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CREDIT OPINION
30 September 2016

Update

Rate this Research

RATINGS

Investcorp Bank B.S.C.

Domicile	Bahrain - Off Shore
Long Term Debt	Not Available
Type	Not Available
Outlook	Not Available
Long Term Deposit	Not Available
Type	Not Available
Outlook	Not Available

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.

Credit Opinion

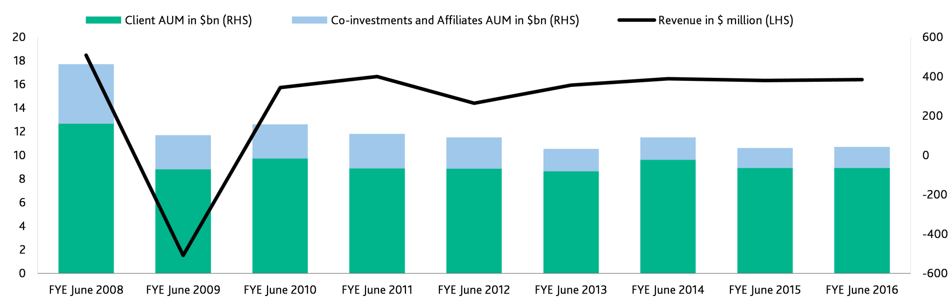
Summary Rating Rationale

The Ba2 rating reflects Investcorp's solid market position in the GCC region as a leading alternative investment provider to Gulf investors, healthy operating margins and solid asset retention. In addition, the rating also incorporates the company's good 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.

Investcorp's rating outlook is negative and reflects the challenges Investcorp might face raising new capital or reinvesting clients' capital in the coming year(s) due to the weakening operating environment in the Gulf Cooperation Council (GCC) region driven by depressed oil prices. Slower asset under management (AUM) growth would put pressure on key rating metrics, including profitability and financial leverage.

Exhibit 1

AUM Fees Growth Contributes To Revenue Stability



Source:

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 as a domestic systemically important bank

Credit Challenges

- High financial leverage

» Elevated balance sheet risk due to large co-investment activities

» Prolonged low oil prices constrain the company's ability to raise new capital from GCC clients

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

Rating Outlook

The rating outlook on Investcorp is negative

Factors that Could Lead to an Upgrade

Upwards rating pressure on Investcorp could result from:

» Reduced debt levels remaining under four times which would improve the company's financial flexibility

» Further reduction in the company's investment portfolio

» Growth of Investcorp's clients' assets under management (AUM), particularly in the hedge fund segment, which would improve the company's market position and asset resilience

» Further expansion and diversification of revenue streams, in particular from fund of hedge fund management fees

Factors that Could Lead to a Downgrade

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

» A deterioration in the company's ability to raise new client capital or reinvest client capital that would result in a noticeable deterioration of Investcorp's AUM resiliency score and would substantially affect revenue generation capacity

» Lower private equity origination and placement activities that would constrain the company's profitability

» Material on-balance sheet investment losses

» A deterioration of Investcorp's liquidity profile

» An erosion in the company's improving capital position.

Key Indicators

Exhibit 2

Key Indicators

Investcorp Bank B.S.C.

	2016 [1]	2015[2]	2014[2]	2013	2012	2011
Assets Under Management (AUM) ($ b)	11	11	11	11	12	12
Net Flows ($ b)	4.8	3.1	3.0	3.3	2.6	2.4
Revenues ($ mm) [3]	383	381	363	355	263	399
AUM Retention Rate (%)	72%	80%	87%	80%	85%	82%
AUM Replacement Rate (%)	105%	65%	172%	94%	106%	45%
EBITDA ($ mm)	105	150	135	155	222	166
EBITDA Margin (%)	27%	39%	37%	44%	84%	41%
Total Debt ($ mm)	1,091	906	1,123	1,031	1,243	1,265
Total Debt/EBITDA (x)	10.4x	6.1x	8.3x	6.6x	5.6x	7.6x
Total Shareholder's Equity / Self Managed Investments (x)	1.2x	0.9x	0.8x	0.9x	0.7x	0.7x
Pre-Tax Income ($ mm)	90	117	103	107	66	140
Pre Tax Income Margin (%)	23%	31%	28%	30%	25%	35%
Stability of Revenue Growth (%) (20 qtr) [4]	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

Detailed Rating Considerations

Market Position: Ba - STRONG NICHE MARKET POSITION IN THE GCC REGION; LOW OIL PRICES AND HEDGE FUND OUTFLOWS STUNT AUM GROWTH OUTLOOK

With total AUM of $10.8 billion (client AUM of $8.9 billion) and revenues of $383 million as of June 2016 (the fiscal year end), the company is a very small player in the asset management industry. That said, Investcorp's Ba market position reflects its strong brand name in the GCC region supported by 30-year plus track record. The company benefits from long-standing relationships with leading high-net-worth and institutional investors in the GCC region.

Investcorp's ability to provide tailored solutions and services to its client base engenders a loyal client base as evidenced by strong asset retention rates in both the company's corporate investment and real estate business segments. That said, persistent outflows in the company's underperforming hedge fund business has constrained organic AUM growth. Weaker economic growth prospects in the GCC region, due to depressed oil prices, should serve as additional growth headwind for the company in the near to medium term. To date the company has not seen a pick-up in redemptions from GCC (including SWF) clients and continues to maintain positive fundraising momentum. In FY2016 the bank's deal-by-deal fundraising in the GCC region was $1,017 million as compared to $1,095 million raised in FY15.

Business Diversification: Baa - GLOBAL REACH WITH HIGH NETWORTH AND INSTITUTIONAL CLIENTS IN THE GCC, US AND EUROPE SOURCED THROUGH DIRECT DISTRIBUTION.

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. It operates under three main segments:

1) Corporate Investment (CI) : the segment targets the acquisition of attractive corporate investments in North America, Europe, the Gulf region, and Turkey with enterprise values of between $100-$400 million;

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

3) Alternative Investment Solutions: The hedge fund business was rebranded to “alternative investment solutions” as the company continues to restructure the segment through strategic hires, acquisition, partnerships and fund launches. The segment counts four main areas of expertise that include the Multi-Manager Solutions platform ($1.7bn), Hedge Fund Partnerships ($1.45bn), Special Opportunity Portfolios ($296m) and Alternative Risk Premia ($200m).

Geographic diversification is good with around 35% of AUM sourced in the US and Europe.

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 but also through local offices in Saudi Arabia, Qatar and Abu Dhabi. Clients are ultra high net worth and institutional, covered through direct distribution. Over the last year, Investcorp added client-facing resources to further increase its market penetration in the Gulf.

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

Investcorp is strengthening its Alternative Investment Solutions business with the aim of expanding its assets under management among institutional investors in the US, Europe and also Asia. In November 2015, Investcorp acquired the Hedge Funds of Funds business unit of SSARIS Advisors, LLC , an investment manager of absolute return hedge fund strategies and hedge funds of funds strategies. With $810 million in discretionary and advisory assets, and clients across the US, Europe and Asia, the aim of the acquisition is to strengthen Investcorp’s existing platform. Earlier in 2015, the company increased its product offering with the launch of Alternative Risk Premia, a product which offers weekly liquidity and aims to increase portfolio diversification as it maintains limited correlation with bonds and equities. However, the product is nascent and its take off depends on Investcorp's reputation, as well as establishing a strong track record of performance. Investcorp's client AUM in Alternative Investment Solutions amounted approximately $3.7 billion as of June 2016 and accounted for around 42% of Investcorp's total client AUM.

Financial Flexibility: B - SIGNIFICANT FINANCIAL LEVERAGE AND CO-INVESTMENT RISKS SOMEWHAT ALLEVIATED BY STRONG LIQUIDITY AND TANGIBLE EQUITY

Investcorp's leverage (as measured by Debt/EBITDA including Moody's standard financial adjustments) is very high at 10x, consistent with a Caa score for this sub-factor. Leverage has increased compared to a year ago, due to:

1/ a decline in EBITDA as staff costs increased (strategic hires) to support the growth of the business.

2/ an increase in long-term debt due mainly to the appreciation of the Yen against the US Dollar, as the majority of the long-term debt is denominated in Japanese Yen. The Japanese Yen outstanding debt is hedged using cross-currency and FX forwards swaps aimed at completely neutralizing Investcorp's exposure to EUR-JPY exchange rate. Although not reflected in our debt calculation, the mark-to-market movement on the hedging derivatives effectively reduced by USD 60 million the reported debt levels as of June end 2016.

3/ A temporary increase in the short term debt levels reflecting unfunded deal acquisitions relating to new investments in corporate investments or real estate that were signed prior to 30 June year end but had not closed and funded prior to this date.

In addition, through its co-investments, Investcorp makes active use of its balance sheet through principal investments in private equity, hedge funds and real estate. 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, hedge fund and real estate assets. Declines in the fair market values of these assets can have significant impacts 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 two exposures accounting for more than 10% of the total portfolio.

The company has stated that going forward it intends to maintain a co-investment to long-term capital ratio 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 2016, 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. As a result we expect the level of co-investments to stabilise around current levels or slightly lower, a credit positive.

Our overall assessment of the financial flexibility factor is higher than the Caa raw factor reflecting the quality of Investcorp's equity capital base. The company maintain a large tangible equity position which represents a significant amount of loss-absorbing equity capital which 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 Central Bank of Bahrain (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 30.3% as of FY2016, well above regulatory requirements and we would expect the company's capital to maintained at current levels.

Profitability & Volatility: Ba - GROWTH SLOWDOWN IN GCC REGION MAY PRESSURE INVESTCORP'S SOLID MARGINS

Investcorp's pre-tax income margin of 23% - a primary measure of profitability - declined over the last year mainly due to an increase in Invescorp's operating expenses which increased to $232 million in FY16 from $206 million in FY15. Most of the increase is attributable to new hires in order to support business growth. Pre-tax income margin remains solid. For the months to come, margins could be put under pressure by the weakening operating environment in the GCC region. Moody's anticipates that the significantly reduced level of government revenues will result in substantially lower Government spending, declining corporate investment and softening consumption in the GCC region. With a majority of the company's clients located in the region, Moody's thinks that Investcorp's AUM growth could slow which would put pressure on Investcorp's profitability.

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 (FYE 2016: USD97 million) over the past three fiscal years, albeit negatively affected by the reduction in higher-yielding AUM, particularly hedge funds. Deal fees (FYE 2016: USD210 million) are less predictable and depends on acquisition and placement of new investments, the sale and exit of investments (realisations), and the performance of existing investments. Asset-based income is the most volatile profitability component as it is based on the annual return on Investcorp's proprietary investments of approximately USD1 billion. The five year average yield on Investcorp's co-investment portfolio was 6.3%, 0.2% and 1.9% for corporate investments, real estate investments, and hedge funds respectively.

Liquidity Analysis

Investcorp's credit profile benefits from its good liquidity management practices and solid liquidity position. Since 2009, Investcorp has embarked on deleveraging its balance sheet, with a reduction in its market funding reliance. The company has also diversified and lengthened the maturity profile of its funding base. Investcorp does not face any maturities until 2017 and maintains a significant liquidity buffer in the form of cash and a revolving credit facility.

The next bond repayment is in November 2017 when a USD250 million bond matures, followed by the maturity of the CHF125 million bond that matures in June 2019. Investcorp has refinanced and reduced to USD50 million its secured revolving that now expires in August 2019. It also counts a USD420 million revolving loan that expires in July 2020.

The company had cash and interbank balances of USD287 million as of June 2016, while accessible liquidity (cash, interbank and committed revolving facilities) stood at USD829 million, which largely covers all outstanding medium-term debt maturing over the next three years.

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							10.4x		
Total Shareholder's Equity / Self-managed Investments							1.2x		
Factor 4: Profitability & Volatility (20%)								Baa	Baa
Pre Tax Income Margin (5 yr ave)			28.4%						
Stability of Revenue Growth (20 qtr, YoY)				12.5%					
Operating Environment								A	Aa
Systemic Risk									
Economic Strength									
Institutional Strength									
Susceptibility to Event Risk									
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	Negative
Corporate Family Rating	Ba2
INVESTCORP CAPITAL LIMITED	
Outlook	Negative
Bkd Senior Unsecured	Ba2
INVESTCORP S.A.	
Outlook	Negative
Bkd Senior Unsecured	Ba2

Source: Moody's Investors Service

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