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CREDIT OPINION
18 October 2018

Update

Rate this Research

RATINGS

Investcorp Bank 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 Bank B.S.C.

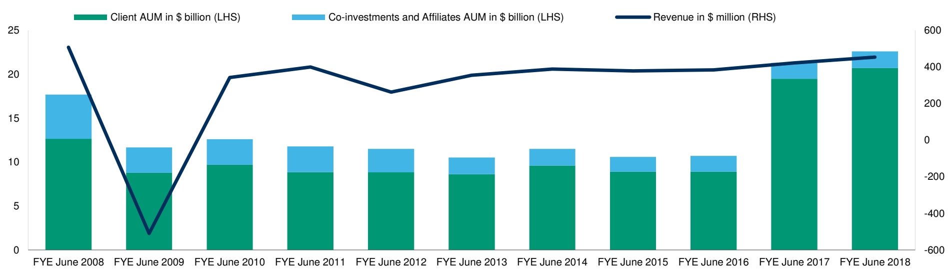
Annual Update

Summary rating rationale

The Ba2 rating reflects Investcorp Bank 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
Revenue growth benefits from increase in AUM fees driven by acquisition of credit management business



Source: 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

» Designated by the Central Bank of Bahrain (CBB) as a domestic systemically important bank

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 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

» the 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 Bank B.S.C.

[1]	2018 FY	2017 FY	2016 FY	2015 FY [2]	2014 FY [2]	2013 FY	2012 FY	2011 FY
Assets Under Management (AUM) ($ b)	23	21	11	11	11	11	12	12
Net Flows ($ mm)	707	2,066	112.0	(645.0)	808.0	(104.0)	71.0	(935.0)
Revenues ($ mm) [3]	454	422	383	381	363	355	263	399
AUM Retention Rate (%)	84%	49%	72%	80%	87%	80%	85%	82%
AUM Replacement Rate (%)	123%	95%	105%	65%	172%	94%	106%	45%
EBITDA ($ mm)	163	160	125	150	135	155	222	166
EBITDA Margin (%)	36%	38%	33%	39%	37%	44%	84%	41%
Total Debt ($ mm)	986	1,046	1,091	906	1,123	1,031	1,243	1,265
Total Debt/EBITDA (x)	6.0x	6.5x	9.7x	6.1x	8.3x	6.6x	5.6x	7.6x
Total Shareholder's Equity / Self Managed Investments (x)	1.6x	1.5x	1.2x	0.9x	0.8x	0.9x	0.7x	0.7x
Pre-Tax Income ($ mm)	138	127	94	117	103	107	66	140
Pre Tax Income Margin (%)	30%	30%	25%	31%	28%	30%	25%	35%
Stability of Revenue Growth (%) (20 qtr) [4]	10%	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.

Source: Company reports, Moody's Investors Service

Corporate Profile

Investcorp Bank B.S.C. (Investcorp), the principal parent of the Investcorp Group, 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 2018, the company had total assets under management of $22.6 billion.

Detailed rating considerations

Market position: Ba - Global player with strong niche market position in the GCC region

With total AUM of $22.6 billion (client AUM of $20.7 billion) and revenue of $454 million as of June 2018, the company is a small player in the asset management industry. It's 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.

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 $76 million to Investcorp's revenue in fiscal 2018. This year the firm announced that it acquired a minority ownership interest in an independent Swiss-regulated private bank based in Geneva and Luxembourg.

Investcorp's fund raising capacity has been strong throughout fiscal 2018 with $7.3 billion in placement and fund raising activity, the highest level experienced historically. $5.6 billion were raised in credit management for three new US CLOs and several refinancings and resets, $580 in private equity, $569 in Real Estate (launch of European real estate portfolios) and $563 in alternative investment solutions, segment that was rebranded absolute return investments (ARI). Fund raising in private equity have been supported by the launch of Investcorp's fourth technology fund, established to invest in European lower middle market tech-enabled companies. Net inflows for the ARI segment were $260 million, reflecting improved performances and clients' interest in the dedicated solutions provided through partnerships with external hedge fund managers. In addition, the company expects to develop cross-selling opportunities with clients from the credit management business and ARI business.

Business diversification: Baa - Increasing business diversification and global client reach

Investcorp's product and geographic diversification is good and is consistent with an A sub-factor score. 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, 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 was a successfull year for the company that raised $260 million of new investor money. The segment counts four main areas of expertise that include the Multi-Manager Solutions platform (clients money of $2 billion) Hedge Fund Partnerships (clients money of $1.4 billion), Special Opportunity Portfolios (clients money of $121 million) and Alternative Risk Premia (clients money 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 strengthened with AUM sourced in the US, the GCC region, 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.

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 fist time in Asia this year. Distribution in Europe in gaining traction and we expect the addition of the Swiss Private Bank to be accretive.

Financial flexibility: B - Significant financial leverage and co-investment risks are somewhat alleviated by strong liquidity and tangible equity

Investcorp's leverage as of the end of June 2018 (as measured by gross debt/EBITDA, including our standard financial adjustments) declined to 6x. Although this is still very high compared to Ba-rated peers, it is trending down, a credit positive. This 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 4.2x. The decrease in liabilities compared to December 2017 was driven by the repayment of a $250 million bond that matured this year, which was only partially offset by increased drawdowns of revolving facilities.

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, alternative investment solutions 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, as well as single investments, with only one exposure accounting for more than 10% of the total portfolio.

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 2018, the aggregate level of co-investments net of a $42 million revolving facility secured against private equity 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. We also view positively the fact that Investcorp has been designated by the CBB as a domestic systemically important bank. As such, Investcorp will continue to report regularly to the regulatory authorities and will be subject to an increased frequency of prudential meetings and inspections by the CBB. Investcorp maintained a Basel III capital adequacy ratio of 31.5% as of June 2018, well above regulatory requirements. We would expect the company's capital to be maintained at these levels.

Profitability and volatility: Baa - Resilient profit margins emerging; more stability expected as fee revenue grows

Investcorp had a pre-tax income margin of 30% in June 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, albeit negatively affected by a reduction in higher-yielding AUM, particularly hedge funds. AUM fees were $173 million in FY18, 27% higher than FY17. The increase reflected a higher level of client assets under management, primarily driven by the acquisition of the credit management business in H2 FY17.

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 decreased in FY18 to $148 million reflecting lower corporate investment activity. Regional and global political and economic factors have caused uncertainty and negatively affected investor sentiment and the pace of placement in the Gulf.

Asset-based income is the most volatile profitability component as it is based on the annual return on Investcorp's proprietary investments. The FY 2018 average yield on Investcorp's co-investment portfolio was 11.3%, 7.1%, 4.8% and 8.1% for private equity, real estate investments, absolute return investments and credit management, respectively. Gross asset-based income during FY18 increased to $133 million from $102 million in FY17, primarily driven by a significant improvement in corporate investment returns and the addition of income from the credit management business.

Going forward, in the next couple of years, the addition of the credit management business (acquired from 3i Group plc) and a number of growth initiatives in the ARI business and in Asia are expected to deliver cross-selling opportunities, that should support revenue growth.

Liquidity analysis

Investcorp's credit profile benefits from its good liquidity, management practices and solid liquidity position. The company had cash and other liquid assets of $371 million as of June 2018, while accessible liquidity (cash, undrawn committed revolving facilities and other liquid assets) stood at $996 million, which largely covers all outstanding medium-term debt maturing over the next four years. If we were to remove the cash associated with short-term debt, the accessible liquidity would be $696 million, still sufficient to cover its debt for the next two years.

The company's next debt maturity is CHF125 million bond that matures in June 2019. During H1 FY18, Investcorp repaid $250 million bonds on maturity. The payment was partially financed by a new three year syndicated revolver facility of $165 million. The new three year syndicated revolver facility was further increased to $250 million in January 2018. The company also has a $426 million revolving loan outstanding with $25 million expiring in March 2020 and the balance in March 2021.

Rating methodology and scorecard factors

Exhibit 3

Senior Debt Rating Scorecard (weights) [1]	Aaa	Aa	A	Baa	Ba	B	Caa	Score	Adjusted Score
Business Profile								Baa	Ba
Factor 1: Market Position (25%)								Baa	Ba
Scale and Franchise Strength				X					
AUM Resilience				X					
Factor 2: Business Diversification (25%)								Baa	Baa
Geographic and Product Diversification			X						
Geographic Diversification									
Product Diversification									
Distribution					X				
Financial Profile								B	Ba
Factor 3: Financial Flexibility (30%)								Caa	B
Debt / EBITDA							6x		
Total Shareholder's Equity / Self-managed Investments							0.9x		
Factor 4: Profitability & Volatility (20%)								Baa	Baa
Pre Tax Income Margin (5 yr ave)			29%						
Stability of Revenue Growth (20 qtr, YoY)				10%					
Operating Environment								Ba	Ba
Aggregate Profile								Ba2	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
INVESTCORP BANK B.S.C.	
Outlook	Stable
Corporate Family Rating	Ba2
INVESTCORP CAPITAL LIMITED	
Outlook	Stable
Bkd Senior Unsecured	Ba2
INVESTCORP S.A.	
Outlook	Stable
Bkd Senior Unsecured	Ba2

Source: Moody's Investors Service

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