



## Fitch Affirms Investcorp at 'BB'; Outlook Revised to Positive

Fitch Ratings-New York-02 November 2016: Fitch Ratings has affirmed the Long-Term Issuer Default Rating (IDR) of Investcorp Bank B.S.C. (Investcorp) at 'BB' and the Viability Rating at 'bb'. The Rating Outlook has been revised to Positive from Stable. A full list of ratings is provided at the end of this release.

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

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

Rating constraints include meaningful balance sheet co-investments in private equity, hedge funds and real estate; increased potential earnings volatility and placement risk relative to peers, given that transactions are originated and placed with investors on a deal by deal basis as opposed to raising dedicated funds with an investment/re-investment period; and potential second-order effects of low oil prices on Gulf-based investors' investment appetite. Investcorp's ratings are also constrained by broader challenges facing the hedge fund industry in terms of performance, outflow and fee pressure and potential growth/execution risks associated with Investcorp's strategy to more than double assets under management (AUM) to \$25 billion in the medium term primarily through inorganic growth.

The Positive Rating Outlook primarily reflects the potential franchise and earnings benefits that may accrue to Investcorp as a result of recent strategic partnerships with Mubadala Development Co. (Mubadala) and another Gulf-based institution. In July 2016, Investcorp agreed to sell a 20% stake in itself to Mubadala, a sovereign-wealth fund of Abu Dhabi. Mubadala took an immediate 9.9% stake and will take a further 10.01% after obtaining regulatory approvals. The sale follows Investcorp's 9.9% ownership stake sale to the other Gulf-based institution in September 2015. Fitch views these transactions positively, as they give Investcorp additional credibility with, and expanded access to, potential Gulf-based investors as well as a potentially more stable equity base.

On Oct. 25, 2016, Investcorp announced an agreement to acquire the debt and collateralized loan obligation (CLO) management business of UK based 3i Group PLC (3i) for GBP222 million (approximately \$271 million), a deal which would add \$12 billion of AUM, bringing Investcorp's total AUM to approximately \$23 billion. Fitch believes the deal will complement Investcorp's existing platform by adding credit and CLO strategies to the suite of products offered to its client base. The acquisition is expected to be accretive for Investcorp, providing a source of stable fee-income, and will be funded entirely through cash on the existing balance sheet, resulting in no additional debt incurrence, which Fitch views positively. On the other hand, the associated acquired assets and on-going CLO risk retention requirements will increase Investcorp's balance sheet exposure.

Over the last year, Investcorp has added strategic hires across its business lines primarily including client facing resources to help drive fundraising which continued to show momentum in fiscal year 2016 (FY16), the second consecutive year with more than \$1 billion raised from Gulf-based clients. In November 2015, Investcorp also expanded its hedge fund business, acquiring the hedge funds-of-funds unit of SSARIS Advisors, LLC (SSARIS). With the addition of four key members of the SSARIS investment team and \$810 million in AUM, this acquisition is expected to support Investcorp's existing hedge fund platform. Absent the addition of the SSARIS AUM, hedge fund AUM would have been down \$717 million in FY16 on outflows and performance pressure at pre-existing hedge funds.

Investcorp has positioned itself for the upcoming 3i acquisition, maintaining its strong liquidity, capitalization and funding profiles. At June 30, 2016 (FYE16), balance sheet cash and other liquid assets of \$410 million were more than sufficient to cover the 3i acquisition cost and, together with undrawn committed revolving facilities of \$428 million covered all outstanding debt maturing through December 2020.

In light of Investcorp's banking status, Fitch used the 'Global Bank Rating Criteria' dated July 15, 2016 to help inform its assessment of certain aspects of Investcorp's credit profile, such as operating environment (and in particular, the regulatory framework), company profile, capitalisation and leverage, and funding and liquidity.

At FYE16, capital levels remained strong with a reported Total Capital Ratio of 30.3%, well in excess of the Central Bank of Bahrain's minimum requirement of 12.5%.

Investcorp relies primarily on a mix of secured and unsecured wholesale funding sources supplemented with deposit funding given its status as a bank. At FYE16, the company remained within 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 capital, which Fitch views as appropriate. The company has also retired more than half of the preference shares raised in 2009 which improved its fixed charge coverage ratio, although the pace of repurchases slowed over the course of FY2016.

Investcorp's 'BB' Long-Term IDR is equalized with its 'bb' Viability Rating based on Fitch's view of limited likelihood of sovereign support. This is reflected in the Support Rating of '5' and the Support Rating Floor of 'No Floor'. The Support Rating of '5' and the Support Rating Floor of 'No Floor' 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.

The affirmation of Investcorp's 'B' Short-Term IDR is based on the affirmation of Investcorp's Long-Term IDR at 'BB' and maintains the mapping relationship between Long-Term and Short-Term IDRs as outlined in Fitch's Global Bank Rating Criteria.

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

### RATING SENSITIVITIES - IDRs, VIABILITY RATINGS, SUPPORT RATINGS, SUPPORT RATING FLOORS, SENIOR UNSECURED DEBT

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

Fitch views a one-notch upgrade as achievable over the 12-24 month Outlook horizon provided that Investcorp is able to leverage its recent strategic partnerships to grow AUM, realize accretive benefits from the 3i acquisition without integration issues, navigate the challenging hedge fund environment and demonstrate a limited impact from continued low oil prices on fundraising. An increase in the proportion of recurring management fee income and continued fixed charge coverage improvement would also be viewed positively.

Should Investcorp be unable to generate sufficient earnings to cover fixed charges, experience material AUM declines as a result of hedge fund industry pressures, secondary effects of low oil prices or otherwise, or experience integration issues as a result of acquisitions, the Outlook could be revised to Stable and/or ratings could be downgraded. Materially increased balance sheet co-investment, increased leverage appetite, or reduced liquidity resources would also be viewed negatively.

The senior unsecured debt rating is equalized with Investcorp's IDRs and therefore, would be expected to move in tandem with any changes to Investcorp's IDRs. Although not expected by Fitch, were Investcorp to incur material additional secured debt, this could result in the unsecured debt being rated below Investcorp's IDR. Investcorp has historically utilized secured funding as a means to fund its balance sheet co-investments. Given that balance sheet co-investments are expected to remain stable, as a percent of the balance sheet, an increase in the magnitude of secured debt is not envisioned by Fitch.

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

Fitch has affirmed the following ratings:

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

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

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

The Rating Outlook has been revised to Positive from Stable.

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#### Applicable Criteria

Global Bank Rating Criteria (pub. 15 Jul 2016) (<https://www.fitchratings.com/site/re/884135>)

Global Non-Bank Financial Institutions Rating Criteria (pub. 15 Jul 2016) (<https://www.fitchratings.com/site/re/884128>)

#### Additional Disclosures

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