

RATING ACTION COMMENTARY

Fitch Affirms Investcorp's Ratings at 'BB'; Outlook Stable

Thu 04 Nov, 2021 - 3:52 PM ET

Fitch Ratings - Chicago - 04 Nov 2021: Fitch Ratings has affirmed the Long-Term Issuer Default Rating (IDR) and Short-Term IDR of Investcorp Holdings B.S.C. and its related entities (collectively Investcorp) at 'BB' and 'B', respectively. Concurrently, Fitch has assigned a Long-Term senior unsecured debt rating of 'BB' to Investcorp's revolving credit facility. The Rating Outlook is Stable.

Today's rating actions have been taken as part of a periodic peer review of the alternative investment manager (IM) industry, which is comprised of 11 publicly rated global firms. For more information on the broader sector review, please see, "Fitch Completes 2021 Alternative Investment Manager Peer Review," available at www.fitchratings.com.

KEY RATING DRIVERS

IDR AND SENIOR UNSECURED DEBT

The rating affirmation reflects the locked-in nature of most of Investcorp's fee streams, its strong client franchise and high degree of brand name recognition in the Gulf, supported by its investment track record and long-term relationships in the region. The affirmation also reflects the vulnerability of Investcorp's business model to a market downturn and Fitch's view of the firm's ability to maintain credit metrics in line with expectations.

Rating constraints include the firm's increased earnings volatility and placement risk relative to peers, given its business model of offering investments to clients on a fully

underwritten deal-by-deal (DBD) basis and its sizable co-investment portfolio, which is subject to fair value changes. Activity fees, which are earned from transactional activities and have comprised almost half of Investcorp's core fees over the past several years, are also susceptible to market volatility.

While the impact of oil price volatility on Investcorp's portfolio companies is limited, it could have fiscal impacts in the region. Still, Investcorp's Gulf investors have demonstrated relatively low sensitivity to oil price movements, as evidenced by record levels of DBD placement activity during previous periods of volatility in the energy sector. Fitch believes Gulf investors will continue to explore opportunities to diversify outside of the region.

Investcorp has embarked upon several strategic initiatives and expansion efforts aimed at enhancing its product offerings and geographic representation, including the institutionalization of its investor base and the expansion of committed capital fund structures. Fitch believes there are execution risks associated with the firm's strategy, including integration risk associated with acquisitions, and increased group complexity related to product and geographic expansion, which will take time to evaluate.

Investcorp's AUM, which is largely invested in the U.S. and Europe, totaled \$37.6 billion at fiscal year-end 2021 (June 30, 2021), up 17.0% from FYE20, driven by strong market performance and solid fundraising. Investcorp raised more capital in committed capital fund structures in FY21, including launching its inaugural North America private equity (PE) fund.

Core operating performance, as measured by fee-related EBITDA (FEBITDA), which excludes investment income from co-investments, performance fees and performance-related compensation, improved in FY21 but remained modest. Fitch believes Investcorp has less variability in its compensation structure than peers, given its business model. As such, the agency has elected to allocate a greater portion of the firm's total compensation to fee-based compensation, which adversely impacts its FEBITDA margin.

The FEBITDA margin amounted to 20.2% for FY21; up from 10.6% in FY20, and at the low-end of Fitch's 'bbb' category benchmark range of 20%-30% for alternative IMs. Profitability could improve over time, to the extent that Investcorp is able to scale its platform.

Performance fees totaled \$33 million and balance sheet gains amounted to \$107 million in FY21, representing a significant improvement over the prior year.

When assessing Investcorp's leverage, Fitch takes a hybrid approach, given the firm's cash generative business model and heavy balance sheet utilization. On this basis, Fitch views Investcorp's leverage profile as commensurate with the current rating level, with its high debt to FEBITDA (8.5x for FY21) somewhat offset by more modest debt to tangible equity (0.5x at FY21).

Fitch believes Investcorp had adequate liquidity at FYE21 with \$289 million of cash, deposits with financial institutions and other liquid assets, along with \$789 million of borrowing capacity on its corporate revolvers. Additionally, Investcorp had \$705 million of balance sheet co-investments, which could serve as additional collateral for debt, although it is comprised of relatively illiquid investments. Aside from client assets, which are due on demand, the firm's nearest debt maturity is March 2030.

Interest coverage, as measured by FEBITDA to interest expense on corporate debt, was modest, at 2.4x for FY21, which is within Fitch's 'bb' category quantitative benchmark range of 2x-4x for alternative IMs.

The Stable Outlook reflects Fitch's expectation that Investcorp will maintain credit metrics in line with Fitch's 'bb' category quantitative benchmark ranges for alternative IMs.

The senior unsecured debt rating is equalized with Investcorp's Long-Term IDR, reflecting the largely unsecured funding profile, expectations for average recovery prospects under a stress scenario and joint and several guarantees by Investcorp S.A., which is the principal operating and asset owning arm of the firm.

SUBSIDIARY AND AFFILIATED COMPANIES

Investcorp S.A. is the principal operating and asset-owning subsidiary of the group and is a joint and several guarantor on debt issued by Investcorp Capital Ltd. Therefore, the Long-Term IDR of each entity is equalized with Investcorp.

RATING SENSITIVITIES

IDRs AND SENIOR UNSECURED DEBT

Factors that could, individually or collectively, lead to positive rating action/upgrade include fee-paying AUM growth, enhanced AUM diversity and scalability of the platform, resulting in FEBITDA margin expansion, further institutionalization of the investor base, an increase in management fee contribution from committed capital fund structures, enhanced incentive earning potential, a decline in balance sheet and/or cash flow leverage, such that

these metrics approach 0.50x and 4.0x, respectively, under Fitch's hybrid leverage analysis, improved interest coverage, while maintaining adequate liquidity and co-investment funding.

Factors that could, individually or collectively, lead to a negative rating action/downgrade include material declines in AUM, which impair the firm's management fee generating capacity; a reduction in liquidity; or material changes in leverage and/or interest coverage resulting from a material degradation of balance sheet assets and/or weaker investment performance which adversely affects the firm's ability to generate FEBITDA. More specifically, increases in debt to tangible equity and debt to FEBITDA, such that the combination of these metrics exceeds 1.0x and 6.0x, respectively, under Fitch's hybrid leverage analysis, could negatively affect ratings.

The senior unsecured debt rating is equalized with Investcorp's IDRs and therefore, would be expected to move in tandem. Although not envisioned by Fitch, were Investcorp to experience an increase in secured debt as a percentage of total debt, this could result in the unsecured debt rating being notched below Investcorp's Long-Term IDR.

SUBSIDIARY AND AFFILIATED COMPANIES

The ratings of Investcorp S.A. and Investcorp Capital Ltd. are linked to the IDR of Investcorp and are, therefore, expected to move in tandem.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Investcorp Capital Ltd.	LT IDR	BB Rating Outlook Stable	Affirmed	BB Rating Outlook Stable
	ST IDR	B	Affirmed	B
● senior unsecured	LT	BB	Affirmed	BB
Investcorp S.A.	LT IDR	BB Rating Outlook Stable	Affirmed	BB Rating Outlook Stable
	ST IDR	B	Affirmed	B

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Non-Bank Financial Institutions Rating Criteria \(pub. 28 Feb 2020\) \(including rating assumption sensitivity\)](#)

[Corporate Hybrids Treatment and Notching Criteria \(pub. 12 Nov 2020\)](#)

ADDITIONAL DISCLOSURES

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ENDORSEMENT STATUS

Investcorp Capital Ltd.

EU Endorsed, UK Endorsed

Investcorp Holdings B.S.C.

EU Endorsed, UK Endorsed

Investcorp S.A.

EU Endorsed, UK Endorsed

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