firm maintains a high, albeit declining, level of on-balance-sheet co-investments across its three business segments. Management has reduced co-investment levels substantially from the levels observed before the financial crisis, and it is expected the company will continue to take smaller shares of each deal going forward. The full effect of this change will take time as legacy co-investments roll off the balance sheet and client asset levels grow at a faster pace than co-investment levels. Fitch believes the firm could achieve greater earnings consistency with reduced co-investments and a fee model based more heavily on AUM.

Corporate Investments: Corporate Investment (CI), the term used by the firm for its private equity business, consists of teams in North America, Europe and the wider MENA region, including Turkey. Unlike traditional private equity managers, which typically utilize a commingled closed-end fund structure, Investcorp largely conducts its buyout business through direct deal-by-deal placement activities. The company seeks to sell a majority of investments directly to clients on a nonrecourse basis and retains a portion on its balance sheet as its co-investment. At FYE15, Investcorp's CI co-investments totaled $667m, down 27% from FYE14, driven by increased realization activity. Asset-based income from CI co-investments was $50m in FY15, representing 13% of total income and 68% of total asset-based income.

Fee income comprises management fees and deal fees. Management fees are based on original amounts invested for deal-by-deal placements and on original commitments for closed-end private equity funds. Investcorp also charges placement, acquisition and exit fees, which are captured in the company's deal fees. Performance fees are earned when returns exceed targeted hurdles and are included in deal fees. Management fees as a percentage of average CI AUM have increased in the past two fiscal years and reached 2.14% in FY15, above the five-year average of 1.61%. The increase was, in part, driven by adoption of IFRS 15 revenue recognition accounting, under which Investcorp recognizes a portion of placement fees relating to services provided over the life of the investment, as management fees.

Hedge Funds: As of FYE15, Investcorp's hedge fund business had $4.1bn of AUM, of which $3.7bn represented client assets and $0.4bn were proprietary co-investments. Investcorp oversees single-manager HFs, customized accounts and, to a lesser extent, fund-of-hedge-fund (FoHF) products. After the financial crisis, client assets shifted toward customized accounts and single-manager funds and away from co-mingled FoHF accounts. These separate accounts allow for an independent custodian and give Investcorp and its clients greater control over gating risk. At FYE15, approximately 61% of client HF assets were in customized accounts and single-manager accounts managed by third-party HF managers; 39% was in FoHF products.

The HF business generates both management fees and potential performance fees while providing an alternative asset class to Investcorp's high-net worth and institutional clients. Unlike corporate investment fees, HF management fees are based on the net asset value (NAV) of the funds so are more sensitive to market volatility. Management fees as a percentage of average HF AUM declined to 0.53% in FY15, below the five-year average of 0.74%. While Investcorp earns performance fees, subject to high-water marks, as well as deal fees for its role as asset selector in special opportunities portfolios, these fees have not been significant in recent years.

At FYE15, Investcorp's HF co-investments totaled $421m, down 12% from FYE14. Asset-based income from HF co-investments was $9m in FY15, representing 2% of total income and 12% of total asset-based income.

Real Estate Investments: As of FYE15, Investcorp managed 27 active real estate (RE) investment portfolios, of which 22 were on or ahead of management's performance plan, with the remainder comprising legacy investments, already written down significantly in value and behind plan. These legacy investments include hotels, condominium developments or offices in regions where the economic environment has been generally subdued.

The strategy for RE portfolios is to position them for medium-term ownership in stable capital structures with modest capital investment requirements. Investcorp's real estate RE team arranges investments in properties with strong cash flows and/or potential for attractive capital gains over a medium-term holding period. Investments are typically focused in the 30 largest U.S. real estate markets, but the company is looking to European real estate markets to increase its investment activity. Properties are assembled into diversified portfolios that are then placed with investors, with a small portion retained as a co-investment on Investcorp's balance sheet.

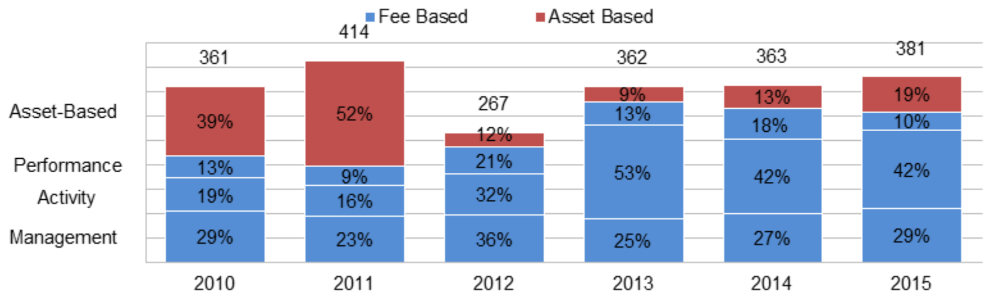
While long-term interest rates are expected to rise, Investcorp believes a gradual increase in rates will not have a significant impact on property values. Taking this view, the firm had a strong level of activity in real estate in FY15, deploying $368m in new investments across four portfolios, representing one of the most active periods in the firm's history. Recent investments were primarily in office and residential properties in key U.S. growth markets, including ones in California, Florida, Georgia, Maryland, North Carolina, Washington and Virginia.

Investcorp's real estate products are primarily offered through deal-by-deal investments, as well as through closed-end funds. Activity fees are earned for placement, acquisition and recapitalization activity, while performance fees are earned when returns exceed hurdles. Management fees as a percentage of average RE AUM increased to 1.02% in FY15, above the five-year average of 0.79%.

At FYE15, Investcorp's RE co-investments totaled $143m, up 10% from FYE14, driven by increased investment activity. Asset-based income from RE co-investments was $11m in FY15, representing 3% of total income and 16% of total asset-based income.

Asset-Based Income: Investcorp co-invests along with its clients in all the alternative investment products it offers. Income from co-investments in private equity deals, HFs and real estate investment deals includes realized returns generated on balance sheet assets, as well as unrealized changes in fair value of private equity and real estate co-investments. Asset-based income was $73m in FY15, up 53% from FY14 and represented 19% of Investcorp's income. Fitch believes asset-based income is more unpredictable and correlated to the economic environment.

Income Composition



Note: 2010– 2013 not restated for IFRS 15.
Source: Company filings.

Organizational Structure

The shareholder structure is designed to ensure that assets are protected against Bahraini or Middle Eastern regional risk. Investcorp owns 100% of Investcorp S.A. (ISA), a Cayman Islands-based financial holding company. ISA was originally established in Luxembourg in 1990 but was re-domiciled to the Cayman Islands in May 2010. As of June 30, 2015, approximately 98% of consolidated assets were owned directly or indirectly by ISA in the Cayman Islands. As a result, substantially all of the Investcorp Group's commercial risks are held outside of Bahrain.

In 2015, Investcorp entered into an agreement to sell a 9.9% ownership stake in the company to a Gulf-based institutional shareholder for $137.8m. Proceeds from the sale, together with net earnings for the year, were used to retire an aggregate $172m worth of preference shares and accrued dividends. Fitch views this transaction positively as the firm gained a strategic partner in its key region.

Management and Strategy

Management Quality

At FYE15, the firm's succession plan for its CEO of 30 years took effect. Nemir Kirdar resigned as executive chairman and CEO of Investcorp Bank, Mohammed Al-Shroogi and Rishi Kapoor became Co-CEOs of Investcorp bank and board director Mohammed Al Ardhi, became executive chairman. While Kirdar was the founder and driving force behind the firm's strategy, Fitch does not view the management succession as posing rating concerns, particularly given the experience and institutional knowledge of the successors and the firm's experienced senior management team.

Corporate Governance

Corporate governance is deemed to be neutral to the rating as Fitch believes adequate policies and procedures are in place to ensure good corporate governance practices including checks and balances of executive control, accountability and transparency. Investcorp's board of directors is elected annually by shareholders. The board of directors consisted of 13 members, 12 of whom are independent; executive chairman Mohammed Al Ardhi, who has been a director since 2008, is the only interested director on the board. Standing committees, including the audit committee and remuneration committee, are completely independent.

Strategic Objectives

Investcorp's core focus of offering alternative investments to its Gulf-based clients remains consistent, but the company is looking to diversify the range of investment products it offers. A key part of the firm's growth strategy is to expand into European real estate to complement its long-established U.S. real estate business. In March 2016, Investcorp hired Neil Hasson, formerly a senior managing director in Macquarie's European real estate lending business, to spearhead its European real estate investment initiative. The firm is also targeting efforts to increase hedge fund AUM by expanding the suite of products it offers across multimanger, single manager, alternative beta and special situation products and increasing marketing efforts.

Execution

Investcorp's history of execution has been mixed. Although profitability rebounded in fiscal years 2010 and 2011 after severe losses during the financial crisis, fee-based income declined in absolute terms and as a percentage of total revenue. More recently, performance and fundraising in CI and real estate have been strong. However, redemptions in hedge funds caused AUM to decline in FY15. Since 2009, the company has meaningfully reduced its balance sheet and altered its funding profile, which Fitch views positively. In an effort to reduce the impact of market liquidity stress or forced refinancing of debt facilities during periods of economic difficulty, the portfolio of illiquid co-investments has been financed with long-term capital. At FYE15, 100% of balance sheet co-investments were funded with equity and long-term debt, which Fitch views favorably. The firm also continues to make progress on reducing its expensive preference shares, issued in 2009.

Risk Appetite

Risk Controls

Fitch believes Investcorp has a sound risk management framework. The financial and risk management committee operates independently and interacts with the business units to identify, measure, report and control risks. The firm uses an enterprise risk management system (ERMS), which employs a multifactor model to identify correlation between asset classes and major risk drivers in the portfolio. The ERMS incorporates all business lines and allocates capital according to risk-weighted factors. In addition, risk is monitored by investment committees within each business line to determine specific risk around new investments and actions.

Each of Investcorp's investing lines of business has an investment committee that includes senior executives within that line of business and a senior executive from another investing line of business. Each investment committee is responsible for vetting and approving potential investment and divestment transactions within that business by focusing on due diligence of key commercial, financial and/or legal issues related to the potential investment or divestment. The committee evaluates proposed investments based on their risk-return profile on a stand-alone and portfolio basis. All investment and divestment transactions are subject to final approval of the Investment Council, which includes the executive chairman and CEO, chief administrative officer and CFO.

Market Risk

Principal market-related risks include foreign currency risk, interest rate risk and valuation risk associated with co-investments in HFs, corporate investments and real estate investments. For the purpose of managing market price risks, the company has established appropriate procedures and limits approved by the board of directors. For internal risk assessments, the company uses a variety of internal models to analyze the market price risks that may arise from adverse market movements. Sensitivities analyzed for CI and RE investments include changes in valuation multiples, interest rates and quoted bid prices.

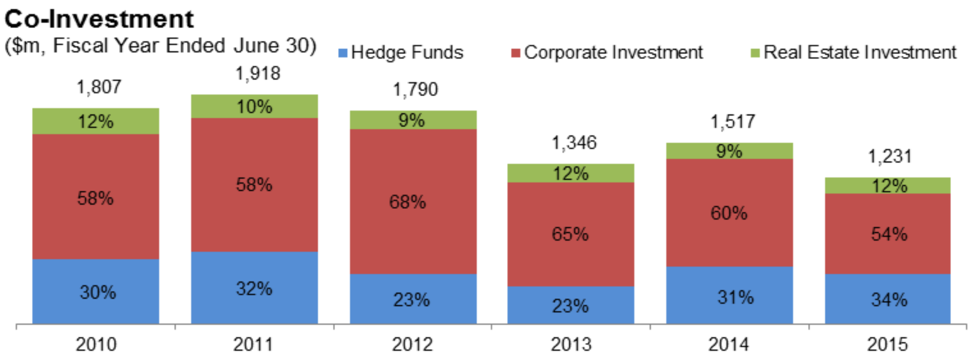
Investcorp has a market risk management framework for managing its hedge fund portfolio which includes value at risk (VaR). Average 99% VaR reported in FY15 was $15.9m, down 13% from FY14. Management does not engage in proprietary trading, and derivatives are only used for hedging purposes. However, for accounting purposes, a certain amount of the book does not receive hedge treatment. Derivatives are used to modify either the interest rate or currency characteristics of assets or liabilities.

Operational Risk

Operational risk is inherent in the company's CI and real estate valuation models, as well as in HF back-office operations. As part of Basel III compliance, Investcorp applies the basic indicator approach (BIA) to measure operational risk. Under BIA, Investcorp's average gross income over the preceding three financial years is multiplied by a fixed alpha coefficient, which has been set at 15% in CBB's Basel III capital adequacy framework.

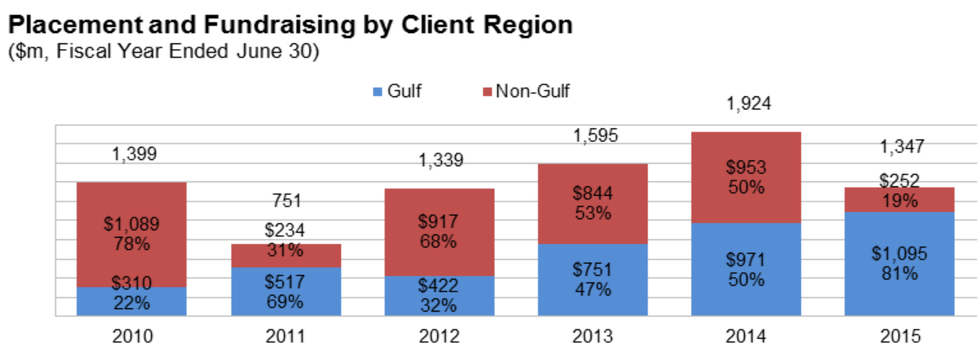
Growth

Fitch views Investcorp's growth rate as manageable relative to capital generation (for balance sheet investments) and operational infrastructure (for third-party managed investments). As previously mentioned, the firm is focused on reducing the size of its balance sheet co-investment which has declined at a 7.4% CAGR since 2010 and totaled $1.2bn at FYE15. A 19% reduction in FY15 was driven by the sale of Berlin Packaging, previously the largest individual CI co-investment, as well as the partial realization of two other CI holdings. Fitch notes that balance sheet risk also includes underwritten investments earmarked for placement with investors ($87.5m at FYE15), which are typically placed within three to six months. Balance sheet risk could increase if the company is unable to place investments with clients post-origination.



Source: Company filings.

Between 2010 and 2015, the firm's level of investment activity, as measured by capital deployed, increased at a CAGR of 25% and Investcorp successfully placed these investments with investors. Investment demand from the firm's core Gulf-based investors has been resilient despite financial pressures in the region resulting from continued low oil prices. Total placement and fundraising from Gulf-based clients grew at a 37.4% CAGR over the past three years and by 12.8% in FY15. Should these investors become pressured and fundraising decline, Fitch expects Investcorp would slow its rate of investment activity. Fitch will monitor potential negative effects from continued economic headwinds in the Gulf.



Source: Company filings.

Financial Profile

Asset Performance

AUM levels in CI and RE have remained steady in recent years with investment realizations offset by strong fundraising and deal placement activity. However, firmwide AUM has fluctuated due to more volatile investor flows in the hedge fund business which is exposed to redemption risk and potential investor concentrations. In FY14, firmwide AUM increased driven by a 20% increase in hedge fund AUM. Subsequently, in FY15, firmwide AUM declined 7% driven by a 20% decline in hedge fund AUM attributable primarily to redemptions from one large investor. At FYE15, CI and hedge funds continued to be the firm's largest segments comprising 45% and 38% of total AUM, respectively.

Management fee income, which represented 29% of FY15 operating income, increased 12% in FY15 but continues to represent a lower proportion of total operating income compared with investment manager peers. The FY15 increase reflects strong placement activity over the past several years given the firm's early adoption of IFRS 15 revenue recognition accounting. Under IFRS 15, a component of Investcorp's placement fee relating to services provided over the investment period, is deferred and recognized over time, as management fee income.

Notwithstanding the effect of the accounting change in FY15, management fee growth in CI and RE was higher than average AUM growth in FY14, which suggests increased management fee yields. Hedge fund management fee yields have declined since 2013, an industry trend due to general downward pressure on fee levels. Fitch notes that the timing of investor flows, investment placements and exits can affect fee yield estimates, which are based on average AUM.

Activity fee income, which represented 42% of FY15 operating income, is based on the amount of capital deployed in new investments and the associated level of deal-by-deal placement volume. Since 2010, placement volume growth has outpaced the increase in activity fees with 22% and 18% CAGRs, respectively, which suggest declining activity fee yields. With reliance on activity fees in deal-by-deal transactions, Investcorp's earnings are more sensitive to market conditions compared with peers with committed fund structures.

Management Fee Rates

(% Average Client AUM)

	2011	2012	2013	2014	2015	Average
Corporate Investments	1.37	1.41	1.27	1.85	2.14	1.61
Hedge Funds	0.65	0.83	0.98	0.70	0.53	0.74
Real Estate	0.95	0.96	0.51	0.52	1.02	0.79

Note: 2011–2013 not restated for IFRS 15.
Source: Investcorp and Fitch.

Since 2010, returns on the co-investment portfolio have been positive and have averaged 4.9% annually. CI has been the best-performing segment delivering, on average, a 6.8% annual yield over this period. In real estate, excluding FY10, when write-downs on legacy investments caused a 34.2% loss, average annual returns have been 6.0%. While real estate returns were negative in FY14 as a result of legacy investment write-downs, returns rebounded to 5.5% in FY15 given solid cash rental yields.

Investcorp's average annual hedge fund co-investment return of 4.8% over the past six fiscal years has outperformed the HFRI Fund-of-Fund Composite Index average of 3.85%. The firm's hedge fund investments returned 6.6%, 7.2% and 2.0% in FY13, FY14 and FY15, respectively, compared with the HFRI Fund-of-Fund Composite Index returns of positive 5.0%, positive 6.1% and positive 6.9% over the same periods.

The CI co-investment portfolio is diversified by single name and sector, with the top sector exposures — industrial products, consumer products and distribution — representing 34%, 21% and 16% of the portfolio at FYE15. The CI portfolio is geographically diversified with investments predominantly in North America and Europe with some exposure to MENA and Turkey. Real estate investments are in U.S. markets, diversified across sectors and region, although the firm is targeting increased investment in Europe.

Co-Investment Asset Yields (Annualized)

(%)

	2010	2011	2012	2013	2014	2015	Average
Corporate Investment	12.80	13.10	5.60	0.00	2.60	6.80	6.82
Real Estate Investment	(34.20)	20.10	7.90	0.10	(3.60)	5.50	(0.70)
Hedge Funds	15.10	6.50	(8.40)	6.60	7.20	2.00	4.83
Aggregate Co-Investment Yield	6.80	11.60	1.40	1.60	2.90	5.00	4.88

Source: Company reports.

Earnings and Profitability

Strong levels of acquisition, realization and placement activity during FY15 contributed to increased net income and stronger overall performance. Net income grew 13% in 2015, to $116m, driven largely by an increase in asset-based income from CI and real estate investments and a 2% decline in operating expenses due to decreased general and administrative costs.

Fee-based income in FY15 declined 2% with lower performance fees partially offset by increased management and activity fees. Management fees increased 12% in FY15, driven by increased investment placement in CI and RE businesses, partially offset by a decrease in HF management fees caused by redemptions. Activity fees and asset-based income increased in CI and RE due to successful realizations and growth in the value of these portfolios. These income streams declined in HFs, challenged by a volatile macroeconomic environment and redemptions.

Gross Fee- and Asset-Based Income

($m)

	2010	2011	2012	2013	2014	2015
Performance Fees	46	39	55	47	64	38
Activity Fees	69	66	84	193	152	159
Management Fees	104	93	97	89	100	112
Fee Based	**219**	**197**	**236**	**329**	**316**	**308**
Asset Based	142	216	31	32	48	73
Gross Income	**361**	**414**	**267**	**362**	**363**	**381**
Provisions for Impairment	(12)	(2)	(1)	(5)	(1)	(3)
Interest Expense	(58)	(56)	(48)	(64)	(61)	(58)
Operating Expenses	(189)	(215)	(151)	(188)	(198)	(204)
Net Income	**102**	**140**	**67**	**105**	**103**	**116**

Note: 2010–2013 not restated for IFRS 15.
Source: Investcorp and Fitch.

EBITDA Metrics

($m)

	2010	2011	2012	2013	2014	2015
Net Income	102	140	67	105	103	117
+ Interest Expense	58	56	48	63	61	58
+ Depreciation	8	7	6	7	7	7
+ Amortization	8	8	7	8	7	6
+ Other	0	3	3	6	9	9
EBITDA	**176**	**214**	**132**	**189**	**187**	**197**
Asset-Based Income Gain	124	202	27	26	44	70
Adjusted EBITDA	52	12	105	164	143	127
Gross Fee Income	219	197	236	330	316	308
Adjusted EBITDA Margin (%)	24	6	44	50	45	41

Source: Investcorp and Fitch.

EBITDA (adjusted to exclude asset based income) declined 11.6% year over year and the adjusted EBITDA margin declined 400 bps to 41% but remained above the five-year average of 37%.

Capitalization and Leverage

While Fitch typically assesses investment managers on the basis of cash flow leverage metrics, Investcorp's meaningful balance sheet risk and regulation as a bank make balance sheet leverage and capitalization metrics more relevant. At FYE15, Investcorp's total risk-based capital ratio was 28.7%, well above the minimum threshold of 12.5% established by the CBB. Fitch core capital (FCC) continued its upward trend, increasing to 20.5% at FYE15 compared with 9.4% at FYE10 as a result of decreased exposure to capital impairments and a reduction of co-investments in volatile and/or illiquid assets. Fitch views Investcorp's capital levels as appropriate relative to existing ratings and the balance sheet risk associated with the company's business model. Leverage, on a debt/adjusted EBITDA basis, was 6.0x at FYE15 and has had a declining trend as Investcorp has been paying down debt.

The FCC calculation makes a range of adjustments to banks' reported equity to arrive at a measure of a bank's highest quality going-concern capital. The table below compares regulatory capital with FCC, the latter of which excludes preference shares, resulting in a notable difference between the two ratios. Risk-weighted assets (RWAs) are used as the denominator in each case. Under Basel III's BIA, Investcorp has relatively high operational risk charges, and co-investments are risk weighted at a blended rate of approximately 150%. As a result, RWAs are higher than total assets and better reflect Investcorp's risk profile.

Capital and Leverage Ratios

(%)

	2010	2011	2012	2013	2014	2015
Risk-Based Capital Ratio	22.9	25.7	26.9	33.8	30.4	28.7
Fitch Core Capital/RWA	9.4	12.2	12.8	15.7	17.0	20.5
Debt/Adjusted EBITDA (x)	36.8	97.4	10.7	5.5	6.2	6.0

RWA – Risk-weighted assets.
Source: Investcorp and Fitch.

At FYE09 and the beginning of FY10, Investcorp issued $512m in preference shares to restore regulatory capital and reduce medium-term debt after a $780m earnings loss in FY09. As a result, a significant proportion of the capital structure since 2009 has consisted of high-cost preference shares, which the company has been focused on reducing through buybacks. Preference shares represented 26% of total equity at FYE15, down from a peak of 56% at FYE09.

In 2015, Investcorp used the proceeds from a 9.9% ownership stake sale, together with residual earnings, to retire an aggregate $172m in preference shares and accrued dividends. In Fitch's view, Investcorp's improved capital levels and fixed-charge coverage offer the company the potential economic flexibility to pursue additional preferred share repurchases if executed at a measured pace.

Leverage, on a debt/adjusted EBITDA basis, was 6.0x at FYE15 and has had a declining trend as Investcorp has been paying down debt.

Funding, Liquidity and Coverage

Funding

Investcorp's funding primarily comprises medium- and long-term debt, preference shares and common equity. Client deposits are transitory balances and include both subscription amounts paid in by clients toward participation in specific investment products and investment realization proceeds held in the interim period prior to distribution or withdrawal by clients. Investcorp seeks to mitigate the impact of market liquidity stress or forced refinancing of debt facilities during sustained periods of economic difficulty by financing its entire portfolio of illiquid co-investments with a combination of equity capital, long-term debt and debt secured by co-investments.

Co-Investment Funding

($m)

	2009	2010	2011	2012	2013[a]	2014[a]	2015[a]
Co-Investment	1,801	1,807	1,918	1,790	1,148	1,517	1,231
Long-Term Capital[b]	1,473	1,586	1,635	1,604	1,485	1,402	1,228
Co-Investment to Long-Term Capital Ratio (x)	1.2	1.1	1.2	1.1	0.8	1.1	1.0

[a]Co-investment excludes underwriting and is net of total facilities, which are secured against hedge funds when drawn.
[b]Long-term capital consists of long-term debt and total equity.
Source: Investcorp and Fitch.

The company targets a co-investment to long-term capital ratio of 1.0x or lower, such that the entire balance sheet co-investment portfolio is funded through permanent or quasi-permanent capital and does not rely on medium-term debt financing, which Fitch views as appropriate given the limited liquidity of such investments.

Investcorp's funding profile remained consistent year over year with a mix of secured and unsecured financing. Investcorp completed a $250m five-year bond transaction in 2012 and a 125m Swiss Franc ($140m) five-year public bond transaction in 2014. The Swiss Franc bond issue opened another channel for funding in the international capital markets to complement its U.S.-dollar issuance.

Investcorp's largest facility is a four-year $400m secured revolving credit facility with a syndicate of 14 banks. The revolver utilizes floating rates of interest when drawn and a fixed rate of commitment fees when undrawn. At FYE15, there were no outstanding borrowings under the facility.

Liquidity

Investcorp maintains operational liquidity through a combination of on-balance-sheet liquidity held in the form of investments in short-tenor liquid assets and off-balance-sheet liquidity of committed medium‐ term revolving bank credit facilities. Such facilities are mainly used in the normal course of business for acquisition underwriting of new corporate investments or real estate investment deals prior to placement with clients, which usually takes between four and eight weeks after the deal is closed. Therefore, bank revolvers, supplement core liquidity; together, they provide a pool of accessible liquidity to underwrite multiple acquisitions.

Having experienced meaningful liquidity stress in the aftermath of the financial crisis, Investcorp has since improved its financial flexibility by maintaining diversified funding sources while keeping laddered debt maturities. The table on the following page summarizes the maturity profile of Investcorp's accessible liquidity and debt. Accessible liquidity, consisting of undrawn committed revolving facilities plus balance sheet cash and other liquid assets, but excluding co-investments in HFs, was $864m at FYE15 and covered all outstanding debt maturing over the next five years, which Fitch views favorably.

While HF co-investments could provide Investcorp with an additional source of liquidity, HF exposure is a less significant component given its substantial reduction over the past five years in both the aggregate level of balance sheet assets and the absolute amount of HF co-investments. Furthermore, the focus on single-manager seeding requires a commitment to lock-up periods. Of Investcorp's $421m HF co-investments at FYE15, management estimates 74% could be monetized within three months and 77% within six months. At FYE15, $50m of HF co-investments were provided as security against financing.

Available Liquidity Resources

($m)

	2013	2014	2015
Cash and Short-Term Funds	102	101	83
Deposits with Financial Institutions	453	126	257
Undrawn Facilities	246	465	525
Total Liquidity	**801**	**692**	**864**
Debt Maturing within Five Years	483	474	417
Debt Maturing after Five Years	419	408	346
Total Debt	**902**	**882**	**763**
Ratio of Liquidity to Debt maturing within Five Years	1.7	1.5	2.1

Sources: Investcorp and Fitch.

Coverage

While Investcorp's debt agreements do not include covenants on EBITDA coverage of interest expense, Fitch calculates interest coverage ratios to assess ongoing liquidity. Fitch adjusts EBITDA to exclude more volatile asset-based income in order to assess the company's coverage of fixed charges with fee income. Interest coverage, as measured by adjusted EBITDA to interest expense, has improved since 2010 but remained relatively low at 2.2x for FY15. Including $25m of proposed dividends with respect to preference shares outstanding during FY15, fixed-charge coverage was 1.4x for FY15. Fitch expects coverage to improve in FY16 given lower preference shares outstanding entering FY16 and would expect further improvements if Investcorp continues to buy back preference shares and pay down debt.

Coverage Metrics

($m, Audited Fiscal Years Ended June 30)

	2010	2011	2012	2013	2014	2015
Adjusted EBITDA	52	12	105	164	143	127
Interest Expense	58	56	48	63	61	58
Preference Shares Dividend	57	61	61	61	49	29
Adjusted EBITDA/Interest Expense (x)	0.9	0.2	2.2	2.6	2.4	2.2
Adjusted EBITDA/Interest Expense Plus Pref. Div (x)	0.5	0.1	1.0	1.3	1.3	1.4

Sources: Investcorp and Fitch.

Selected Financial Statistics — Investcorp Bank BSC

($m)

	6/30/08	6/30/09	6/30/10	6/30/11	6/30/12	6/30/13	6/30/14	6/30/15
Balance Sheet								
Assets								
Cash and Short-Term Funds	194.2	416.1	21.3	24.7	156.2	101.9	101.3	82.7
Deposits with Banks and Other Financial Institutions	257.4	713.2	881.5	341.4	194.6	453.1	125.9	256.6
Cash and Deposits	451.6	1,129.3	902.8	366.1	350.8	555.0	227.2	339.3
Accounts Receivable	459.6	335.7	316.0	300.5	284.3	283.0	206.3	274.9
Loans and Advances	341.1	224.1	247.6	169.8	188.8	147.0	128.8	111.5
Co-Investments								
Hedge Funds Investments	2,020.8	614.5	537.3	607.4	414.1	315.8	476.4	421.0
Corporate Investments	1,029.1	903.4	1,052.8	1,121.7	1,221.8	873.6	910.8	667.2
Real Estate Investments	337.0	283.2	216.8	188.8	154.5	156.5	130.0	143.0
Underwritten Investments	—	—	—	—	—	33.0	112.4	87.5
FV of Derivatives	62.2	56.2	74.8	45.0	81.3	62.8	66.6	74.2
Fixed Assets	64.9	74.0	69.0	59.3	54.1	50.6	45.6	42.8
Total Assets	**4,766.3**	**3,620.4**	**3,417.1**	**2,858.6**	**2,749.7**	**2,477.3**	**2,304.1**	**2,161.4**
Liabilities								
Deposits from banks	385.5	15.0	N.A.	N.A.	10.1	23.8	80.9	0.6
Deposits from Clients – Short Term	558.0	373.1	247.5	318.0	195.3	206.1	26.9	13.7
Deposits from Clients – Medium Term	0.0	0.0	90.6	95.3	119.2	88.2	68.9	87.3
Total Deposits	**943.5**	**388.1**	**338.1**	**413.3**	**324.6**	**318.1**	**176.7**	**101.6**
Accrued Interest and Payables	217.1	90.4	144.4	202.6	214.4	148.3	164.1	240.4
Other Liabilities	240.0	0.0	0.0	0.0	(0.0)	0.0	61.1	137.4
Unfunded deal Acquisitions	234.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Medium-Term Facilities	1,116.4	1,635.5	1,321.4	584.9	567.3	482.5	474.2	417.1
Long-Term Notes	971.9	578.4	591.6	574.7	560.5	419.1	408.1	346.2
Negative FV Derivatives	45.9	33.3	27.2	22.8	39.2	43.0	25.2	36.7
Total Liabilities	**3,769.1**	**2,725.7**	**2,422.7**	**1,798.3**	**1,706.0**	**1,411.0**	**1,309.4**	**1,279.4**
Equity								
Preferred Stock	0.0	500.0	508.7	511.5	511.5	511.5	391.2	225.0
Common Stock (Par Value)	200.0	200.0	200.0	200.0	200.0	200.0	200.0	200.0
Reserves	414.0	605.0	596.2	242.9	233.0	229.4	215.9	259.2
Retained Earnings	542.5	16.9	65.4	139.1	183.5	213.5	281.6	268.1
Treasury Shares	(177.6)	(150.5)	(161.6)	(181.3)	(163.6)	(163.6)	(158.2)	(103.6)
Proposed Appropriations (Preferred Stock Dividend)	0.0	0.0	57.4	61.4	61.4	61.4	49.4	29.4
Proposed Common Stock Dividend	63.3	0.0	0.0	9.3	4.7	9.3	9.4	10.4
Proposed Charitable Contributions	0.0	0.0	0.0	4.0	0.0	4.5	4.5	2.5
Unrealized FV of Corporate/RE Co-Investments	(42.5)	(297.0)	(299.9)	42.7	0.0	0.0	0.0	0.0
Unrealized FV Recognized Directly in Equity	(2.5)	20.3	28.2	30.7	13.2	0.3	0.9	(9.0)
Shareholders Equity	997.2	894.7	994.4	1,060.3	1,043.7	1,066.3	994.7	882.0
Ordinary Shareholders Equity	997.2	394.7	428.3	487.4	470.8	493.4	554.1	627.6
Total Liabilities and Shareholders Equity	**4,766.3**	**3,620.4**	**3,417.1**	**2,858.6**	**2,749.7**	**2,477.3**	**2,304.1**	**2,161.4**

N.A. – Not available.

Selected Financial Statistics — Investcorp Bank BSC

($m)

	6/30/08	6/30/09	6/30/10	6/30/11	6/30/12	6/30/13	6/30/14	6/30/15
Income Statement								
Fee Income								
Management Fees	136.5	107.4	104.3	93.2	96.7	88.8	100.0	111.5
Activity Fees	221.5	21.7	68.6	65.7	84.2	193.4	151.6	158.9
Performance Fees	24.9	0.3	46.0	38.5	55.2	47.3	64.2	37.7
Gross Fee Income	**382.9**	**129.4**	**218.9**	**197.4**	**236.1**	**329.5**	**315.8**	**308.1**
Expenses and Taxes Attributable to Fee Income	(223.4)	(169.4)	(149.4)	(159.8)	(136.8)	(175.8)	(187.9)	(191.8)
Net Fee Income Before Interest Expense	**159.5**	**(40.0)**	**69.5**	**37.6**	**99.3**	**153.7**	**127.9**	**116.3**
Asset Based Income								
Corporate Investments	5.0	(229.4)	122.3	121.7	59.8	0.3	23.8	49.8
Hedge Funds	100.5	(323.8)	91.3	39.5	(50.2)	25.3	28.2	9.1
Real Estate	19.1	(86.1)	(90.0)	40.6	17.3	0.1	(7.8)	11.5
Treasury and Other	74.9	72.9	18.1	14.5	4.2	6.6	3.5	2.6
Gross Asset-Based Income (ABI)	**199.5**	**(566.4)**	**141.7**	**216.3**	**31.1**	**32.3**	**47.7**	**73.0**
Expenses Attributable to ABI	(42.7)	(37.0)	(39.4)	(55.4)	(13.9)	(12.2)	(10.4)	(11.7)
Provision	(5.4)	(22.2)	(11.7)	(2.1)	(1.1)	(5.4)	(1.4)	(2.8)
Net ABI Income Before Interest Expense	**151.4**	**(625.6)**	**90.6**	**158.8**	**16.1**	**14.7**	**35.9**	**58.5**
Interest Expense Fee Business	N.A.	N.A.	N.A.	N.A.	(17.9)	(31.8)	(30.5)	(30.0)
Interest Expense ABI Business	N.A.	N.A.	N.A.	N.A.	(29.9)	(31.7)	(30.0)	(28.1)
Interest Expense	(159.9)	(115.0)	(58.0)	(56.0)	(47.8)	(63.5)	(60.5)	(58.1)
Net Income	151.1	(780.6)	102.2	140.3	67.4	104.9	103.3	116.7

N.A. – Not available.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.