

## CREDIT OPINION

28 October 2019

Update

✓ Rate this Research

### RATINGS

#### Investcorp Holdings B.S.C.

Domicile	Bahrain - Off Shore
Long Term CRR	Not Assigned
Long Term Issuer Rating	Ba2
Type	LT Corporate Family Ratings
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## Investcorp Holdings B.S.C.

### Annual Update

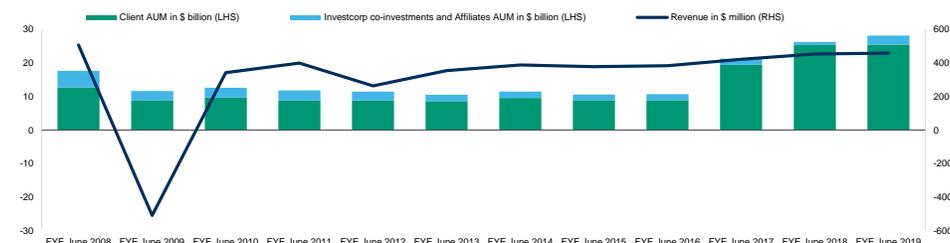
#### Summary

The Ba2 rating reflects Investcorp Holdings B.S.C.'s (Investcorp) solid market position in the Gulf Cooperation Council (GCC) region as a leading alternative investment provider, its global franchise, healthy operating margins and good asset retention. The rating incorporates the company's adequate liquidity profile and the ongoing improvement in earnings quality due to the growth in more stable and predictable asset management fees.

The rating also reflects Investcorp's high financial leverage and balance sheet risk related to its co-investment activities.

Exhibit 1

#### The progression of fee income is contributing to higher stability of revenue growth



Note: Client AUM for FY2018 was restated as per FY2019, to reflect a change of real estate valorisation to gross value.

Sources: Company reports, Moody's Investors Service

#### Credit strengths

- » Leading alternative asset manager in the GCC region, global reach
- » Good AUM resilience rates supported by long-term locked-up capital commitments
- » Strong capitalization and proven capital markets access even in difficult market conditions

#### Credit challenges

- » High financial leverage
- » Elevated balance sheet risk owing to large co-investment activities

#### Rating outlook

The rating outlook on Investcorp is stable.

## Factors that could lead to an upgrade

Upward rating pressure on Investcorp could result from:

- » reduced debt levels, with debt/EBITDA remaining consistently under 4x
- » a further reduction in the company's investment portfolio
- » the growth of Investcorp's clients' assets under management (AUM), contributing to substantial growth in management fees and EBITDA
- » a further expansion and diversification of revenue streams

## Factors that could lead to a downgrade

Downward rating pressure could result from a weaker financial position driven by:

- » a reversal in the trend of declining debt and on-balance sheet investment levels
- » a deterioration in liquidity
- » a deterioration in the company's ability to raise new client capital or reinvest client capital that would substantially affect its revenue generation capacity
- » lower private equity origination and placement activities that would constrain the company's profitability
- » material on-balance sheet investment losses

## Key Indicators

Exhibit 2

### Key indicators

Investcorp Holdings B.S.C.

[1]	2019 FY	2018 FY	2017 FY	2016 FY	2015 FY [2]	2014 FY [2]	2013 FY	2012 FY	2011 FY
Assets Under Management (AUM) (\$ b)	28	26.3 [5]	21	11	11	11	11	12	12
Net Flows (\$ mm)	2,347	707	2,066	112.0	(645.0)	808.0	(104.0)	71.0	(935.0)
Revenues (\$ mm) [3]	460	454	422	383	381	363	355	263	399
AUM Retention Rate (%)	85%	84%	49%	72%	80%	87%	80%	85%	82%
AUM Replacement Rate (%)	169%	123%	95%	105%	65%	172%	94%	106%	45%
EBITDA (\$ mm)	199	186	160	125	150	135	155	222	166
EBITDA Margin (%)	43%	41%	38%	33%	39%	37%	44%	84%	41%
Total Debt (\$ mm)	1,008	1,135	1,046	1,091	906	1,123	1,031	1,243	1,265
Total Debt/EBITDA (x)	5.1x	6.1x	6.5x	8.7x	6.0x	8.3x	6.6x	5.6x	7.6x
Total Shareholder's Equity / Self Managed Investments (x)	0.86x	0.87x	1.5x	1.2x	0.9x	0.8x	0.9x	0.7x	0.7x
Pre-Tax Income (\$ mm)	142	138	127	94	117	103	107	66	140
Pre-Tax Income Margin (%)	31%	30%	30%	25%	31%	28%	30%	25%	35%
Stability of Revenue Growth (%) (20 qtr) [4]	42%	21%	47%	12%	29%	21%	-30%	-70%	

[1]Fiscal year end June 30

[2]Adoption of IFRS 15 in 2015. 2014 Income and balance sheet items have been restated to reflect the change.

[3] Revenue is all operating revenue reported by the company, net of distribution expense.

[4] Stability of revenue growth = the average of quarter over quarter revenue growth rates divided by the standard deviation of revenue growth rates, (using the past 20 quarters of growth rates). Here calculated with semi annual information.

[5] FY2018 was restated as per FY2019, to reflect a change of real estate valorisation to gross value.

Source: Company reports, Moody's Investors Service

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## Profile

Investcorp Holdings B.S.C. (Investcorp), previously Investcorp Bank B.S.C., is the principal parent of the Investcorp Group and primarily provides and manages alternative investment products in four asset classes – private equity, absolute return investments, real estate and credit management – on behalf of high-net-worth individuals and institutional clients. As of June 2019, the company had total assets under management of \$28.2 billion.

Investcorp transitioned to a holding company and renounced to its banking license to better align its operating structure with its business model.

## Detailed credit considerations

### Global player with strong niche market position in the GCC region

With total AUM of \$28.2 billion (client AUM of \$25.4 billion) and revenue of \$460 million as of June 2019, the company is a small player in the asset management industry. Its Ba market position reflects its strong brand name in the GCC region, supported by a more than 30-year track record. The company benefits from long-standing relationships with leading ultra-high-net-worth and institutional investors in the GCC region. The company's ability to provide tailored solutions and services to its client base engenders a loyal client base as shown by strong asset retention rates in both the company's private equity and real estate business segments.

Since 2017, Investcorp has been actively developing its franchise, incrementally adding AUM, geographic and product diversification, a credit positive. In March 2017, Investcorp completed the acquisition of the debt management business of [3i Group plc](#) (Baa1 stable), which contributed an additional \$11 billion of AUM. This acquisition more than doubled Investcorp's AUM and contributed \$73 million to Investcorp's revenue in fiscal 2019, of which \$50 million were fee income. In 2019, it acquired a minority ownership interest in an independent Swiss-regulated private bank based in Geneva and Luxembourg. It opened an office in India following the acquisition of the private equity and real estate funds businesses of IDFC Alternatives Limited in India. It also raised the firm's first private equity investment in China, in partnership with China Everbright Limited. Over time, we expect the company to develop cross-selling opportunities within its different divisions.

Investcorp's fund raising capacity has been strong throughout fiscal 2019 with \$5.7 billion in placement and fund raising activity supported by continued client appetite for alternative investments.

Deal by deal and fund raising in private equity have been supported by Investcorp's first time full placement in the US of United Talent Agency, a US portfolio company, by the placement of Investcorp's debut China-focused investment offering in partnership with China Everbright Limited and by the placement of the firm's first India-focused investment offering. It was also supported by Investcorp's fourth technology fund, established to invest in European lower middle market tech-enabled companies, with the focus of shifting to investors outside of the Gulf. In addition, the firm successfully closed a fund of approximately \$1 billion with Collier Capital where Investcorp transferred some of its European private equity investments that it had previously acquired through various deal-by-deal transactions and obtained new commitments for follow-on investments, future investments and co-investments.

\$2 billion were raised in credit management with, in particular, two new US CLOs and two new European CLOs. Gross inflows for the ARI segment were \$1.2 billion, reflecting improved performances and clients' interest in the dedicated solutions provided through partnerships with external hedge fund managers. However, the modest increase in ARI's client AUM during the year of \$154 million compared to the \$1.2 billion fundraising reflects redemptions in the period largely related to the roll-off of older, less profitable AUM. the ARI segment also registered \$267m of unfunded at year-end new client commitments.

### Increasing business diversification and global client reach

Investcorp's product and geographic diversification is good and is expected to benefit from the implementation of the strategic initiatives. The company's product range is diversified among alternative investments. The company operates under four main segments:

1) Private equity (previously corporate investments) (PE): The segment targets the acquisition of attractive corporate investments in North America, Europe, Asia, the GCC region and Turkey with enterprise values of between \$400 million-\$800 million.

2) Real estate (RE): The segment targets the acquisition of existing core and core-plus commercial and residential real-estate assets (primarily income-earning properties) situated in the 30 largest and most diversified US and European markets (UK and Germany mainly). The majority of real-estate investments are structured in a Shari'ah-compliant manner.

3) Absolute return investments (ARI): The hedge fund business which suffered outflows following the great financial crisis has been restructured through strategic hires, acquisitions, partnerships and fund launches. FY2018 and FY2019 were successful years for the company that raised \$1.2 billion of new investor money. However the roll off of older non profitable AUM in multi manager solutions led only to a modest 2% ARI AUM increase in 2019 to \$3.8 billion. The segment counts four main areas of expertise that include the Multi-Manager Solutions platform (clients money AUM of \$1.6 billion) Hedge Fund Partnerships (clients money AUM of \$1.9 billion), Special Opportunity Portfolios (clients money AUM of \$96 million) and Alternative Risk Premia (clients money AUM of \$38 million).

4) Credit management (CM): Investcorp manages open and closed end funds mainly in collateralized loan obligation (CLO) structure that invest primarily in senior secured corporate debt issued by mid- and large-cap corporates in Western Europe and the US. This business has widened Investcorp's product range and is expected to open up distribution synergies as it will provide access to new and incremental sources of capital to both former 3i Debt Management's and Investcorp's clients.

Geographic diversification is strong, with AUM sourced in the GCC region representing 39% of total, the rest sourced in the US, Europe and Asia.

Investcorp's distribution profile benefits from good customer granularity. Investcorp has broader client coverage of the GCC region than its peers, with a team of dedicated relationship managers operating through a regional office in Bahrain and through local offices in Saudi Arabia, Qatar and Abu Dhabi. Clients are ultra-high-net-worth and institutional, covered mainly through direct distribution. Over the last year, Investcorp added client-facing resources to further increase its market penetration in the GCC region and expand in Asia.

In the US, Investcorp has a sales team that distributes its products directly to the institutional segment. The company has been distributing its products directly in the US since 2005 and includes relationships with most of the big pension plans, endowments, foundations, fund of funds, family offices and asset managers. The company also has a 100% owned broker dealer entity.

ARI and CM benefit from combined sales forces with a growing focus on Asia. Investcorp raised money for the first time in Asia this year. Distribution in Europe is gaining traction and we expect the addition of the Swiss Private Bank to be accretive.

#### **Significant financial leverage and co-investment risks are somewhat alleviated by strong liquidity and tangible equity**

Investcorp's leverage as of the end of December 2019 (as measured by gross debt/EBITDA, including our standard financial adjustments) declined to 5x. Although this is still high compared to Ba-rated peers, it is trending down, a credit positive. The decline compared to June 2018 reflects lower client money left with Investcorp. Indeed, our financial leverage ratio includes the company's short-term debt (client money left with the company in between two investments), although these term and institutional accounts are matched by cash on balance sheet. Without those, the leverage ratio is 3x, stable compared to June 2018.

In addition, through its co-investments, Investcorp makes active use of its balance sheet through principal investments in private equity, hedge funds, CLO and real estate. The objective is to align its interests with those of its clients and to comply with regulation as far as European CLOs are concerned. However, Investcorp's financial leverage and balance sheet risk reduce the company's financial flexibility and constrain the company's rating. The company's principal investments (co-investments) are principally in less-liquid private equity investments, credit management, absolute return investments and real estate assets. Declines in the fair market values of these assets can have significant impact on Investcorp's financial performance. The risk in the company's co-investment portfolio is somewhat mitigated by the granularity of the portfolio in terms of sectors and regions.

The company's intention is to maintain co-investment/long-term capital of 1.0x or lower, such that the entire balance sheet co-investment portfolio is fully funded through permanent or quasi-permanent capital and does not rely on medium-term debt financing. As of June 2019, the aggregate level of co-investments net of a \$84 million revolving facility secured against credit management co-investments remained fully covered by permanent and long-term sources of capital. We expect the level of co-investments to stabilize at around current levels or slightly lower, a credit positive.

Our overall assessment of Investcorp's financial flexibility also takes into consideration the quality of its equity capital base. The company maintains a large tangible equity position, which represents a significant amount of loss-absorbing equity capital. This position helps mitigate risks that may arise from losses in the company's principal investment portfolio.

### Resilient profit margins emerging; more stability expected as fee revenue grows

Investcorp had a pre-tax income margin of 30% in December 2018. The company's gross revenue can be broken down into three components: (1) AUM fees, (2) deal fees and (3) asset-based income.

AUM fees have been the most stable source of income over the past three fiscal years. AUM fees were 181 million in FY19, 5% higher than FY18. The increase reflects a higher level of client assets under management, primarily driven by the acquisition of the credit management business in H2 FY17, but also the progresses made in the ARI business.

Deal fees are less predictable and depend on the acquisition and placement of new investments, the sale and exit of investments (realizations) and the performance of existing investments. Deal fees increased by 30% in FY19 to \$167 million reflecting strong private equity investment activity supported by the new China focused investment offering and the new technology fund. Those have attracted clients' interest despite political uncertainty both in the Gulf and on the global scene.

Asset-based income is the most volatile profitability component as it is based on the annual return on Investcorp's proprietary investments. Gross asset-based income during FY19 decreased to \$84 million from \$133 million in FY18 mainly driven by lower income from the private equity division affected by lower returns in investments in the Turkey region negatively impacted by the depreciation in the Turkish Lira and by valuation declines in certain US retail sector exposures and in a legacy investment. The FY 2019 average yield on Investcorp's co-investment portfolio remained strong with returns of 6.8%, 9.5%, 5.8% and 7.4% for private equity, real estate investments, absolute return investments and credit management, respectively.

Going forward, we expect Investcorp's strategic acquisitions and growth initiatives in all divisions including the ARI business in the US, the PE business in Asia, to deliver cross-selling opportunities, that should support revenue growth.

### Liquidity analysis

Investcorp's credit profile benefits from its good liquidity management practices and adequate liquidity position. The company had cash and other liquid assets of \$390 million as of June 2019, while accessible liquidity (cash, undrawn committed revolving facilities and other liquid assets) stood at \$1.1 billion. The company's repaid its CHF125 million bond that matured in June 2019. The payment was partially offset by a new repo credit facility secured against CM co-investments. Investcorp has an undrawn and available balance of \$686 million from its revolving medium-term facilities - \$250 million maturing in December 2020 and \$436 million in 2023. There is no debt repayment due before 2030.

## Environmental, Social and Governance (ESG)

### Governance

Like all other corporate credits, the credit quality of Investcorp is influenced by a wide range of governance-related issues, relating to financial, managerial, ownership or other factors, all of which can be exacerbated by regulatory oversight and intervention.

While Investcorp's investments in illiquid asset classes entail above average risk levels, the group has strong risk management processes that mitigate various governance risks. It also displays high levels of transparency. Under the oversight of its Board of Directors, the Group's management team has a strong track record and experience.

## Rating methodology and scorecard factors

Exhibit 3

Senior Debt Rating Scorecard (weights) [1]	Aaa	Aa	A	Baa	Ba	B	Caa	Score	Adjusted Score
<b>Business Profile</b>								Baa	Ba
<b>Factor 1: Market Position (25%)</b>								Baa	Ba
Scale and Franchise Strength				X					
AUM Resilience			X						
<b>Factor 2: Business Diversification (25%)</b>								Baa	Baa
Geographic and Product Diversification			X						
Geographic Diversification									
Product Diversification									
Distribution					X				
<b>Financial Profile</b>								Ba	Ba
<b>Factor 3: Financial Flexibility (30%)</b>								B	B
Debt / EBITDA						5.1x			
Total Shareholder's Equity / Self-managed Investments							0.9x		
<b>Factor 4: Profitability &amp; Volatility (20%)</b>								Baa	Baa
Pre Tax Income Margin (5 yr ave)			29%						
Stability of Revenue Growth (20 qtr, YoY)				42%					
<b>Operating Environment</b>								Ba	Ba
<b>Aggregate Profile</b>								Ba1	Ba2

[1] The Scorecard rating is an important component of the company's published rating, reflecting the stand-alone financial strength before other considerations (discussed above) are incorporated into the analysis.

Source: Moody's Investors Service

## Ratings

Exhibit 4

Category	Moody's Rating
<b>INVESTCORP HOLDINGS B.S.C.</b>	
Outlook	Stable
Corporate Family Rating	Ba2
<b>INVESTCORP CAPITAL LIMITED</b>	
Outlook	Stable
Bkd Senior Unsecured	Ba2

Source: Moody's Investors Service

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