CREDIT OPINION
24 April 2018

Update

Rate this Research

Investcorp Bank B.S.C.

Annual Update

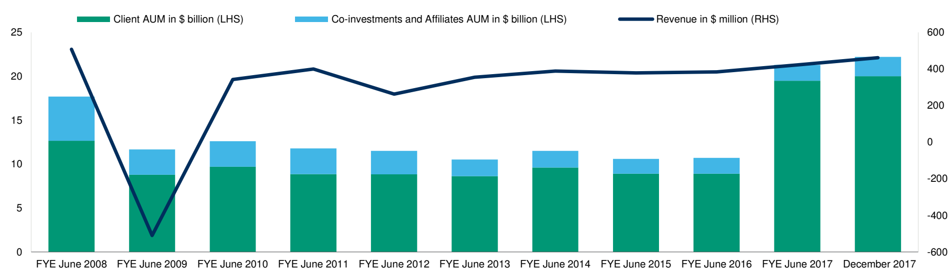
Summary rating rationale

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 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

» 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

» Stabilizing net outflow in the company's hedge fund business

RATINGS

Investcorp Bank B.S.C.

Domicile	Bahrain - Off Shore
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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CLIENT SERVICES

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]	2017 CY	2017 FY	2016 FY	2015 FY [2]	2014 FY [2]	2013 FY	2012 FY	2011 FY
Assets Under Management (AUM) ($ b)	22	21	11	11	11	11	12	12
Net Flows ($ mm)	156	2,066	112.0	(645.0)	808.0	(104.0)	71.0	(935.0)
Revenues ($ mm) [3]	462	422	383	381	363	355	263	399
AUM Retention Rate (%)	66%	76%	72%	80%	87%	80%	85%	82%
AUM Replacement Rate (%)	102%	105%	105%	65%	172%	94%	106%	45%
EBITDA ($ mm)	153	160	125	150	135	155	222	166
EBITDA Margin (%)	33%	38%	33%	39%	37%	44%	84%	41%
Total Debt ($ mm)	1,391	1,046	1,091	906	1,123	1,031	1,243	1,265
Total Debt/EBITDA (x)	9.1x	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)	130	127	94	117	103	107	66	140
Pre Tax Income Margin (%)	28%	30%	25%	31%	28%	30%	25%	35%
Stability of Revenue Growth (%) (20 qtr) [4]	46%	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 – corporate investments, alternative investment solutions, real estate and credit management – on behalf of high-net-worth individuals and institutional clients. As of December 2017, the company had total assets under management of $22.2 billion.

Detailed rating considerations

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

With total AUM of $22.2 billion (client AUM of $20 billion) and revenue of $462 million as of December 2017, the company is a small player in the asset management industry. 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 $49 million to Investcorp's revenue in fiscal 2017. In 2018, the contribution will increase as it will reflect a whole year exercise.

Investcorp'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 corporate investment and real estate business segments. Investcorp's fund raising capacity has been strong throughout fiscal 2017 with $4.1 billion in placement and fund raising activity, the highest level experienced historically. The first half of FY2018 (July to December 2017) recorded $3.6 billion fund raising, in sharp augmentation compared to $1 billion over the same period last year. $2.9 billion were raised in credit management for one new US CLO and several refinancings and resets. In addition, the company expects to develop cross-selling opportunities with clients from the credit management business and alternative investment solutions (AIS) business. The AIS segment recorded net inflows of $15 million over the six month period to December 2017, reflecting improved performance and clients' interest in the multi manager solutions.

Business diversification: Baa - Acquisition of debt management adds to 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. With the addition of 3i Group plc's debt management business division, the company now operates under four main segments:

1) Corporate investment (CI): 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. The majority of real-estate investments are structured in a Shari'ah-compliant manner

3) Alternative investment solutions (AIS): The hedge fund business was rebranded as Alternative Investment Solutions as the company continues to restructure the segment through strategic hires, acquisitions, partnerships and fund launches. The segment counts four main areas of expertise that include the Multi-Manager Solutions platform (clients money of $1.9 billion) Hedge Fund Partnerships (clients money of $1 billion), Special Opportunity Portfolios (clients money of $107 million) and Alternative Risk Premia (clients money of $263 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 widens 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.

Investcorp continues to strengthen its AIS business through partnerships and select product offerings. Investcorp's client AUM in AIS amounted to approximately $3.3 billion as of December 2017. The company raised $838million in fiscal 2017, with 16 new US clients added to the platform, including two of the top 10 US state pension funds. It is the implementation of a combined AIS/CM distribution structure.

AIS and CM benefit from combined sales forces with a growing focus on Asia. 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 December 2017 (as measured by gross debt/EBITDA, including our standard financial adjustments) was very high at 9x compared with that of its Ba-rated peers. 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 8x. The increase in liabilities compared to June was driven by an increase in term and institutional accounts placed with Investcorp on call.

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 corporate 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 December 2017, the aggregate level of co-investments net of a $50 million revolving facility secured against hedge funds 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 29.8% as of December 2017, 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 28% in December 2017. 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 $79.3 million in H1 FY18, 45% higher than H1 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 H1 FY18 to $58.1 million as they were impacted by regional and global political and economic factors causing uncertainty and temporarily affecting 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 2017 average yield on Investcorp's co-investment portfolio was 3.4%, 7.5%, 5.7% and 12% for corporate investments, real estate investments, hedge funds and credit management, respectively. Gross asset-based income during H1 FY18 increased to $71.0 million from $40.3 million in H1 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) is 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 $534 million as of December 2017, while accessible liquidity (cash, undrawn committed revolving facilities and other liquid assets) stood at $871 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 $714 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	Baa
Factor 1: Market Position (25%)								Ba	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	B
Factor 3: Financial Flexibility (30%)								Caa	B
Debt / EBITDA							9x		
Total Shareholder's Equity / Self-managed Investments							1.6x		
Factor 4: Profitability & Volatility (20%)								Baa	Baa
Pre Tax Income Margin (5 yr ave)				24%					
Stability of Revenue Growth (20 qtr, YoY)				46%					
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 5

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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Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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