PEI Alternative Insight

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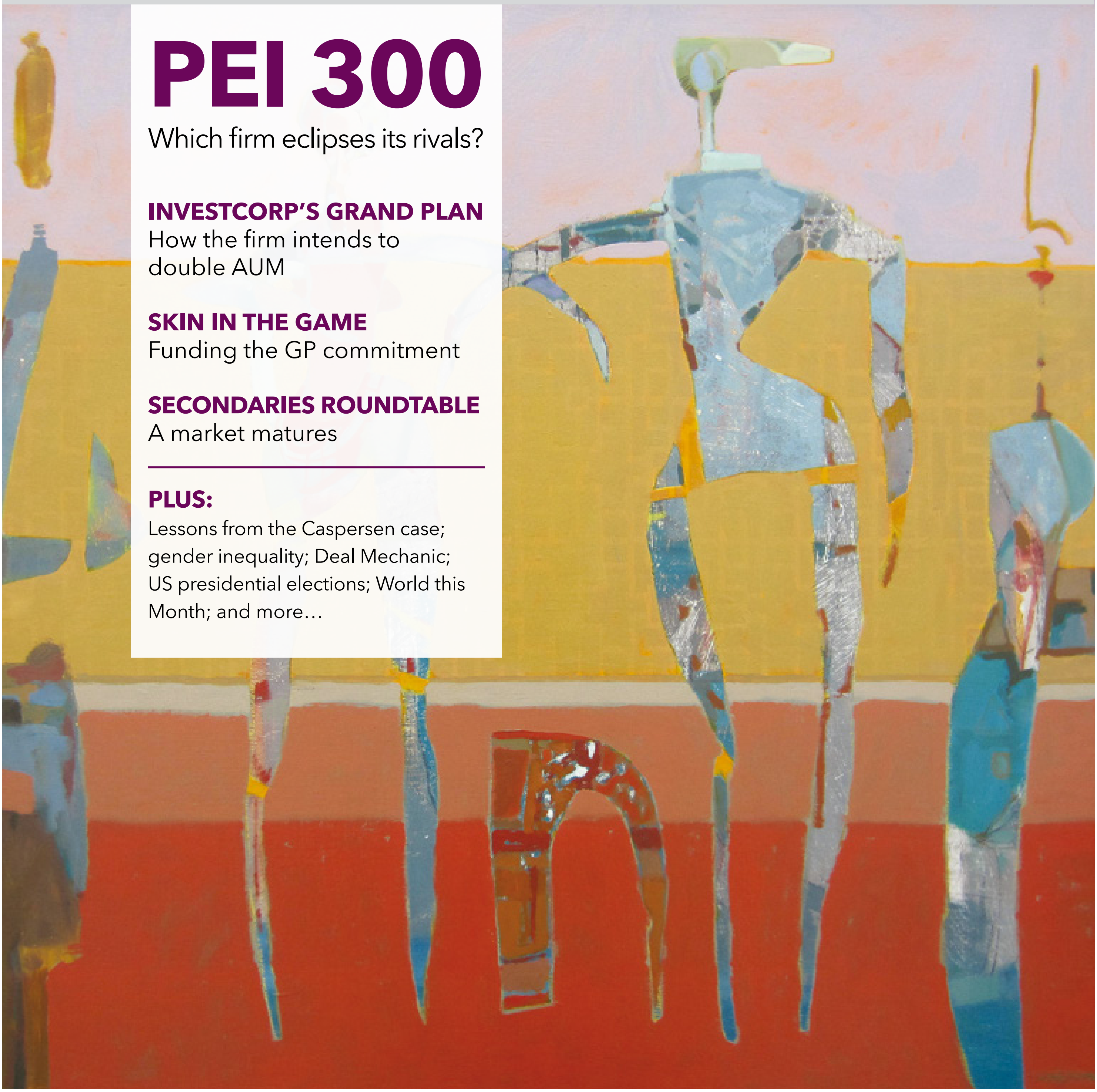


PEI 300

Which firm eclipses its rivals?

INVESTCORP'S GRAND PLAN
How the firm intends to double AUM

SKIN IN THE GAME
Funding the GP commitment

SECONDARIES ROUNDTABLE
A market matures

PLUS:
Lessons from the Caspersen case; gender inequality; Deal Mechanic; US presidential elections; World this Month; and more…

Stepping up

When Mohammed Al Ardhi took the helm at Bahraini investment company Investcorp last July he laid out a daringly ambitious plan to more than double the firm's AUM in less than seven years. With European head of corporate investments Hazem Ben-Gacem, he tells Isobel Markham and Toby Mitchenall how he intends to achieve this monumental goal

PHOTOGRAPHY BY JAMES CLARKE

The London office of Bahraini investment company Investcorp is a hive of activity when *Private Equity International* arrives on a bright and crisp spring morning. The front step and the lobby of the opulent Mayfair building is teeming with the offspring of some of Investcorp's wealthiest investors.

"We invited about 30 or 40 of the sons and daughters of many of our large investors to come for a programme which we are organising at Oxford University," says Hazem Ben-Gacem, Investcorp's head of corporate investment in Europe.

The annual four-day Investcorp Leadership Programme at the University of Oxford's Saïd Business School includes a series of interactive sessions on shaping markets, entrepreneurship and scaling family businesses.

Investcorp also donated £11 million to the university to fund its Middle East Centre, which was unveiled in the grounds of St Antony's College last summer. The striking Investcorp Building was designed by the formidable and pioneering Iraq-born architect Zaha Hadid, whose sudden death filled newspapers across the globe just days after this interview.

Taking such a personal interest in investors' families is not the norm within the private equity industry, but, as Ben-Gacem says, the relationship between Investcorp and the extremely wealthy individuals it collaborates with is "significantly closer" than that of a more traditional private equity firm and its institutional backers.

"That's the nature of the relationship you need to build if you're tapping into ultra-high net worth individuals. It is investing in them, investing in that second generation, how to make them good leaders, good managers of their own family businesses."

Investcorp, which is listed on the Bahrain Bourse, was established in 1982 to fulfil a particular need. Nemir Kirdar, who is now chairman of the board of directors, founded the firm as a bridge between the prodigious personal wealth of the Gulf region and the abundance of alternative investment opportunities in the US and Western Europe.

Under Kirdar's leadership Investcorp has grown to close to $11 billion in assets under management (AUM), divided between hedge funds, private equity and real estate investments. Today the firm's hedge fund business accounts for around $5 billion while, following a string of exits, private equity makes up around $4 billion.

But Mohammed Al Ardhi, who took over as executive chairman on 1 July last year, is not content to leave it there. Just three months after assuming his new role he unveiled an audacious plan to more than double the firm's AUM to $25 billion in a five- to seven-year window. To achieve this, Al Ardhi is asking for every area of the business to grow.

"Obviously some are more scalable faster than others," he says, referring to the »

» opportunity Investcorp has already taken to boost its hedge funds arm inorganically, acquiring the hedge fund of funds business of SSARIS Advisors last November.

The unit is looking at a "handful" of other potential acquisitions, Ben-Gacem says. "With the sheer size of our balance sheet we are able to do a lot of this organic plus inorganic growth."

Growth is also on the cards in the real estate and private equity business units, with the immediate plan to push real estate investing, previously confined to the US, into Europe, and on the private equity side to up its average equity cheque from $150 million to closer to $300 million.

"After 30 years we thought, 'We have the whole infrastructure built, but we need to leverage more of the things that we currently do not," Al Ardhi says.

DEAL-BY-DEAL

Unlike traditional fund-based private equity firms, Investcorp serves the needs of its predominantly retail clients by investing on a deal-by-deal basis, underwriting the full transaction and then offering it to investors.

But Ben-Gacem is quick to point out that it bears no relation to the underwriting and syndication carried out by banks.

"Day one, we own that business 100 percent, regardless of whether our investors decide to co-invest with us or not," he says. Investcorp, which always remains the largest single investor, then approaches its investors seeking co-investment. Anything from 60 to 150 investors join Investcorp in its transactions, with widely disparate ticket sizes.

"Our investors in the Gulf really like the deal-by-deal [strategy], because they have so much clarity and visibility on what they're putting their money into, and they know that we are with them," Al Ardhi says.

Al Ardhi stepped into his new role not just with ideas but with a challenge, Ben-Gacem says.

"One of the first times we had Mohammed in the management committee meeting, his question was, 'Why is Blackstone bigger than us?' Which is a very good question, because Investcorp did start before Blackstone or Carlyle. Always when there is new leadership there is a new kind of ambition and excitement, and I think that is what Investcorp is living today."

A former air vice-marshal in the Royal Air Force of Oman and a recipient of the Order of Oman, Al Ardhi joined the Investcorp board as a director in 2008, just a few months before "the whole world was collapsing".

"It was a really interesting time. It was really great to be in that type of a firm where the whole thing was just shaking, and then see it actually get out of the crisis. That was a really great experience, and it gave me a good insight into the strength of this institution."

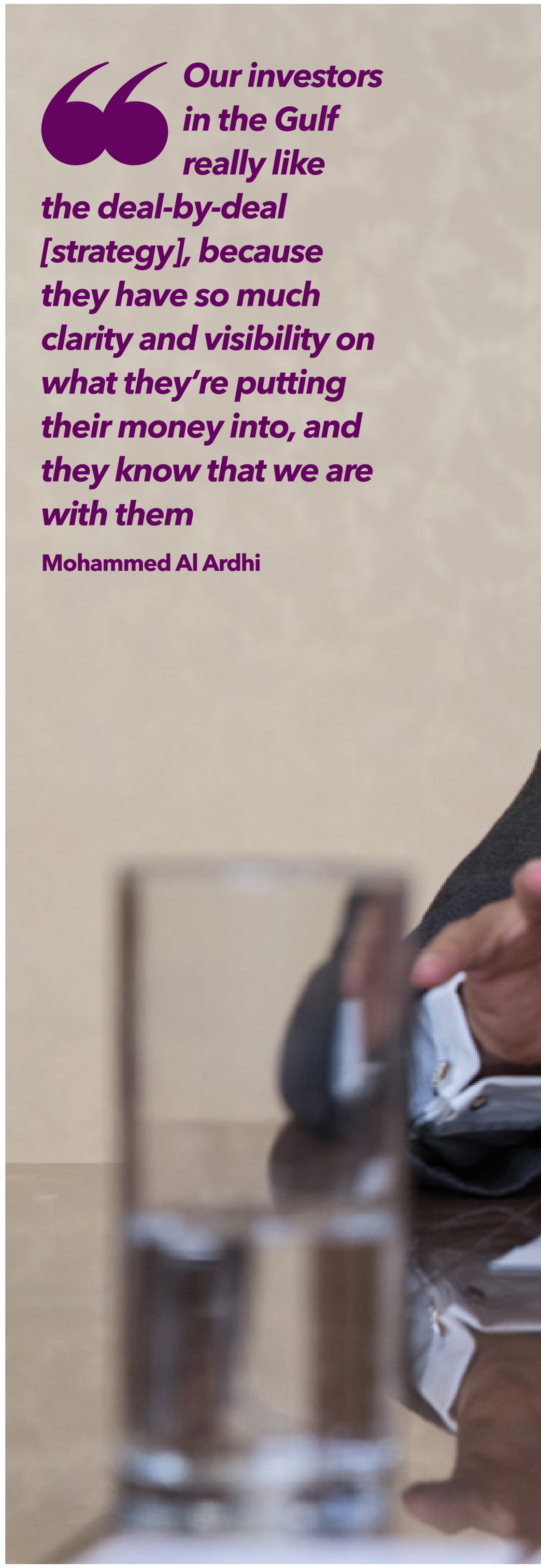
The dark days of the global financial crisis taught Investcorp two important lessons: humility, and not to carry too much debt.

"No matter how great you are, no matter how good you think your reputation is, that crisis is going to hit you one way or another," Al Ardhi says. "In addition to just building to grow, you need to build to actually stand those beatings when they come."

Consequently, Investcorp has reduced the leverage on its balance sheet from 2.5x in the 2008 financial year to 1.3x for the 2015 financial year.

As an investor in alternatives, Investcorp has also taken advantage of the low interest rate environment to extend the maturity of its existing debt facilities, Ben-Gacem explains.

"Our balance sheet needs to have leverage which is more back-ended," he says. "Also over the last three years we've taken advantage of the public markets, so there are today Swiss Franc denominated Investcorp bonds that are trading. We [also] »



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>
> **Mohammed Al Ardhi**

» have 30-year financing from Japanese insurance companies, which at the time was quite a unique [thing] for a Middle Eastern alternative asset investor to tap into."

Investcorp abandoned investing into European real estate in 1994 because of low returns, according to *PEI* sister publication *PERE*. But in March the firm hired former Macquarie Capital real estate lending head Neil Hasson to spearhead its renewed efforts, and has already put in its first offer on a property in Germany.

In the US, Investcorp is experimenting with new products in real estate, offering "club deals" in which investments are shared with just a handful of investors. It's first transaction of this kind, the $180 million acquisition of an office building in Washington DC, was announced in February.

"I think it went in one week to four or five people only," Al Ardhi says. "We need to do more of that, because we weren't able to satisfy all the people that wanted to be on the deal."

On the private equity side, Investcorp's peers in the European mid-market hold the institution in high regard, particularly when it comes to its deal-making capability and understanding of target companies. Because of its longevity in the market, it is viewed as something of a "breaking ground" for private equity professionals, counting KKR's European head Johannes Huth, CVC Capital Partners senior managing director James Mahoney and Trilantic North America partner Charles Fleischmann among its alumni.

A new avenue of exploration is co-investing in the more traditional sense, in which Investcorp agrees prior to an acquisition to team up with one of its institutional investor-partners on a transaction.

"It allows you to do bigger deals," Al Ardhi says. "Instead of perhaps a retail guy who can [invest] anything from $250,000 to $10 million, this guy can put in $150 million."

Ben-Gacem acknowledges that larger private equity deals will, in general, move the firm into a more expensive and hotly-contested part of the private equity landscape. However, he is firm in his conviction that the unique "Investcorp attributes" can help the firm differentiate itself in a process.

"First of all, we are a growth investor. Every single investment we do, the overriding premise is top-line growth. And that's where our international reach comes into play," Ben-Gacem says.

The second lies within the deal-by-deal structure: "Sometimes things go wrong and you just have to take your time. We don't have any restrictions, there isn't this

OIL PRICE VOLATILITY: A MIXED BLESSING

In March Moody's Investors Service assigned a BA2 corporate family rating and a Ba2-PD probability of default rating with a negative outlook to Investcorp Bank. It came on the back of the firm's operations as an alternative asset manager, from which, Moody's says, it derives 80 percent of its revenues in the form of fee income.

Just because oil prices are going down, it does not mean that economies have gone; economies in the Gulf region are resilient

Mohammed Al Ardhi

The credit rating service said the negative outlook was a reflection of its concern that, in light of depressed oil prices, Investcorp might face increasing difficulties in raising new capital or reinvesting clients' capital in the coming years.

However, when asked about the effect of depressed oil prices on Investcorp's business, Mohammed Al Ardhi is insistent that it plays no bigger role than for any other firm.

"What a lot of people don't understand about a lot of the investors we deal with is that their money initially, in the seventies, came from oil and gas. It's not now in oil and gas. It's in retail, it's in American shopping malls, it's in Japanese bonds."

In fact, volatility in markets closer to home has proven beneficial to Investcorp's strategy of focusing on investments in the US and Europe.

"[Our investors] love [American real estate] because, by way of diversification and with the weaker sentiment that we have in the Gulf region because of the oil prices, they want to park part of their wealth in a safe, good, growing economy, and then take some good yield on it."

He does, however, admit that "is maybe not the whole story". In July 2015 Investcorp acquired a majority stake in NDT Corrosion Control Services, a testing services company for the industrial sector, including oil and gas and petrochemicals, in Saudi Arabia. Hypothetically, were the firm to try to list or exit the business now, it might be a tough sell.

However, there is still strong interest in consumer goods deals. In January the firm invested in Saudi Arabian supermarket group Bindawood Holding, a $180 million deal subsequently oversubscribed by its clients.

"Just because oil prices are going down, it does not mean that economies have gone; economies in the Gulf region are resilient. There are still about 300 million people around that region. They want food and water and medical [services] and education and infrastructure."

notional five-year investment horizon." A more long-term initiative for Investcorp is to build its investor base. Al Ardhi estimates that there are 10,000 ultra-high net worth individuals in the Gulf, and Investcorp is currently servicing close to 2,000 of them.

"There's depth in this pool that we also want to get into," he says.

"We also cannot ignore that there are institutions that maybe don't have the time to look at deal-by-deal as the retail guys have time and flexibility. But we also find that even those big investors would like some kind of transparency rather than just the old blind fund pool, so we're starting to think of how we can serve those people."

Investcorp's previous experience with blind pool funds has been mixed. It last raised a generalist private equity fund in 2007, which closed short of its $1 billion target on $746 million. While performance data for the vehicle is not publicly available, one investor in the fund described its performance as "mediocre, even for a 2007 fund". Ben-Gacem assesses the performance to be "probably second quartile".

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Hazem Ben-Gacem

The firm had better success with its series of technology funds, of which it has raised three since 2000. The last, Technology Partners Fund III, a 2007-vintage vehicle that closed on $500 million according to PEI Research & Analytics, is delivering a return of 1.8x and an IRR of 17 percent, according to private equity and venture capital technology monitor Bison.

It's most recent closed-ended vehicle is the Gulf Opportunity Fund, which closed in 2008 on $929 million and invests in the Gulf region and Turkey. It took some time to put that capital to work, and the average age of that fund's portfolio companies is around 3.2 years, Ben-Gacem says.

As in the case of the tech funds, commingled vehicles allow Investcorp to access the smaller end of the market, which it would be impractical to approach on a deal-by-deal basis. They also open up a world of international institutional investors that don't have the bandwidth to invest on a deal-by-deal basis.

Al Ardhi and Ben-Gacem refuse to be drawn on specifics regarding the firm's plans for future blind pool funds, but it's clearly something the pair are giving some thought.

"As we look to grow our business, Investcorp's DNA in large part is retail investors," Ben-Gacem says. "However, a key part of the strategy is to tap into institutional investors, and a large portion of that institutional base has more comfort investing within a fund structure."

But Investcorp does not only have international institutional investors in its sights; it is keen to develop its network of ultra-high net worth individuals outside the Gulf region which, thus far, has only invested with the firm through its commingled funds.

"The Investcorp model is not necessarily unique to the Middle East. It's unique to ultra-high net worth individuals, regardless of whether they're in the Middle East or other parts of the world," Ben-Gacem says.

Big change, then, is afoot at Investcorp. But while the firm has been making strategic hires across its business, the focus is on balancing executional and operational expertise rather than a drastic expansion, Ben-Gacem says.

"When Mohammed talks about doubling our AUM, it's something which should be achievable within our current infrastructure." ■

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