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

Investcorp S.A.
Investcorp Capital Ltd.

Long-Term IDR	BB
Short-Term IDR	B
Senior Unsecured Debt	BB
Support Rating Floor	NF

Rating Outlook

Positive

Financial Data

Investcorp Bank B.S.C.

	FYE 2017	FYE 2016
Total Assets ($ Mil.)	2,656	2,497
Total Equity ($ Mil.)	1,145	1,017
Debt ($ Mil.)	791	882
Net Income ($ Mil.)	120.3	90.1
ROAA (%)	11.9%	9.3%
ROAE (%)	5.0%	3.8%
FCC/RWA (%)	24.9%	23.5%

Note: Fiscal Years Ended June 30.
Source: Company filings, Fitch.

Related Research

2017 Outlook: Investment Managers (November 2017)

U.S. Diversified Alternative Investment Managers: 2016 Update (November 2016)

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Key Rating Drivers

Strong Gulf Franchise: The ratings of Investcorp B.S.C. (Investcorp, or the company) reflect the company's strong client franchise in the Gulf, established track record in private equity (PE) and commercial real estate investment, strong capital levels and solid funding profile. Rating constraints include sizable balance sheet co-investments and potential earnings volatility and placement risks presented by the business model, which could pressure interest coverage.

Gulf Institutional Owners Positive: The Positive Rating Outlook reflects franchise and earnings benefits that may accrue to Investcorp from the 20% strategic equity stake sale to Mubadala Development Co. (Mubadala) in March 2017, a sovereign wealth fund of Abu Dhabi. This follows a 9.99% equity stake sale to another Gulf-based institution in 2015. Fitch Ratings views these transactions favorably, as the relationships may give Investcorp expanded access to potential new investors as well as a more stable equity base.

3i Business Diversifies AUM: The cash-funded acquisition of 3i Debt Management (3iDM) in March 2017 added $10.8 billion in AUM and is expected to be accretive for Investcorp, adding stable management fee income. However, the acquired co-investment assets and ongoing risk retention requirements do increase Investcorp's balance sheet risk exposure.

Solid Funding Profile: Fitch believes the use of equity and long-term debt to fund co-investments reduces refinancing and liquidity risk. At YE17, the company was below its targeted co-investment to long-term capital ratio of 1.0x. Capital levels remained strong relative to existing ratings and are well in excess of the Central Bank of Bahrain's (CBB) minimum requirement.

Significant Co-Investment Exposure: Balance sheet exposure to co-investments remains material ($1.1 billion at fiscal year-end 2017) and presents increased potential risk of 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.

Inherent Earnings Volatility: The company invests primarily on a deal-by-deal basis and a significant portion of fee earnings are based on activity fees earned from transactional activities including initial acquisition, add-ons, subsequent placement and investment exit. Activity fees are dependent on the firm's ability to transact in the marketplace and can be volatile. In a period of reduced investment origination and/or placement activity weakness, profitability and fixed-charge coverage would be constrained.

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 also be viewed negatively.

Operating Environment

Sovereign Rating

Investcorp is domiciled in Bahrain (rated BB+/Negative by Fitch). Bahrain's ratings are supported by relatively high GDP per capita and human development indicators, a developed financial sector and the boost to external financing flexibility from strong Gulf Cooperation Council (GCC) support. Rating constraints include the country's double-digit fiscal deficits, high and rising debt, a highly oil-dependent government budget and domestic political tensions that have hampered fiscal adjustment.

According to Fitch's Non-Bank Financial Institutions Criteria, globally diversified investment managers (IMs) 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. 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.

Investcorp invests globally in companies and other assets based in the U.S, Europe and the Middle East and North Africa (MENA), including Turkey. Over 90% of Investcorp's assets are held in subsidiaries domiciled in the Cayman Islands with most of the firm's investment activities conducted in the U.S. (rated AAA/Stable by Fitch) and Europe. That said, a large portion of the firm's investor base is in the Gulf region and the firm has some exposure to investments in the region.

Economic and Business Environment

Fitch's outlook for the alternative IM industry is stable, as overall issuer fundamentals are expected to remain solid in 2017–2018, particularly for established managers with AUM in locked-up structures. Management fees could be under modest pressure for some alternative IMs, to the extent the deployment of dry powder is delayed by a shortage of attractive investment opportunities and given the potential for further outflows in hedge fund strategies. However, overall management fees are poised for growth across the sector in the coming years given the continuation of strong fundraising trends and record amounts of dry powder.

Exit activity is expected to continue to moderate given the sheer volume of realizations in recent years, the length of time that market valuations have been relatively high and the lower average age of investment capital in the ground, which is likely to require more seasoning to realize full value. This should help support some baseline amount of management fees, as the size of funds earning fees on invested capital is likely to decline at a slower pace, although realized incentive income would be adversely affected. That said, the absolute volatility of incentive income may be altered, compared to the pre-financial crisis period, given the increased diversity of alternative IM platforms, with PE, real estate (RE), credit and liquid strategies contributing to incentive income.

Dry powder in the sector has been significant for several years and has continued to grow, despite the difficult investing environment. Capital deployed, for rated firms, increased in 1H17, but Fitch remains cautious about significant amounts of capital put to work in today's environment, particularly if multiple expansion is part of the investment thesis. While pockets of dislocation periodically exist in certain industries, asset classes and regions, the common view is that it may be some time before a true distressed cycle emerges, which would allow for a more meaningful increase in capital deployment. As a result, Fitch expects transaction fees to remain episodic, driven more heavily by larger transactions that may require co-investment capital.

Related Criteria

Global Non-Bank Rating Criteria (March 2017)

Global Bank Rating Criteria (Nov 2016)

Exposure Draft: Non-Bank Rating Criteria (December 2017)

Exposure Draft: Bank Rating Criteria (December 2017)

Fitch expects leverage ratios to improve in 20178 for most alternative IMs, with incremental fee-related EBITDA (FEBITDA) growth driven by cost controls, increased scale, continued fundraising and gradual deployment of FAUM that earns fees on invested capital. Should the amount of investment opportunities increase, fees generated from drawdown funds are likely to grow materially, which will help to reduce firm leverage ratios more meaningfully.

Many alternative IMs have continued to take advantage of the low interest rate environment to extend liability structures and add to balance sheet liquidity in recent years. Fitch believes debt issuance is likely to slow in 2018, as most alternative IMs are operating with above-average leverage ratios and near-term debt maturities are already funded.

Financial Market Development

The U.S. and Europe have the broadest, deepest and most liquid capital markets in the world. Funding availability for PE transactions has remained strong and attractive, particularly in the low-interest rate environment, despite 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.

Bahrain's financing flexibility has allowed it to be a regular Eurobond issuer. The domestic capital market continues to provide the main source of financing. The government has active conventional and Islamic issuance programs including domestic sukuk issuance programs.

Regulatory Framework

Investcorp is domiciled in Bahrain as a wholesale bank, under the regulatory oversight of the CBB, with shares listed on the Bahrain Bourse. The 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.

The CBB designates 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, Investcorp’s relatively smaller size compared to other Bahraini DSIBs and the fact that much of Investcorp’s activities are conducted outside of Bahrain.

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

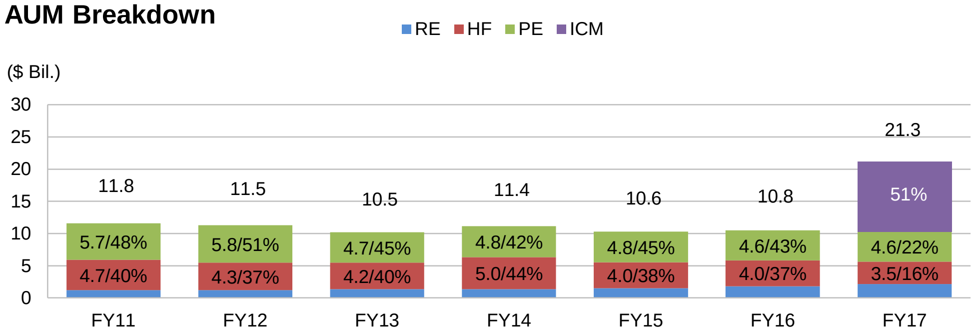
Company Profile

Franchise

Since its founding in 1982, Investcorp has defined itself as an investment intermediary to channel the wealth of high-net-worth and institutional Arabian Gulf clients into alternative investments in the U.S. and Europe. The company’s focus continues to be on serving the needs of investors from the six GCC countries — Bahrain, Kuwait, Qatar, Saudi Arabia, Oman and the United Arab Emirates — where there is strong demand for international alternative investment products.

At the fiscal-year ended June, 30 2017 (FYE17), the firm had $21.3 billion AUM, up from $10.6 billion the year prior, driven by the March 2017 acquisition of 3i Debt Management Group (3iDM), the debt and collateralized loan obligation (CLO) management business of UK-based 3i Group PLC, for a total consideration of approximately $316 million. 3iDM, renamed Investcorp Credit Management (ICM), is an established leveraged loan management platform (10th largest CLO manager globally) with an experienced team and a long track record of successful CLO issuance and administration. The acquisition added approximately $11 billion in AUM and 50 investment professionals and is expected to be accretive to Investcorp, adding approximately $50 million in annual fee income.

AUM Breakdown



Note: Fiscal years ended June 30.
Source: Company filings.

The acquisition was funded entirely by cash on Investcorp's existing balance sheet and did not require additional debt funding, which Fitch views favorably. Investcorp currently has the lowest AUM within Fitch's rated universe but management has added fundraising staff in Europe and the Gulf, targeting additional AUM growth within ICM and its other businesses.

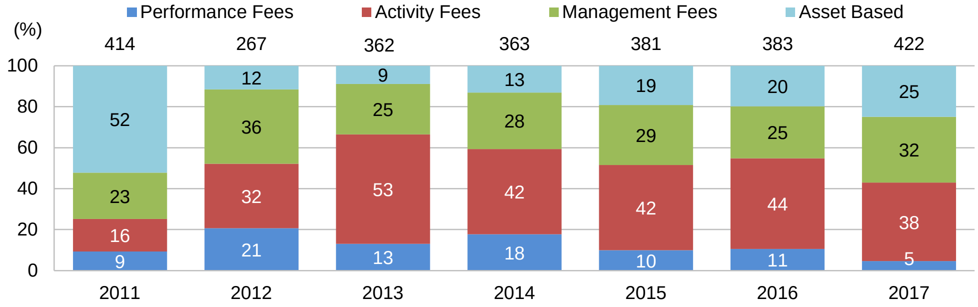
Investcorp operates globally across four lines of business including Corporate Investments (PE), RE, Alternative Investment Solutions (hedge funds) and ICM (credit), with offices in Bahrain, New York, London, Saudi Arabia, Doha, Abu Dhabi and Singapore. At FYE17, ICM was the dominant asset class in terms of client AUM with 54% of the total. Corporate investments were the next largest asset class (19%), followed by AIS (17%) and RE (10%).

Business Model

The company seeks to differentiate itself from other asset managers by appealing to investors' preference for investment discretion and offering investments primarily on a deal-by-deal basis without dedicated fund structures. Investments are initially underwritten by the company with a significant portion earmarked for placement with investors, typically in four weeks to eight weeks. However, adverse market conditions may result in the firm having to hold underwritten investments for a longer period, which presents elevated balance sheet risk.

Fee income is comprised of management fees, performance fees and activity fees. Management fees are based on deal-by-deal AUM placements and on committed capital for closed-end PE funds. Activity fees are earned from transactional activities including initial acquisition, add-ons, subsequent placement and eventual investment exit. Since 2012, activity fees have represented the largest portion of annual fee income; however, Fitch notes they are dependent on the firm's ability to transact in the marketplace, which can be volatile. Performance fees (5% of fiscal 2017 revenue) are earned when returns exceed contractual return hurdles.

Revenue Composition
(Fiscal Years Ended June 30)



Source: Company filings.

Corporate Investments: Corporate investment (CI), the term used by the firm for its PE business, consists of teams in North America, Europe and the wider MENA region and targets investments in midsize companies with capable management, strong cash flows and potential for growth. Unlike traditional PE managers, which primarily utilize commingled closed-end fund structures, 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 a co-investment.

At FYE17, CI AUM remained steady year on year at $4.6 billion as new deal placement during the year was offset by distributions of investment exits. AUM in deal-by-deal structures comprised 78% of segment AUM at FY17, while additional AUM was in closed-end technology-focused funds.

Alternative Investment Solutions: The alternative investment solutions (AIS) business was launched in 1996 and currently consists of investments in third-party funds via customized funds-of-hedge-funds, single manager partnerships, special opportunities portfolios and alternative risk premia strategies.

At FYE17, segment AUM was $3.5 billion, down 13% from $4.0 billion a year prior, as redemptions more than offset performance gains and new subscriptions. Client net redemptions for the year were $410 million, driven primarily by certain underperforming managers, partially offset by $550 million in new subscriptions. At FYE17, approximately 60% of segment AUM was in customized fund-of-funds; 30% in hedge fund partnerships; 8% in risk premia strategies; and 3% in special opportunities portfolios.

In hedge fund partnerships, Investcorp aims to seed alongside other institutional partners to limit its capital commitment. The firm invests in emerging managers (two-three-year commitment) with the objective of gaining diversified exposure to fund performance as well as revenue share. The platform is designed to merge the investor relationships and distribution platform of Investcorp with the investment skill of experienced portfolio managers looking for seed capital.

The AIS business generates management fees and potential performance fees while providing a hedge fund asset class to clients. Unlike corporate investment fees, AIS fees are based on the net asset value (NAV) of the funds, so are more sensitive to market volatility. The company also earns activity fees for its role as asset selector in special opportunities portfolios, but these fees have not been material.

Real Estate: Real estate (RE) products are primarily offered through deal-by-deal investments, as well as through closed-end funds. As of FYE17, Investcorp managed 28 active commercial RE investment portfolios including two debt funds. About 21 portfolios consisted of investments that are on or ahead of management's performance plan, with the remaining seven being primarily pre-2009 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 RE investment team primarily invests in properties with strong cash flows and/or potential for attractive capital gains over medium-term holding periods. Investments are typically focused in the 30 largest U.S. RE markets, but the company has recently expanded its European activity having built a team in that region. 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.

Credit Management (ICM):

ICM is a global credit manager with approximately $5 billion managed in the U.S. by Investcorp Credit Management US LLC and $6 billion managed by Investcorp Credit Management E.U. Limited, as of FYE17. The business invests principally in non-investment-grade corporate credit in the form of senior loans. Business activities include the launch and management of CLOs and open ended senior debt funds, as well as investment in retention equity tranches in these funds.

ICM focuses on broadly syndicated loans, specifically companies with EBITDA of greater than $50 million and facilities greater than $300 million, with strong management teams. The investment process is formalized and is based on bottom-up fundamental credit selection conducted by an analyst team organized by sector. ICM has an established market presence with strong relationships with sponsors, banks and intermediaries, which ensures access to deal flow.

Asset-Based Income: Investcorp retains a portion of investments as a co-investment alongside its clients. Asset-based income on co-investments was $105 million in FY17 (25% of total revenue) and represents realized returns generated on balance sheet assets as well as unrealized changes in fair value. Asset-based income is considered less reliable than AUM-based fees as it depends on the economic environment.

Organizational Structure

The shareholder structure is designed to ensure that assets are protected against Bahraini or Middle Eastern regional risk. Investcorp Bank is the principal parent entity and owns a 100% economic interest in Investcorp Holdings Limited (IHL), its Cayman Islands-based subsidiary. In turn, IHL owns a 100% economic interest in Investcorp S.A. (ISA), domiciled in the Cayman Islands as a holding company. As of June 30, 2017, approximately 95% 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.

Management and Strategy

Management Quality

Investcorp has an experienced and stable management team that has positioned the firm well for the next phase of growth. In 2015, the current co-CEOs succeeded the 30-year CEO and founder, Nemir Kidar, and executed steps to position the firm to achieve substantial growth targets, complementing each other in their respective roles. Mohammed Al-Shroogi focuses on the firm's activities and client relationships in the Gulf and Rishi Kapor oversees financial management and strategic development.

Additionally, Fitch believes there is a good degree of management depth and experience within each business line. In 2016, the firm hired Neil Hasson, formerly a senior managing director in Macquarie's European RE business, to spearhead its European RE investment initiative. In the past two years, Investcorp hired 10 new members in its fundraising team as part of management's plan to grow and diversify AUM.

Corporate Governance

Corporate governance is deemed to be sound 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. At FYE17, the board of directors consisted of 14 members, 13 of whom are independent with executive chairman Mohammed Al Ardhi being the only interested director on the board. In October, standing committees, including the audit committee and remuneration committee, are completely independent.

In October 2017, Nemir Kidar stepped down as board chairman to enter full retirement and was replaced by Dr. Yousef Al-Ebraheem, currently vice chairman. Al-Ebraheem has served on the board since May 2014 and is the advisor of economic affairs to His Highness the Amir of the State of Kuwait.

Strategic Objectives

Investcorp's core focus of offering alternative investments to Gulf-based investors remains consistent, but the firm has taken steps to grow AUM and diversify its client base by expanding the suite of products offered and adding additional fundraising staff. Fitch views the 3iDM acquisition as a sound strategic move as it extends the firm's offerings into credit and provides the firm with stable AUM and management fee earnings (10-to-12-year locked-up capital).

Another key part of the firm's growth strategy is to expand its European RE investments to complement its long-established U.S. RE business. Additionally, the firm has begun doing larger 'club deals' in recent years, investing alongside other sponsors in order to give clients exposure to larger companies and RE projects. The firm completed its first two club deals in FY16 for $200 million and was well under way with RE club deals in two assets in Washington, D.C. and Seattle, syndicated to a small group of investors.

The firm continues to maintain a significant level of co-investment on its balance sheet across the various investments it offers, although the size of the portfolio has been reduced to more a moderate level since 2010. In an effort to reduce the impact of market liquidity stress or forced refinancing, Investcorp continues to target a co-investment to long-term capital ratio of below 1.0x such that the entire balance sheet co-investment portfolio is fully funded through equity and long-term debt.

Execution

Investcorp has demonstrated a good track record executing on recent initiatives. Despite economic headwinds in GCC economies, the firm's fundraising in the Gulf region has been robust with over $1 billion raised annually in the past three years. In Fitch's opinion, Investcorp has positioned itself well to achieve AUM growth, investor diversification and earnings growth over the medium term with notable steps taken toward these ends including the acquisition of 3iDM, the 20% equity stake sale to Mubadala and increased fundraising resources.

That said, organic AUM growth in FY17, excluding the 3iDM acquisition, was flat, with fundraising offset by capital distributions and net redemptions in AIS. The AIS business had net client outflows in FY15 and FY17 driven by poor performing third-party managers, but Fitch notes that AIS is a smaller driver of total fee income. Fitch believes that material organic AUM growth in new and existing products across regions and, particularly in the Gulf, could signal benefits accruing to the firm from its influential institutional shareholders.

Since suffering losses in 2008–2009, the company's earnings performance has been relatively stable despite a reliance on activity fees and asset-based income. The percentage of recurring management fee revenue is lower than alternative IM peers; however, the ICM business is expected to increase the proportion of recurring management fee revenue, which Fitch views favorably.

Risk Appetite

Risk Controls

The firm's risk management framework is considered sound. 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 its 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 co-CEOs, 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 hedge funds, corporate investments and RE 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 FY17 was $6.7 million (down from $12.2 million at FY16). 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/Underwriting Standards

Operational risk is inherent in the company's CI, RE and ICM valuation models, as well as in AIS back-office operations, but the firm has not reported material operational loses. 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.

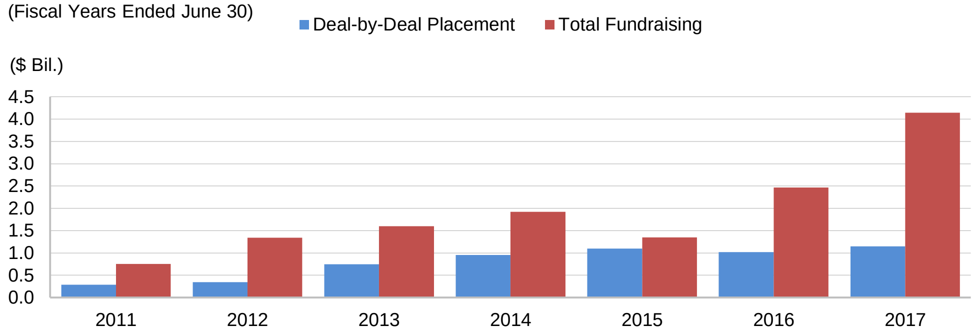
In the leverage lending business, the investment team focuses on senior-secured loans of corporate borrowers with EBITDA ranging from $50 million to several billion and facility sizes great than $300 million. The investment process includes in-depth analysis of business and industry fundamentals and evaluation of cash flow generation, asset coverage, capital structures, loan documents and covenants. RE deals are primarily core-plus assets in multifamily and industrial sectors underwritten with acceptable leverage levels.

Growth

Investcorp has undertaken an aggressive AUM growth strategy, more than doubling AUM in FY17 with the 3i acquisition. However, Fitch views the firm's growth rate as manageable relative to capital generation (for balance sheet investments) and operational infrastructure (for third-party managed investments). Capital ratios remain strong and the firm acquired the infrastructure supporting the new ICM business.

In FY17, investment activity increased with total fundraising of $4.1 billion driven by $2.0 billion raised in CLOs. Deal-by-deal investment activity in CI and RE remained steady with the prior two years at $1.1 billion and largely kept pace with distributions. In FY17, $604 million of capital was deployed in CI across five new PE investments and new add-ons, in addition to $17 million invested through Investcorp's fourth technology fund. In RE, an aggregate $533 million was deployed in new RE investments primarily in the U.S., including student housing, office and laboratory building s and multifamily buildings. In the four-month period from the transaction close to FYE17, a total of $932 million of investments relating to new CLO issuance were made in the ICM business.

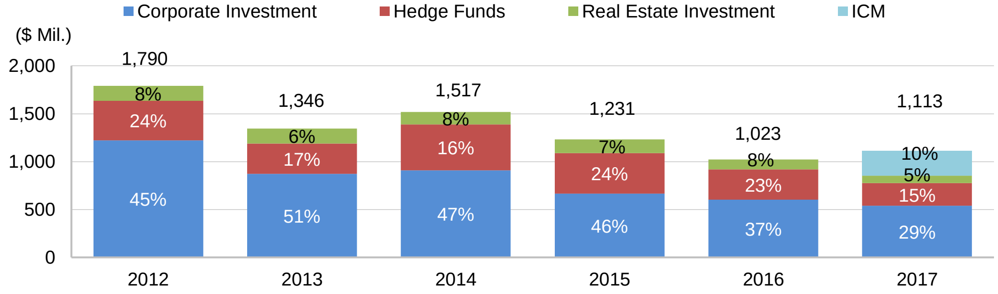
Deal-by-Deal and Total Fundraising
(Fiscal Years Ended June 30)



Note: Estimates of fundraising by product provided verbally in annual report, hard to reconcile exactly with total figure.
Source: Company reports.

Since 2012, the level of balance sheet co-investments has declined by approximately 39% to $1.1 billion at FYE17, but this was up from $1.0 billion at FYE16, driven by the addition of credit co-investments in ICM. While the level of co-investment is below historically reported levels, underwritten investments on the balance sheet not yet placed with investors has increased in the past two fiscal year ends. Fitch notes that fiscal year end is a busy period in the Islamic holiday calendar and investments may be front loaded and placed with clients in the short term. While this presents increased balance sheet exposure in the near term, Fitch believes Investcorp has adequate capital buffers and a solid risk management framework to manage this exposure.

Co-Investment
(% of Total Assets, Fiscal Years Ended June 30)



Source: Company filings.

Financial Profile

Asset Performance

Net client flows have generally been positive, averaging 1.6% annually over the past four years, excluding the 3i acquisition. Strong fundraising and deal placement has moderately outpaced realization activity in the firm's largest revenue contributing segments, CI and RE, offset by net outflows in AIS.

Since 2012, RE AUM increased at a 12% CAGR as the relatively smaller business ramped up. Meanwhile, CI AUM declined at a 4% CAGR as distributions outpaced strong fundraising. The firm reported that FY17 marked the third consecutive year with over $1 billion raised from Gulf clients, highlighting resilient Gulf client demand for alternative investments. The AIS business has seen overall net investor outflows driven by investor redemptions in underperforming managers offset by new subscriptions.

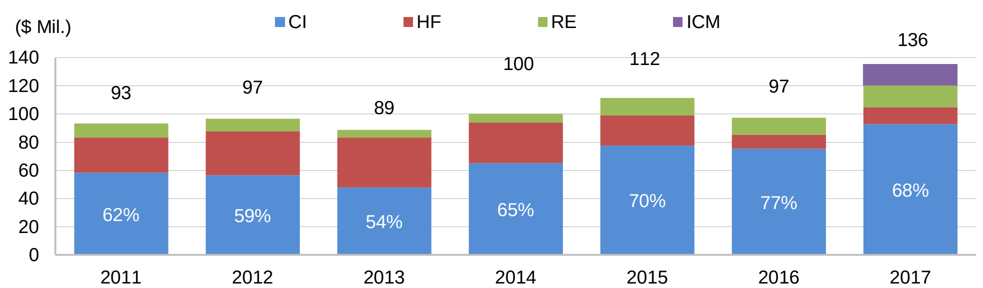
Management Fee Yield

(%, Fiscal Year Ended June 30)

	2012	2013	2014	2015	2016	2017	Average
RE	0.7	0.4	0.4	0.9	0.7	0.8	67.4
AIS	0.7	0.8	0.6	0.5	0.2	0.3	53.2
CI	1.0	0.9	1.4	1.6	1.6	2.0	141.6
ICM[a]	N.A.	N.A.	N.A.	N.A.	N.A.	0.4	42.5
Aggregate Yield	0.8	0.8	0.9	1.0	0.9	0.8	88.7

[a]Annualized management fees for FY17. N.A. – Not applicable.
Source: Company reports, Fitch.

Management Fees
(Fiscal Years Ended June 30)



FY17 – ICM management fee represent the period March-June.
Source: Company filings.

The average management fee yield, calculated as management fees divided by average AUM was 0.84% in FY17, below the five year average of 0.89%, which primarily reflects lower fee rates earned in the ICM business relative to CI and RE. The CI fee yield increased to 2.0% in FY17, up from 1.6% in FY16 and above the five year average of 1.4%. Fitch notes that the timing of investor flows, investment placements and exits can affect fee yield estimates which are based on average AUM, which likely explains this increase. The AIS fee yield has been declining as the fund-of-fund industry has experienced general downward pressure on rates and was 0.32% in FY17.

Performance of the firm's investments observed through the co-investment return has been positive since 2010, averaging of 4.9% annually. Returns in hedge fund investments have been volatile but have averaged 2.2% annually since 2010, outperforming the HFRI Fund-of-Fund Composite Index average return of 1.6% over the same period. Managers with whom Investcorp has seed partnership arrangements delivered positive performance of 11.6% in FY17. RE returns, after suffering writedowns on legacy assets in 2010 have generally been positive.

Asset Yields
(%, Annualized, Fiscal Years Ended June 30)

(%, Annualized)	2011	2012	2013	2014	2015	2016	2017	Average	% of Total Assets
Corporate Investment	13.1	5.6	0.0	2.6	6.8	16.5	3.4	6.9	20.3
Real Estate	20.1	7.9	0.1	(3.6)	5.5	(0.6)	5.7	5.0	3.0
AIS (Hedge Funds)	6.5	(8.4)	6.6	7.2	2.0	(6.2)	7.5	2.2	8.9
ICM (Credit)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	12.0	12.0	9.7
Aggregate Co-Investment Yield	11.6	1.4	1.6	2.9	5.0	5.4	6.4	4.9	41.9

Source: Company reports.

In ICM, CLO equity distributions remained strong. At FYE17, the average annualized cash distribution on Investcorp's 2.0 CLOs in Europe was 16.8% and, in the U.S., was 16.3%. Two U.S. CLO deals were realized during FY17, one returning an IRR of 12.0% and the other 10.5%. For the past five years ended June 2017, the annualized net return of the ICM Senior Loan Fund has exceeded the Credit Suisse Leveraged Loan Index by 12 basis points (4.95% versus 4.83%). Historically reported loss rates in ICM investments have been lower than benchmarks. Since 2006, the U.S. and European business average annual loss rates is 0.5% and 0.8%, which compared favorably to the CS WE LL Index average of 1.1% over the same period.

At FYE17, Investcorp reported that its corporate investments increased its aggregate EBITDA by approximately 6% year on year. The CI portfolio is diversified by single name and sector, with the top sector exposures – consumer products, telecom and industrial products – representing 26%, 22% and 16% of the portfolio at FYE17, respectively. The CI portfolio is geographically diversified with investments predominantly in North America and Europe (79%) with some exposure to MENA and Turkey (21%). RE investments are primarily in U.S. markets, diversified across sectors and regions.

Earnings and Profitability

In FY17, fee-based income increased 3% to $317 million from the year prior with higher management fees partially offset by lower activity fees and performance fees. Management fees increased to $136 million, up 39% from the prior year driven by increased corporate investments and RE placements with clients and fees from ICM.

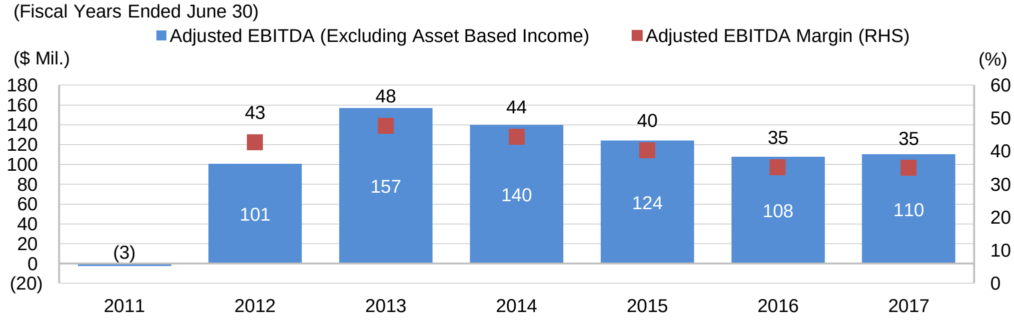
Management fee income as a proportion of total operating income increased in FY17 to 32% (from 25% in FY16) but continued to trail alternative IM peers. The increase was primarily driven by CI and the four-month contribution from the new ICM business. Fitch would view positively an increase in the proportion of recurring management fees.

When assessing earnings performance, Fitch adjusts EBITDA to exclude more volatile asset-based income. Since 2011, fee-based earnings margin (measured as adjusted EBITDA to fee income) has been relatively steady and strong. In FY17, the adjusted EBITDA margin was consistent year-on-year at 35% but below the five-year average of 41% due to lower performance fees and increased compensation expense. Fitch notes that a significant portion of the firm's fee earnings are activity fees based on transactional activity which are considered a less stable fee stream compared to management fees.

To be more comparable to industry peers, Fitch further adjusts EBITDA to add-back 25% of asset-based income, which the agency uses as an estimate for performance-related compensation. This adjustment is meant to approximate fee-related EBITDA (FEBITDA), which is a metric more consistently reported by alternative IM peers. In FY17, Investcorp's FEBITDA margin, improved to 32% (from 30% in FY16). Asset-based income has become a less dominant earnings contributor since 2011 but still represented 25% of revenue in FY17.

Adjusted EBITDA

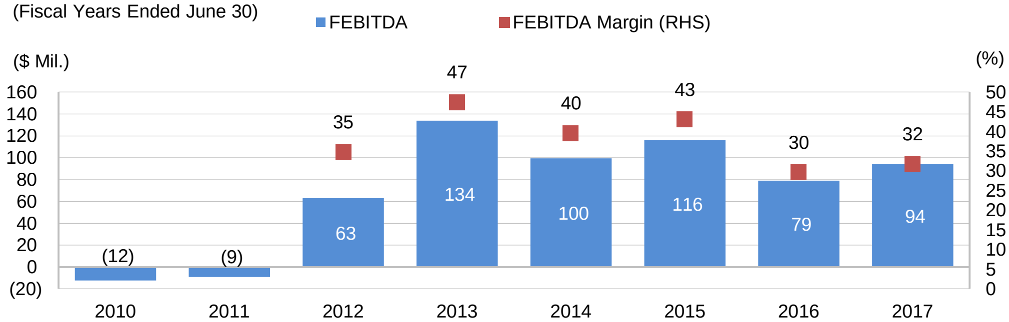
(Fiscal Years Ended June 30)



Source: Company filings, Fitch.

FEBITDA

(Fiscal Years Ended June 30)



Source: Company filings, Fitch.

Capitalization and Leverage

While Fitch typically assesses IMs 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 FYE17, Investcorp's total risk-based capital ratio was 31.7% (up from 30.3% at FYE16) and well above the CBB minimum requirement of 12.5%. Fitch's core bank capital measure, Fitch Core Capital (FCC)/FCC adjusted Risk Weighted Assets (RWA), has trended upward to 24.9% at FYE17 (up from 23.5% at FYE16) driven by increased deposits and lower co-investment. Fitch views Investcorp's capital levels as appropriate given the balance sheet risk associated with the company's business model.

The FCC calculation makes a range of adjustments to reported equity to arrive at a measure of a bank's highest quality "going-concern" capital. The table below compares regulatory capital with FCC, which excludes preference shares, resulting in a notable difference between the two ratios. 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

(%, Fiscal Years Ended June 30)

	2012	2013	2014	2015	2016	2017
Risk-Based Capital Ratio	26.9	33.8	30.4	28.7	30.3	31.7
Fitch Core Capital/FCC Adjusted RWA	14.4	17.7	16.2	21.4	23.5	24.9
Debt/Tangible Equity (x)	1.1	0.8	1.0	0.9	0.9	0.7
Debt/Adjusted EBITDA (x)	11.2x	5.7x	6.3x	6.2x	8.2x	7.2x
Debt/FEBITDA (x)	17.9x	6.7x	8.9x	6.6x	11.2x	8.4x

Source: Company filings, Fitch.

Leverage, measured on a Debt to Adj. EBITDA basis, was 7.2x at FYE17, down from 8.2x at FYE16. On a Debt to FEBITDA basis, leverage was 8.4x at FYE17, down from 11.2x driven by improved fee earnings.

Funding, Liquidity and Coverage

Funding

Funding is primarily comprised of 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 by maintaining a co-investment to long-term capital ratio of 1.0x or lower (0.7x at FYE17), such that the entire balance sheet co-investment portfolio is funded through equity and long-term debt, which Fitch views as appropriate given the limited liquidity of the co-investment portfolio.

Co-Investment Funding

($Mil., Fiscal Years Ended June 30)

	2012	2013	2014	2015	2016	2017
Co-Investment[a]	1,615	1,171	1,342	1,056	973	1,099
Long-Term Capital[b]	1,426	1,449	1,301	1,264	1,400	1,528
Co-Investments[a]/Long-Term Capital[b] (x)	1.1	0.8	1.0	0.8	0.6	0.7

[a]Net of revolving facilities secured against hedge fund co-investments. [b]JPY 37 billion debt maturing in 2030 and $50 million debt maturing in 2032, deferred fees and total equity.
Source: Company reports.

At FYE17, long-term debt consisted of unsecured private notes of JPY37 billion and $50 million, maturing in 2030 and 2032, respectively. Medium-term debt consisted of U.S.-denominated bonds maturing in 2020, Swiss Franc bonds maturing in 2019 bonds and borrowings under a secured bilateral revolver maturing in June 2019.

Medium-term funding sources include two secured revolving credit facilities; a $420 million revolver with a syndicate of banks maturing in March 2021 and a $50 million revolver maturing in June 2019. At FYE17, there were no outstanding borrowings under the former and $14 million outstanding under the later. The revolvers carry floating rates of interest when drawn and a fixed rate of commitment fees when undrawn.

The company's preference shares issued in 2009 have been reduced but still represent a portion of the firm's capital (20% at FYE17) and carry a high dividend rate of LIBOR +9.75%. Fitch gives full equity credit to the company's preference share capital the shares are noncumulative, nonconvertible and perpetual in nature. At FYE17, $223 million of preference shares remained outstanding, unchanged from FYE16. Fitch views these preference shares as equity as they are perpetual noncumulative.

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 RE 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.

The firm's liquidity profile is considered sound given its diversified funding sources with well laddered debt maturities. Accessible liquidity, consisting of undrawn committed revolving facilities plus balance sheet cash and other liquid assets, but excluding co-investments in hedge funds, was $984 million at FYE17 (up from $829 million at FYE16) and covered all outstanding debt maturing over the next five years, as well as $61 million in unfunded co-investment commitments, which Fitch views positively. These unfunded co-investment commitments were to various CI and RE investment funds, a special opportunities portfolio, and forward placements in money market instruments.

Available Liquidity Resources

($Mil., Fiscal Years Ended June 30)

	FYE15	FYE16	FYE17
Liquidity			
Cash and Short-Term Funds	83	292	45
Deposits with Financial Institutions	257	108	517
Undrawn Facilities	525	429	422
Total Liquidity	**864**	**829**	**984**
Debt			
Debt Maturing within Five Years	417	403	382
Debt Maturing after Five Years	346	479	410
Total Debt	**763**	**882**	**791**
Ratio of Liquidity to Debt maturing within Five Years	2.1	2.1	2.6

Source: Investcorp and Fitch.

Hedge fund co-investments are not included in liquidity as they are subject to redemption restrictions and include seed capital in hedge fund partnerships, which is locked-up for multiple years. Management estimates 40% of the HF co-investment could be monetized within three months and 72% within 12 months. The firm's ordinary dividend policy is a target of 24 cents per share (25% payout ratio in FY17). Including preference share dividends the payout ratio increases to 46%, a level which is below that of other alternative IM peers.

Coverage

Coverage

($ Mil.)	2012	2013	2014	2015	2016	2017
Share (Purchase)/Issuance						
Treasury Shares	(7,878)	3,601	2,175	—	—	—
Preference Shares	—	—	126,243	53,400	1,761	—
Dividend Activity						
Preference Shares Dividend	61,376	61,376	49,376	29,394	23,901	24,972
Ordinary Shares Dividend	9,306	4,720	9,413	10,394	17,740	19,115
Charitable Contributions	4,000	—	4,500	2,500	2,970	—
Net Distributed	**66,804**	**69,697**	**191,707**	**95,688**	**46,372**	**44,087**
Interest Expense	47,800	63,475	60,555	58,100	58,100	57,400
Adjusted EBITDA (Excluding Asset Based Income)	100,844	156,948	139,858	126,700	124,100	163,666
Adjusted EBITDA/Interest Expense (x)	2.1	2.5	2.3	2.2	2.1	2.9
Adjusted EBITDA/Interest Expense + Preferred Dividend) (x)	0.9	1.3	1.3	1.4	1.5	2.0
Adj. EBITDA/Interest Expense + Net Distributed) (x)	0.9	1.2	0.6	0.8	1.2	1.6

Source: Company filings, Fitch.

Investcorp’s debt agreements do not include covenants relating to EBITDA coverage of interest expense, but Fitch calculates interest coverage ratios to assess ongoing liquidity. Interest coverage, measured as Adjusted EBITDA to interest expense, was 2.9x in FY17, up from 2.2x in FY16 but remained relatively low.

Including preference share dividends, coverage (Adj. EBITDA/interest plus preferred dividends) was 2.0x in FY17, which has improved over the past few years as Investcorp bought back preferred shares in 2014–2016. Given the cash generative nature of the business, Fitch believes the firm may have the flexibility to further reduce preference shares at a measured pace, which would improve coverage.

Investcorp Bank BSC — Balance Sheet

($ Mil., Years Ended June 30)	2017	2016	2015	2014	2013	2012
Assets						
Cash and Short-Term Funds	44.5	292.2	82.7	101.3	101.9	156.2
Deposits with Banks and Other Financial Institutions	517.4	133.2	256.6	125.9	453.1	194.6
Cash and Deposits	561.9	425.4	339.3	227.2	555.0	350.8
Marketable Securities						
Accounts Receivable	277.1	320.6	274.9	206.3	283.0	284.3
Loans and Advances	85.6	105.3	111.5	128.8	147.0	188.8
Accrued Interest and Other Assets	—	—	—	—	—	—
Hedge Funds	236.3	315.8	421.0	476.4	315.8	414.1
Corporate Investments (Private Equity before FY10)	539.0	602.6	667.2	910.8	906.6	1,221.8
Real Estate	79.1	104.4	143.0	130.0	156.5	154.5
Venture Capital	—	—	—	—	—	—
Strategic Investments	—	—	—	—	—	—
Consolidated Investments	854.4	1,022.8	1,231.2	1,517.2	1,378.9	1,790.4
Underwritten Investments	460.4	493.5	87.5	112.4	—	—
FV of Derivatives	62.1	90.2	74.2	66.6	62.8	81.3
Fixed Assets	37.7	39.3	42.8	45.6	50.6	54.1
Other Assets	316.8	0.1	0.0	0.0	0.0	0.0
Total Assets	**2,656.0**	**2,497.2**	**2,161.4**	**2,304.1**	**2,477.3**	**2,749.7**
Liabilities						
Deposits from Banks	166.3	95.9	0.6	80.9	23.8	10.1
Deposits from Clients — Short Term	30.8	11.3	13.7	26.9	206.1	195.3
Deposits from Clients — Medium Term	218.4	118.7	87.3	68.9	88.2	119.2
Total Deposits	415.5	225.9	101.6	176.7	318.1	324.6
Accrued Interest and Payables	155.4	201.4	240.4	164.1	148.3	214.4
Other Liabilities	105.1	121.1	137.4	137.4	0.0	(0.0)
Unfunded Deal Acquisitions	0.0	0.0	0.0	0.0	0.0	0.0
Medium-Term Facilities	381.7	403.1	417.1	474.2	482.5	567.3
Long-Term Notes	409.5	479.0	346.2	408.1	419.1	560.5
Negative FV Derivatives	43.6	49.5	36.7	25.2	43.0	39.2
Total Liabilities	**1,510.8**	**1,480.0**	**1,279.4**	**1,385.7**	**1,411.0**	**1,706.0**
Equity						
Preferred Stock	223.2	223.2	225.0	391.2	511.5	511.5
Common Stock (Par Value)	194.5	200.0	200.0	200.0	200.0	200.0
Reserves	325.8	282.3	259.2	221.9	229.4	233.0
Retained Earnings	367.0	313.4	268.1	199.3	213.5	183.5
Treasury Shares	(3.2)	(45.4)	(103.6)	(158.2)	(163.6)	(163.6)
Proposed Appropriations (Preferred Stock Dividend)	25.0	23.9	29.4	49.4	61.4	61.4
Proposed Common Stock Dividend	19.1	17.7	10.4	9.4	9.3	4.7
Proposed Charitable Contributions	0.0	3.0	2.5	4.5	4.5	0.0
Unrealized FV of Corporate/RE Co-Investments	0.0	0.0	0.0	0.0	0.0	0.0
Unrealized FV Recognized Directly in Equity	(6.2)	(0.9)	(9.0)	0.9	0.3	13.2
Shareholders Equity	1,145.2	1,017.2	882.0	918.4	1,066.3	1,043.7
Ordinary Shareholders Equity	897.0	770.1	627.6	477.8	493.4	470.8
Total Liabilities and Shareholders Equity	**2,656.0**	**2,497.2**	**2,161.4**	**2,304.1**	**2,477.3**	**2,749.7**

Source: Company filings.

Investcorp Bank BSC — Balance Sheet

($ Mil., Years Ended June 30)	2017	2016	2015	2014	2013	2012
Fee Income						
Management Fees	135.5	97.4	111.5	100.0	88.8	96.7
Activity Fees	161.3	169.5	158.9	151.6	193.4	84.2
Performance Fees	19.7	40.6	37.7	64.2	47.3	55.2
Gross Fee Income	**316.5**	**307.5**	**308.1**	**315.8**	**329.5**	**236.1**
Expenses and Taxes Attributable to Fee Income	(212.8)	(208.1)	(191.8)	(187.9)	(175.8)	(136.8)
Net Fee Income Before Interest Expense	**103.7**	**99.4**	**116.3**	**127.9**	**153.7**	**99.3**
Asset-Based Income	—	—	—	—	—	—
Corporate Investments (Private Equity before FY10)	19.2	100.8	49.8	23.8	0.3	59.8
Hedge Funds	15.8	(27.7)	9.1	28.2	25.3	(50.2)
Real Estate	23.4	(1.5)	11.5	(7.8)	0.1	17.3
Treasury and Other	46.8	4.4	2.6	3.5	6.6	4.2
Gross Asset Based Income (ABI)	**105.2**	**76.0**	**73.0**	**47.7**	**32.3**	**31.1**
Expenses Attributable to ABI	(27.0)	(16.1)	(11.7)	(10.4)	(12.2)	(13.9)
Provision	(4.1)	(8.2)	(2.8)	(1.4)	(5.4)	(1.1)
Net ABI Income Before Interest Expense	**74.1**	**51.7**	**58.5**	**35.9**	**14.7**	**16.1**
Interest Expense Fee Business	(35.3)	(31.0)	(30.0)	(30.5)	(31.8)	(17.9)
Interest Expense ABI Business	(22.1)	(29.9)	(28.1)	(30.0)	(31.7)	(29.9)
Interest Expense	**(57.4)**	**(60.9)**	**(58.1)**	**(60.5)**	**(63.5)**	**(47.8)**
Net Income	**120.3**	**90.1**	**116.7**	**103.3**	**104.9**	**67.4**
Total Expenses	(301.3)	(293.3)	(264.4)	(260.2)	(256.9)	(199.6)
Interest Expense	57.4	60.9	58.1	60.5	63.5	47.8
Operating Expenses						
Staff Compensation	150.2	143.8	129.1	115.8	102.8	72.5
G&A Expenses	89.6	80.4	74.4	82.5	85.2	78.2
Other Personnel Costs	10.5	8.1	8.1	10.6	17.8	9.7
Professional Fees	24.0	22.6	20.9	21.5	21.4	23.4
Travel and Business Development	12.5	11.7	9.0	10.3	9.7	9.1
Administration and Research	13.5	13.5	13.1	14.5	11.9	14.5
Technology and Communication	6.2	4.6	4.2	3.4	3.0	3.0
Premises	10.9	11.0	11.2	11.2	10.8	10.5
Depreciation	5.2	4.9	6.9	7.3	7.1	6.0
Other	6.8	4.0	1.0	3.7	3.5	2.0
Total	**239.8**	**224.2**	**203.5**	**198.3**	**188.0**	**150.7**
Operating Expense	**297.2**	**285.1**	**261.6**	**258.8**	**251.5**	**198.5**

Source: Company filings.