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LPEA

CONTENT

LPEA

THE MAGAZINE OF THE LUXEMBOURG PRIVATE EQUITY & VENTURE CAPITAL ASSOCIATION

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LUXEMBOURG: IT IS TIME FOR A 360° GP VIEW

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PHILHARMONIE LUXEMBOURG | 26 APRIL | 2 – 7 P.M.

LPEA will host in 2017 Luxembourg's first major Private Equity (PE) conference fully dedicated to PE practitioners and investors. The meeting aims at highlighting the work developed by PE firms in Luxembourg and showcasing the asset class and the range of PE investing strategies to the asset management community at large.

Topics such as direct, fund of fund and co-investment PE investing will be addressed across the spectrum from buyout, VC, private debt and emerging markets PE. Such a wide panel will offer the audience a broad perspective on the extent of possibilities afforded by PE.

On the back of its success promoting Luxembourg abroad for many years through its regular roadshows in Europe and in the US, LPEA decided the time has come to talk about private equity at home, in Luxembourg.

The sector has changed considerably since LPEA's creation in 2010: the number of PE firms present in Luxembourg has grown 6-fold, the functions deployed in Luxembourg have evolved significantly towards more middle and front office, the number of professionals has jumped from a mere couple hundred people to several thousands and many new legal and regulatory tools have been made available to the PE community.

For those familiar with the sector, it has become extremely easy to obtain information on the overall legal and tax framework for PE made in Luxembourg. On top of publications produced by the market, some of which published by LPEA, educational and networking events abound to make sure the message gets through and that all participants comply with the new regulations and practices.

Little attention has been given, nevertheless, to how PE operations have changed in Luxembourg and how the country has been able to accommodate different segments of the PE value chain, most notably investment managers. The market has been witnessing a significant expansion of PE firms' operations, new risk management functions were created and more investment teams moved or started in Luxembourg.

This is why LPEA believe it is paramount to take a new look at the market, hear from the practitioners and discover the latest trends in Luxembourg and abroad. The agenda will bring on stage local and foreign GPs and LPs, from venture to buyout strategies to discuss what the opportunities are and explore the future of the industry.

Given the educational role of the event, LPEA decided to offer free access to all investors and asset managers.

For more information visit www.lpea.lu.

KEY TOPICS

- **What it takes to succeed in Private Equity**
- **Luxembourg in the global Venture Capital ecosystem**
- **The rise of direct lending in Europe**
- **Luxembourg in the crossroads of Emerging Markets**
- **Structuring benchmark**

DEAR PRIVATE EQUITY PROFESSIONALS,

The year is off to a great start for our industry with the news that some of the world's biggest Private Equity firms decided to expand their operations to Luxembourg as a result of Brexit. This is the public face of a powerful trend observed by all of us and confirms Luxembourg's attractive conditions.

Regardless of future political outcomes regarding access to EU investors, Luxembourg is firmly committed to speed ahead and grow its leadership as #1 PE Hub in Europe. In this context, LPEA decided it was time to bring the sector together at the "LPEA Insights: 360 GP View" conference. The event is open to all private equity professionals as well as to the growing number of asset managers such as private bankers and family offices who are demonstrating increasing appetite for the sector.

Swancap, one of the firms which will be on stage, shares its multi-strategy approach in the current issue and illustrates how Luxembourg was a natural choice to set up their AIFMD.

We also take the opportunity to inform you that LPEA continues to grow in members and staff. With 140 members at the year end, the office now has its own Legal & Regulatory Manager to support our work in public advocacy.

Enjoy your magazine!

Jérôme Wittamer, President
Paul Junck, Managing Director

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KHARIS CAPITAL COMPLETES ACQUISITION OF QUICK IN BELGIUM AND LUXEMBOURG

IN SEPTEMBER 2016, KHARIS CAPITAL, A DIRECT INVESTMENT PLATFORM DEDICATED TO LONG-TERM INVESTORS AND FOCUSED ON THE CONSUMER SECTOR, FINALISED THE ACQUISITION OF THE QUICK RESTAURANT CHAIN IN BELGIUM AND LUXEMBOURG FROM GROUPE BERTRAND, VIA ITS BELGIUM-BASED VEHICLE "QSR BELGIUM".

In January 2017, QSR Belgium also increased its ownership in the Luxembourg subsidiary (Happy Quick) from 55% to 100%, having bought the remaining shares from minority investors Flavio Becca and Rene Faltz. Founded in 1971, the Quick brand is the leading burger brand in Belgium and Luxembourg and counts 101 Quick restaurants, including 92 in Belgium (including 81 franchisees) and 9 in Luxembourg. The Quick network of restaurants employs around 3,500 people in total.

QSR Belgium also secured separately the Master Franchise of Burger King ("BK") for both countries, which was facilitated by its close relationship with 3G Capital, the owners of Burger King.

The new owners plan on managing both brands in parallel and to grow the company through new openings and transformation. The first BK opening in Belgium is expected during the summer of 2017. Kevin Derycke, who has been part of the management team of Quick for several years, was appointed as the new CEO. His focus, together with the rest of the team, will be the interests of all stakeholders: the franchisees, the staff and the consumers. Daniel Grossmann, a Kharis founder and board member of QSR Belgium, notes that: "This is a new impetus for the company, the franchisees and the 3,500 employees who are today part of the Quick network in Belgium and Luxembourg. In the coming months, the new team will work closely with the franchisees to develop the company and open the first Burger King restaurants. Together we hold all the keys, with two strong brands, to grow and create jobs, while ensuring customer satisfaction and attracting new ones. Quick and the Giant still have bright days ahead and will naturally make place for Burger King and the much anticipated Whopper!"

Kharis Capital was founded by Daniel Grossmann and Manuel Roumain in 2015, to invest in mid-cap consumer companies. Unlike a typical PE fund, Kharis Capital invests with the backing of family investors on a deal-by-deal mode, with a select number of them coming in any one investment through a dedicated (Luxembourg-based) vehicle. Kharis Capital has the long-term financial support of a few prominent family offices. This differentiated approach allows for alignment of interests, a flexible investment horizon, and capital structure, while ensuring ongoing and value-add support to the investee companies. Kharis Capital seeks to invest between €50m and €250m equity per deal and counts on an eight-strong investment team, based in Luxembourg, Brussels and Zug. In Luxembourg, Kharis Capital is represented by Rajaa Mekouar, who joined the firm to lead the Syndication and Partnership effort, while working on investments with the team. Kharis Capital intends to launch an RAIF (Reserved Alternative Investment Fund), which will broaden its appeal to new types of investors willing to get exposure to its investments.

"Together we hold all the keys, with two strong brands, to grow and create jobs, while ensuring customer satisfaction and attracting new ones."

JOB TODAY RECRUITMENT PLATFORM RAISES FURTHER USD 20M

Job Today, a mobile app that connects employers and jobseekers in seconds and runs 24/7 has raised USD 20m in November 2016, bringing total investment in the company up to USD 30m after a USD 10m Series A ten months earlier. The round was led by Flint Capital with participation from Accel Partners, Mangrove Capital Partners, Felix Capital, Atresmedia, Channel 4's Commercial Growth Fund and German Media Pool VC. Operating in Barcelona, Madrid, London and Paris, the Luxembourg-based start-up has already attracted 2 million candidates and 200,000 employers.

TALKWALKER AIMS FOR INTERNATIONAL GROWTH WITH EUR 5M INVESTMENT

The Dutch investor Main Mezzanine Capital invested EUR 5m in the social media monitoring start-up Talkwalker. With a 120 staff, most of which in Luxembourg, the company aims at fostering its international growth and exploring the AI potential of its platform, currently monitoring over 150 million websites in 187 different languages.

BREXIT MEANS BREXIT AND PE MANAGERS SHOULD BE PREPARED

IN HER SPEECH OF 17 JANUARY, UK PRIME MINISTER THERESA MAY CONFIRMED HER DETERMINATION TO IMPLEMENT A «'HARD'» BREXIT. IT NOW SEEMS INEVITABLE THAT, AT THE END OF A TWO-YEAR NEGOTIATION PERIOD, THE UK WILL LEAVE THE SINGLE MARKET. THIS PERIOD WILL START UPON DELIVERY OF THE OFFICIAL ARTICLE 50 NOTICE BY THE UK GOVERNMENT, WHICH IS EXPECTED TO OCCUR AT THE END OF Q1 2017.

All UK private equity firms that are now relying on the AIFMD passports to either manage EU funds or to market funds in the EU have now to work on the assumption that, as from the end of Q1 2019, they will lose the benefits from such passports. The UK will become a 'third country' and UK managers will be subject to similar rules to those that currently apply to other managers, such as those in the US and Switzerland, for instance.

However, not all UK private equity firms are in the same situation, and they may adopt different strategies to respond to the Brexit challenge.

Certain UK private equity firms may decide to refocus on the UK domestic and non-EU market. Brexit will have no, or limited, impact on UK firms that only raise capital in the UK and outside the EU.

By contrast, all UK private equity firms (including, for instance, US firms that currently use the UK as a gateway to the EU market) that want to secure access to EU investors post-Brexit have now just over two years to adapt their regulatory set-up. UK firms that have an affiliate which is authorised as an AIFM in another EU member state, such as Luxembourg, are in a good position to weather the Brexit storm. The others now have a window of approximately 26 months to either team up with a third-party EU AIFM or to establish their own EU AIFM.

The appointment of a third-party EU AIFM may be an attractive solution for smaller players that do not have the volume to establish their own structure and get it approved as an AIFM in time. This is a quick fix, either as a temporary or a long-term solution. The presence in Luxembourg of several quality third-party AIFMs with PE expertise is one of the solutions that Luxembourg offers to UK firms that are confronted with the Brexit challenge.

Larger players will want to have their own EU AIFM in place before Q1 2019. Most are currently assessing the different options available in various EU jurisdictions. The Luxembourg option is very strong and many factors act in favour of Luxembourg, including a stable and attractive tax and regulatory framework. Most UK managers are not considering relocating their entire team to another EU jurisdiction. If they want to establish their AIFM in Luxembourg, this is clearly not necessary. The option to have an AIFM authorised in Luxembourg to perform key functions (such as risk management and oversight) and delegate portfolio management back to a UK-regulated entity should be Brexit-proof and should prevail, as it implies a relocation of those necessary only to fulfil these duties and not the entire investment team. A number of technical issues, such as minimum reciprocity and equivalency requirements, will have to be addressed but it seems reasonable to assume that UK-regulated entities will retain the right to provide those services on a cross-border basis under the MiFID II third-country regime that will apply as from January 2018.

Luxembourg has been used for decades as a gateway to the EU market by third-country asset managers. Many UK asset managers have already confirmed their intention to use Luxembourg tried-and-tested solutions to navigate through Brexit.

Co-chairs of the LPEA Brexit Taskforce:


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Jean-Christian Six (Allen & Overy)


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Olivier Coekelbergs (Ernst & Young)

"The option to have an AIFM authorised in Luxembourg to perform key functions and delegate portfolio management back to a UK-regulated entity should be Brexit-proof and prevail."

EQT VENTURES OUT FROM LUXEMBOURG

ON 25 MAY 2016, THE EQT VENTURES FUND («EQT VENTURES») HELD ITS FINAL CLOSE AND SECURED COMMITMENTS TOTALING EUR 566 MILLION TO SUPPORT FAST-GROWING, INNOVATIVE AND TECH-ENABLED COMPANIES, AND SUPPORT GREAT ENTREPRENEURS THROUGHOUT ALL DIFFERENT STAGES OF GROWTH. THE FUND'S CORE REGION IS EUROPE, BUT IT CONSIDERS AND EVALUATES INVESTMENTS ANYWHERE IN THE WORLD. IN ADDITION TO A STRONG INTEREST FROM GLOBAL INSTITUTIONAL INVESTORS, EQT VENTURES WAS ALSO BACKED BY A NETWORK OF PROMINENT ENTREPRENEURS.

EQT Ventures has a multi-stage strategy. The investments range from an early stage A round of EUR 1 million to growth investments of up to EUR 75 million. This means that EQT Ventures' support window is wider than a typical single-phase fund. EQT Ventures also evaluates minority equity or equity-related investments along between founders and other venture capital firms in technology-enabled businesses across all sectors.

Considering that EQT already had an AIFM licence in the Grand-Duchy, and the attractive conditions for setting up private equity funds in the area, it was decided to launch EQT Ventures and all related vehicles in Luxembourg, being a one-stop shop solution with superior substance that is simpler, cost-efficient and less risky. In order to facilitate a smooth set-up process, EQT sought direct contact from the regulator and other authorities for an open and progressive dialogue.

The EQT Ventures investment advisory team combines some of Europe's most experienced and successful serial entrepreneurs and company builders, engineers, designers, marketers, data scientists and scaling experts. The team use their experience from success stories including Booking.com, Uber, King and Spotify, to support ambitious founders on their journey to global success. Europe in particular is currently facing a huge demand for venture capital, as transformational shifts in technology are occurring across numerous industries, and this disruption is spurring on new, innovative companies. EQT Ventures is very well positioned to support entrepreneurs in this fast-paced environment, combining the team's own entrepreneurial skills with EQT's proven track record of developing companies and its established network of over 250 independent Industrial Advisors, which features a variety of global business leaders and successful entrepreneurs.

The aim is to provide the resources, skills and experience to help partnering companies deliver sustainable, profitable growth.

While EQT Ventures' focus is not seed investments, a matchmaking platform and app, called Together, has also been launched for angels and early-stage startups, aimed at making the earlier stage of raising funding for founders of startups easier. Additionally, EQT Ventures has created its own AI-driven initiative called Motherbrain, which builds data sets from available information on companies in relevant regions and stages, analyses growth signals and ranks the most interesting companies to proactively source potential investment opportunities.


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Jens Hoellermann,
Senior Manager,
EQT Fund Management S.à.r.l

INTERVIEW

ENOVOS AND CREOS EMBRACE CORPORATE VENTURING

INTERVIEW WITH NICOLAS MILERIOUX, INVESTMENT MANAGER OF THE NEWLY CREATED LIMB OF ENCEVO GROUP. THE GROUP, COMPOSED OF ENERGY PROVIDER ENOVOS AND GRID OPERATOR CREOS, IS A REGIONAL ENERGY LEADER AND KEY PLAYER IN LUXEMBOURG'S ENERGY TRANSITION.

After other innovation driven initiatives such as enosmart or enosolar, the group now adds corporate venturing as a supplementary layer to accelerate the deployment of innovative solutions through hand-picked equity investments into European ventures during the expansion stage, usually referred to as the Series A funding round.

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Nicolas Milerioux with Peter Räke, Head of Energy Solutions and Services

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WHAT TYPE OF COMPANIES ARE YOU LOOKING FOR AND WHAT CAN ENOVOS OFFER TO ITS FUNDED COMPANIES?

We look for companies with scalable solutions, a clear innovation edge, first customers and working installations leveraging on key topics such as decarbonisation, digitalisation and decentralisation.

We are not aiming at becoming their main customer but see ourselves more as an active, strategic partner that will make an impact by providing, beyond funding, access to our brands, sales channels as well as in-house expertise.

WHICH ARE ENOVOS' GOALS WITH THIS INITIATIVE?

This initiative is meant to assist the Encevo Group to keep track of evolution of market dynamics and technology trends and developments. New innovative products and solutions, if relevant to our structure and strategy, will enable us to participate in new market segments or business areas. Aside from the investment aspect, we will also scout and identify potential partners for specific projects or developments.

HOW MANY INVESTMENTS ARE YOU PLANNING PER YEAR?

We plan two to three investments per annum, which is probably lower than traditional funds, but our idea is not to build up a large portfolio but rather to focus on getting the most of our investee companies.

HOW MANY COMPANIES DO YOU HAVE UNDER YOUR RADAR?

Nearly 200 companies have gone through our reviews and we are currently looking into more details of a limited number of them. I am quite happy with the pace we are ramping-up at, given that we did not make any marketing expenditure.

DO YOU EXPECT TO FIND GOOD INVESTMENT OPPORTUNITIES WITHIN LUXEMBOURG? ARE YOU DOING ANYTHING SPECIFIC TO FOSTER TARGETS IN LUXEMBOURG?

We have seen interesting projects in Luxembourg that we follow closely. Our local and international ecosystem is gaining in maturity every year and we would be thrilled to foster our local entrepreneurs. We support local activities and initiatives for start-ups, e.g. by participating in Technoport and Nyuko, as well as related activities, like being jurors in pitches. We could rely on our excellent relationships with the local ecosystem if we were planning to organise a call for start-ups later on.

On the other hand, our investee companies from abroad will be able to rely on our network to operate in Luxembourg.

DO YOU EXPECT THE FUNDED COMPANIES TO BE ABSORBED BY ENOVOS AT SOME POINT OR YOU HAVE A MORE OPEN MARKET APPROACH? (CO-INVESTMENT WITH OTHER INVESTORS)

Our size and regional footprint may not be sufficient to entertain an exponential growth that success stories require. As a consequence, spin-ins will be the exception.

Co-investment is our preferred route. We have already built a number of relevant connections, as our value proposition is complementary to both generalist and cleantech/energy funds.

GIVEN THAT THE LUXEMBOURG FUTURE FUND ALSO TARGETS CLEANTECH, WILL THERE BE ROOM AT SOME POINT TO RAISE FUNDS FROM LFF?

We are currently outside some key criteria of the LFF, which are aimed at investing in clearly segregated teams and structures.

However, we are currently evaluating several options for the medium term. Once the roadmap has been be cleared, we will certainly revert to the SNCI and EIF to see if the LFF or other programmes could be relevant.

DID YOU SET A TIME FRAME FOR A FIRST ASSESSMENT OF THE IMPACT OF THIS INITIATIVE?

We have continuously measured the progress and impact of this initiative since day one but most foreseeable outcomes will take 12-24 months from the initial investments.

PRIVATE LOAN FUNDS

IN THE AFTERMATH OF THE GLOBAL FINANCIAL CRISIS, THE WORDS "CREDIT CRUNCH" WERE ON EVERYONE'S LIPS WITHIN THE PRIVATE EQUITY INDUSTRY.

Bank restructurings and the increasing cost of capital deprived PE fund managers from a traditional source of leverage, reinforcing the importance of direct lending by investment fund managers as a dedicated asset class.

While the U.S. debt fund market reached maturity long ago, the European market focused essentially on secondary mezzanine debt acquisition rather than on loan origination at a time that it was still dominated by credit institutions.

Over the last few years, however, not only has the European market shown an increased attractiveness, but lawmakers and regulators have come to realise that the activity of private loan origination could be an alternative source of financing for the European economy.

A GROWING MARKET MEETING A MACRO-ECONOMIC NEED

Private loan fund managers achieved an outstanding high level of fund raising (six-year high) with USD 85.2bn raised from 120 funds closing in 2015. Dry powder was hitting, mid-2016, a record-high USD 199bn – a significant proportion of USD 512bn PE dry powder.

The industry remains strongly U.S.-dominated both from a general partner and a limited partner perspective. In Q3 2016, three out of four of the largest loan funds were launched out of the U.S., by Bain Capital (USD 3.1bn), Audax Mezzanine (USD 1.2bn), H.I.G. (USD 1.1bn) and Penfun Capital (USD 556m).[1] TIAA also remains by far the largest contributor to private debt with a current allocation of USD 25.9bn (3% of its current assets).

2016 is also marked by a geographic shift. While the loan origination investment activity remains strongly driven by the U.S. market, the European scene is slowly catching up and reaching maturity. Preqin 2016 Private Debt Quarterly Updates have consistently pointed out Europe as being the main investment target region for the coming months.

THE PATH TO AN HARMONISED EUROPEAN FRAMEWORK

In parallel with these promising market trends, awareness among European policymakers is rising as to the importance of private loan origination as an alternative for financing the economy. In its "Action Plan on Building a Capital Markets Union"[2], the European Commission recognises loan funds as the way to "further diversify credit intermediation and increase financing opportunities", hence easing credit access for SMEs. The Commission however points out the importance of ensuring loan funds are "regulated appropriately from an investor protection and financial stability perspective". Anticipating a potential new piece of European legislation, the European Securities and Market Authority (ESMA) issued an opinion on 11 April 2016 with a view to set the main topics that would need to be addressed in this context.[3]

In its opinion, ESMA generally raises questions rather than take strong positions. Such questions will, however, most probably shape the debate which will for sure emerge from the implementation of a dedicated loan fund regime, should there be one. First and foremost, both loan origination (originating new lines of credit) and loan participation (acquiring an existing line of credit on the secondary market) are addressed by this opinion. ESMA is considering the creation of a harmonised framework which would materialise either as a legislative proposal or by way of an ESMA instrument supplementing the AIFMD. It is unclear at this stage whether alternative investment funds (AIFs) qualifying as debt funds would be subject to a special authorisation regime or would fall within the common AIFMD regime.

"It is unclear at this stage whether alternative investment funds (AIFs) qualifying as debt funds would be subject to a special authorisation regime or would fall within the common AIFMD regime."

A specific regime would most probably focus exclusively on loan origination, excluding loan participation or loan restructuring from its scope. ESMA's opinion focuses on the potential risks inherent to the origination activity and the best way to monitor such risks both at systemic and portfolio levels, hence recommending the creation of specific regulatory obligations as well as specific processes and risk management frameworks.

ESMA takes the view that debt originating funds should be closed-ended by default unless certain conditions, similar to those applying to open-ended ELTIFs, are fulfilled. The opinion also expresses ESMA's concern as to the eligibility of retail investors in loan origination funds. Minimum requirements applying in case such investors would be considered as eligible should be inspired by the ELTIF regime, making them practically unattractive to fund managers.

Finally, the opinion identifies categories of counterparties, such as consumers, which should be forbidden from contracting debt from a debt fund. Other categories such as credit institutions might prove restrictive in an environment where private equity investment, in equity or in debt, is sector agnostic.

With its opinion, ESMA is setting the tone for discussions to come in the coming months, which could be led in parallel with the planned assessment of the AIFMD in 2017. Harmonising at European level the regulatory and legal regime is certainly going in the right direction, but the multiplication of special EU regulatory regimes should be avoided where the mere amendment of an existing piece of legislation could achieve the same goal.

LUXEMBOURG MARKET READINESS

In reaction to the ESMA opinion, in June 2016 the Luxembourg Supervisory Authority of the Financial Sector (CSSF) published an update of its AIFM Law FAQ. The CSSF thereby confirms that Luxembourg AIFs may engage in loan origination, loan acquisition or loan participation activities, subject to specific organisational and operational requirements. In particular, such AIFs shall comply with the specific product laws they are subject to (if any) and ensure they have an adequate governance, expertise and risk management approach with respect to loan assets.

The CSSF thereby clarified its position, bringing more legal certainty to an existing market practice.

Luxembourg has indeed been hosting loan (origination and participation) funds for many years, leveraging on a sufficiently flexible legal and regulatory framework while developing operational tools and expertise.

Among the most commonly used vehicles, the Luxembourg specialised investment fund (SIF) has shown a great deal of flexibility to accommodate loan fund structuring. Since its inception in 2007, new types of vehicles were added to the Luxembourg toolbox, some of them such as the EuVECA and the ELTIF, being driven by European legislative initiatives.

Market players have also adapted to this growing trend, developing expertise and know-how specific to the PE debt asset class in term of operations (e.g. cashflow reporting, trade processing), valuation or risk management.

With a number of loan fund managers already operating Luxembourg AIF and some of them transferring their middle office in the Grand Duchy, the financial centre has successfully positioned itself in a new industry, the macro-economic benefits of which are well advertised.

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1 Preqin Quarterly Private Debt Update – Q3 2016
2 Action Plan on Building a Capital Markets Union, COM (2015) 468 final, 30 September 2015
3 ESMA, Key principles for a European framework on loan origination by funds, 11 April 2016, ESMA/2016/596

Arnaud Bon
Deloitte

PRIVATE EQUITY'S BUSINESS MODEL IS CHANGING

OVER THE PAST TEN YEARS, THE PRIVATE EQUITY INDUSTRY HAS GONE THROUGH A MAJOR TRANSFORMATION TO ABSORB NUMEROUS REGULATORY AND TAX EVOLUTIONS. AS OF TODAY, IT IS FAIR TO SAY THAT PRIVATE EQUITY FUNDS HAVE BEEN COMPLETELY RESHAPED FROM A STRUCTURING, GOVERNANCE AND TRANSPARENCY PERSPECTIVE WITH MANY STAKEHOLDERS AND REGULATORS BECOMING MUCH MORE INTRUSIVE IN THEIR DAY-TO-DAY ACTIVITIES. CONTENDING WITH THESE CHANGES HAS REQUIRED PRIVATE EQUITY FIRMS TO BECOME MUCH MORE FLEXIBLE AND AGILE. IN EFFECT, THOSE WHO HAVE BETTER EMBRACED THESE CHANGES APPEAR NOWADAYS TO BE THE MOST SUCCESSFUL IN THE MARKET.

In the current environment, we see trends which should not only affect the structures, the governance and the transparency of the Private Equity structures, but the core business model of Private Equity funds.

THE DOWNSIDE OF EXCESS CAPITAL

The past five years have been extremely successful for the industry in terms of the amount of capital raised. Governmental initiatives aiming at supporting the industry and creating a stronger investor appetite for the asset class have placed the industry at a peak in terms of available capital to invest. With close to USD

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550bn for buyout funds only, dry powders are higher than ever – and this figure does not include the so-called "shadow capital", an alternative way for investors to put money at work in Private Equity to boost return at a lower cost.

Therefore, while Private Equity firms do not struggle to find capital, the other side of the coin is that the competition for the best deals is fiercer than ever with very high pricing and ultimately a deal flow to be shared among a larger number of players made up of the traditional Private Equity firms and other investors such as Limited Partners who are themselves building investment capabilities and competing with the traditional houses. In such a context, generating returns for investors and Private Equity firms tends to become very challenging as it can only result from real value creation over a longer period of time. It requires Private Equity firms to go the extra-mile and enter into a much deeper value creation process. This requires the implementation of various measures to accompany and support the fund's investee companies in the improvement of their operations, sales forces, cost management, innovation capabilities and other factors that should positively impact their earnings.

LPS HAVE EVOLVED

Since 2008, limited partners have continuously reduced the number of relationships they had with Private Equity firms but invested larger tickets with those they retained. This trend is partially owing to the increased cost linked to the closer investment monitoring they have had to implement. For institutional investors, improving the monitoring of their investments in Private Equity funds has become a priority. Participation in advisory boards, extended due diligence before investments and requests for more detailed and sophisticated reporting provide factual evidence that current day investors want to be closer to the activities of the Private Equity funds in which they invest. Obviously, absorbing the cost of such robust and sophisticated investment selection and monitoring processes requires them to invest larger amounts with a fund for a longer period of time and reduce the number of relationships they have with fund managers. It also puts them in a stronger position to negotiate the terms under which they invest into the funds, being the financial conditions or the option to deploy shadow capital through co-investments alongside the fund and get greater control over their investments. It can also help investors to develop their own internal capabilities, gain experience in direct investment and acquire valuable knowledge about industries to which they may not otherwise have access.

Also, a significant portion of investors, such as pension funds, do not expect a spectacular short-term return; they want to have regular cashflows to meet their commitments. Typically, for pension funds, the choice between a 20% return over a period of five years versus a 10% return over a period of ten years is not so obvious.

THE COST MODEL IS ALSO EVOLVING

A negative effect of the new regulations is the cost generated for the Private Equity funds and their investors. The cost of running a fund has significantly increased over the past ten years and the threshold of capital needed for a Private Equity fund to be viable has also increased. On the other hand, larger investors are in a better position to negotiate financial terms and call for more transparency on fees charged while value creation in the portfolio companies requires more staff and resources.

"Overall investors want to enter into longer relationships with the fund they invest in."

While one could say that the higher pressure on management fees paid to Private Equity firms helps compensate for the increased costs linked to regulation, Private Equity firms are in a situation where a tangible upside in their income can only result from the performance of the fund and therefore value creation at the level of portfolio companies.

Overall, in the current market investors seek longer relationships with funds focusing on long-term value creation and closer involvement in the management of the fund and its supervision at a controlled cost. We should therefore see funds incorporated for a longer time, with a limited number of investors and investments, but with strong capabilities in, and focus on, value creation. While there will always be exceptions to this new generation of Private Equity funds and the evolution towards this model will take some time, future changes in regulations or resulting from Brexit, the growth of shadow capital and the overall low growth economic environment are factors which should fuel this transformation.

"We should therefore see funds incorporated for a longer time, with a limited number of investors and investments, but with strong capabilities in, and focus on, value creation."

Olivier Coekelbergs
Vice-President of LPEA

COVER STORY

SEEKING EVERY OPPORTUNITY FOR HIGHER RETURNS

INTERVIEW WITH SWANCAP ON THEIR FUND OF FUNDS STRATEGY AND THE RISING APPETITE FOR CO-INVESTMENTS.

Anja Grenner

ANJA GRENNER (AG) – SWANCAP WAS FOUNDED IN 2013 BUT THERE IS A GOOD DEAL OF HISTORY BEFORE THAT MOMENT.

Claus Mansfeldt (CM) – We have invested in Private Equity since the year 2000 as part of UniCredit Bank, originally as an adjunct to the leveraged finance business. This is the background to what we do and there are important aspects of that, such as a deep understanding of PE financing and risk. Analysis and diligence is something we were doing as part of the bank's DNA. Moving into equity investing represented different risk-rewards and different diligence requirements, but there are also many parallels.

As of now, we are 27 people worldwide, of which six are based in Luxembourg. We manage about EUR 3 billion in private equity strategies, comprising primary PE funds, secondary investments in PE funds and direct co-investments. To date, we've invested cumulatively in excess of EUR 5 billion since 2000. This consists of commitments to over 150 funds and 80 co-investments.

IS THERE ANY SPECIFIC INDUSTRY THAT THE TARGET FUNDS SHOULD BE INVESTED IN OR DO YOU LOOK AT PERFORMANCE FIGURES ONLY?

CM – Rather than specific industries we have limited ourselves to the more traditional and established mid- and large cap buyout markets and geographically to Europe and North America. This focus is a successful one, where we are comfortable and is the largest space in PE. Of course, indirectly we are occasionally exposed to certain high-growth technology sectors or emerging markets. Consistent performance with a focus on capital preservation is key for us. Sector wise we are, however, mostly agnostic.

SWANCAP WAS OFFICIALLY SPUN OUT IN 2013 BUT THE EXECUTING TEAM HAS BEEN THERE SINCE 2000. THIS MEANS YOU ARE NOW EXITING THE FIRST GENERATION OF FUNDS STILL SET UP AT UNICREDIT?

Andrea Millioni (AM) – The first two SwanCap funds have an average maturity of five to six years, with a combination of assets from the portfolio built by the team while still at UniCredit and new investments made since becoming an independent player. More recent funds are still in their investment period. In the past three years realisations have been strong, but new investment activity also continued at a healthy pace. As we fundraised in conjunction with the launch of SwanCap, we gained new capital to deploy from day one. So we have been very active in the market in the last 17 years without any break.

Holger Emmel, Andrea Millioni, Claus Mansfeldt and Anja Grenner

Andrea Millioni

SO YOU HAVE BEEN ABLE TO BUILD UP A GOOD TRACK RECORD SINCE. WHAT IS THE IRR TO DATE?


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AM – The gross IRR we have generated is about 17% (per annum) and the net around 15%, which we believe puts us in the top quartile in the FoF business. We obviously try to look at benchmarks and there are different ways to compare performance because we do not have a specific fund for each vintage. Nevertheless, by looking at groups of three consecutive vintages since 2000 we believe we have been consistently performing extremely well vis-à-vis our peers.

IS PART OF THAT GOOD TRACK RECORD DUE TO A COMBINATION OF MAKING INVESTMENTS IN FUNDS AND DIRECT INVESTMENTS OR IS IT JUST THE SELECTION OF THE RIGHT FUNDS?

CM – It all relates to good GPs, but also deal selection and deep Due Diligence and direct investment capabilities. In our case we have found that direct co-investing has been a great portfolio management tool. We can rebalance the overall portfolio, accelerate deployment or slow it down by our own choices. This contrasts to one's more passive invest-along duty as an LP in a given fund. To answer your question, yes, fund-selection is key but also the active co-investing side can be accretive to overall returns, by several percentage points, in our experience.


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Claus Mansfeldt

AM - PART OF IT IS ABOUT BEING DISCIPLINED IN SELECTING GOOD GPS AND GOOD CO-INVESTMENTS BUT ANOTHER PART IS DUE TO THE LACK OF AN EXTRA FEE LAYER.

CM – We probably run a higher ratio than the market with up to 20% to 30% allocation to co-investments. Our firm is populated with direct investment expertise and that helps us gain conviction to take on extra commitments in co-investments. When you do a co-investment you really stick your neck out – a bit like the underlying GP himself. You can't hide behind the fact that you've just been drawn into it like a general LP. You need to be convinced when you proactively opt to invest tens of millions euros into it.

WHAT DOES IT TAKE TO BE SUCCESSFUL IN DOING CO-INVESTMENTS?

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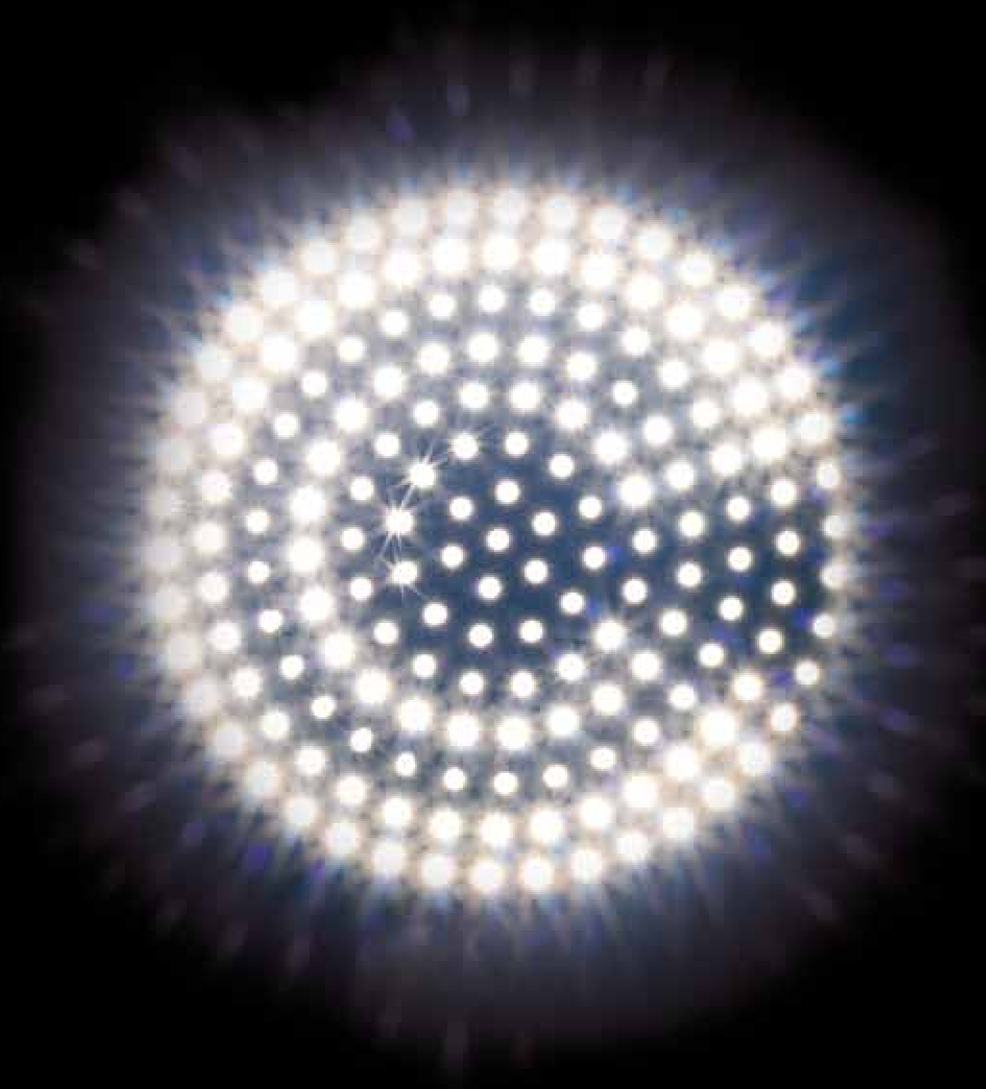

Bright minds, bright ideas

www.deloitte.lu

AM – There are many factors. It all starts from having a strong pipeline of opportunities. Effective sourcing requires one to be very close to the GP investment teams. We try to get into deals early, even before the sponsor secures the investment. In some cases, we are part of the bidding consortia, especially when our own insights, knowledge and experience in direct investments may add value. We leverage our expertise in specific sectors but also spend money in our own independent due diligence to deepen of our understanding of a business or challenge plan assumptions.

Then it is about deal selection and ability to maintain pricing discipline throughout the cycle. We very much focus on risk-adjusted returns. Regarding performance, all data shows that private equity is a profitable asset class but there is a wide gap between the top and the low performers; we strive to remain part of the former group by only deploying capital when we have a strong conviction that an investment can deliver at least our target returns. In our experience, the most attractive co-investments often relate to quality businesses offering visible strong cashflow generation and multiple levers of value creation. About risk, we always look at capital preservation for each investment while careful portfolio construction is a very powerful tool in reducing overall risk via diversification by GP, vintage, sector and geography at fund level.

IS THE CO-INVESTMENT ROUTE EMBRACED BY ALL OF YOUR INVESTORS OR YOU ALSO HAVE INVESTORS WHO JUST WANT TO GO DOWN THE MORE DIVERSIFIED FUND ROUTE?

CM – Yes, we have some mandates that express their preference for the diversified fund approach only and we tailor the solution to their requirements.

AM – It is also fair to say that some investors have expressed a desire to find ways to have a pure direct investment strategy which would allow a faster deployment of their capital and leverage on our ability to work on a more concentrated portfolio.

YOU ARE ALSO REACHING OUT TO FAMILY OFFICES?

CM – Yes, we already have some family offices who have invested into our funds. One comment on family offices though is that some are not necessarily mandated to do alternative investments. They are more often mandated to do mainly liquidity management so there is a little bit of differentiation within the family office space. Perhaps the founder family perceive that what they do on their entrepreneurial side constitutes their PE exposure. We would argue that institutionalised PE investments sit somewhere in between, more like pension savings or legacy endowments.

YOU OPTED FOR LUXEMBOURG AS HOME JURISDICTION FOR THE FUND FROM THE FIRST MOMENT ON. WHAT WAS THE REASON FOR THIS?

Holger Emmel (HE) – At the time in 2013, just as the AIFMD went live in Europe, we were questioning ourselves, where could be the perfect headquarters for the regulated entity, and we rapidly came to the conclusion Luxembourg would be ideal as we wanted to market the funds across various European jurisdictions. For instance, our current fund is marketed in 15 countries in Europe. Luxembourg was an early adopter of the AIFMD Directive, thus providing a clear regulatory environment, and was known for having a very knowledgeable and responsive regulator. We also found a supportive and highly professional ecosystem with where we could select the right service providers for our needs and a very international workforce to leverage on.

Holger Emmel

HOW HAVE YOU ORGANISED THE SET-UP HERE IN LUXEMBOURG?

HE – I believe we were amongst the first handful of managers to obtain an AIFM licence here in Luxembourg. We started with two FTEs who moved from London, and then added local resources as the platform expanded. We now have six full-time employees based in Luxembourg. Since the beginning, we wanted to have our own AIFM with substance on the ground, covering portfolio and risk management, valuation and compliance, and set up on a strong control framework for the delegated functions, in particular central administration. We continue to build and strengthen our platform as we are growing.

BESIDES THE REGULATORY REQUIREMENTS – WHICH YOU OBVIOUSLY HAVE TO COMPLY WITH – ARE INVESTORS ACTUALLY LOOKING AT COMPLIANCE MORE IN-DEPTH TODAY?

HE – Yes, very much so. We get frequent requests from current and future investors. Compliance is very much at the core of their due diligence. They really look at how we approach compliance and challenge our policies and procedures.

CM – This is also a competitive element. If an investor has the choice with a best-in-class practice – compliance, ESG, etc., all else being equal, the investment committee will have a very easy choice to make. We have decided to be at the forefront of that. We have recently joined the United Nations Principles for Responsible Investing.

AM – One other area where we try to differentiate ourselves is the reporting we produce on a quarterly basis for every fund. Information is always appreciated, in particular by the more professional investors which sometimes act as the anchor for a fund.

PERFORMANCE

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NEW RESEARCH REVEALS SHORTCOMINGS IN BUYOUT FIRMS' SELF-EVALUATION OF THEIR PERFORMANCE

THE KPMG GLOBAL VALUATION INSTITUTE HAS ISSUED A NEW RESEARCH PAPER ON PRIVATE EQUITY (PE) WHICH CALLS INTO QUESTION THE WAY IN WHICH BUYOUT FIRMS EVALUATE THEIR PERFORMANCE, A SUBJECT WHICH HAS BEEN FRAUGHT WITH UNCERTAINTY AND CONTROVERSY FOR MANY YEARS, NOTABLY WITHIN THE LIMITED PARTNER (LP) COMMUNITY.

Although the academic literature does not support a link between value creation and the value bridge in buyouts, the latter continues to be used in practice. The paper was authored by Peter Morris, a former banker with Morgan Stanley. In this research, the author explains the shortcomings of the value bridge and illustrates how economic performance should be interpreted.

When PE firms are involved in buyout transactions, they are faced with a challenge in measuring and communicating to their LPs how much value has been created. A technique known as the 'value bridge' is frequently used to report performance. However, the research reveals that this method has many shortcomings, even if the numbers add up. The value bridge is essentially an accounting analysis, but it should not be confused with an economic analysis, which matters most to LPs. For a true and meaningful reflection of economic performance, more care needs to be taken with the interpretation of the figures. This requires looking beyond familiar headline measures of return such as internal rate of return (IRR) and cash multiple. The value bridge fails to measure how much

“The research pointed out that a better way to measure value creation in private equity is already available in the academic literature.”

financial debt contributes to private equity returns, and since it focuses on operating performance in absolute terms, rather than relative to peers, the value bridge does not help to assess if a company has been performing better than its peers.

The research pointed out that a better way to measure value creation in private equity is already available in the academic literature. It starts from economics, not accounting, and breaks down the profit on a buyout into three main factors: the return on a stock market comparable, the impact of high debt, and a residual that may include the effect of running the company better relative to peers. Not everyone in private equity has an incentive to use this more meaningful approach. It is however gaining traction among the more sophisticated institutional LP community and is expected to gain further ground in the years to come.

To illustrate the point, Peter Morris also conducted empirical research of 21 buyout exits observed in the UK in 2014. Using the standard cash multiple (before fees) approach, 13 buyout exits (62%) delivered a multiple in excess of 1, i.e. translated into a capital gain from an accounting standpoint. When using the Public Market Equivalent (PME) (before fees) approach, which shows whether a buyout outperformed the stock market over the holding period, only 6 out of 21 buyouts (29%) outperformed the FTSE 250 index. Additionally, when further neutralising financial performance coming from the extra debt relative to quoted peers, only 3 out of the 21 observed buyouts (14%) exhibited superior economic performance! Therefore, although the value bridge may justify up to 62% of successful buyout exits that year, only 14% of the total exits generated superior economic performance to LPs. This example is almost self-explanatory when considering why economic, and not accounting-based, measures of performance need to be employed to measure private equity firms’ value creation.

This paper is the seventh management paper to be issued by the Global Valuation Institute and forms part of a thought-provoking research agenda launched in 2008. As an independent think tank, the GVI recognises that valuation is a constantly evolving discipline that has been shaped by practical and theoretical advances. Many high quality research papers on valuation subjects never find their way to practitioners, so they have no influence on the evolution of standards and practice. In addition, inertia and entrenched habits and interests make necessary change difficult. The GVI’s goal is to act as a catalyst for the adoption of breakthrough valuation research, by bridging the gap between the academic and business worlds. Its Academic Advisory Board is made up of professors from Northwestern University in the US and Oxford University in the UK. These high-profile academics are actively involved in designing the research agenda and selecting and reviewing the research that the GVI sponsors. The GVI works closely with researchers to present their managerial papers in a format that is understandable to a broad range of business professionals. This includes illustrative papers with applications and/or case studies. There is a real appetite for research that is thought-provoking, engaging and academically sound.


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Yves Courtois is Co-Chair of the LPEA Accounting & Valuation Technical Committee. He is also Co-Lead of KPMG Global Valuation Institute (GVI) and Partner in charge of Deal Advisory at KPMG Luxembourg

A glimpse into other released GVI research papers includes: valuing employee stock options in the presence of market imperfections, profitability and royalty rates across industries, the firm value effect of carbon emissions, differences in impairment practices under IFRS and US GAAP, marketability discount of controlling blocks of shares and valuation of contingent convertible bonds.

“Evaluating Private Equity performance” is available for download at www.kpmg.lu.


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THE REDEFINITION OF THE PERMANENT ESTABLISHMENT CONCEPT: WHY THE ALTERNATIVE FUND MANAGERS SHOULD WORRY

WITH THE RELEASE ON NOVEMBER 24 OF THE MULTILATERAL INSTRUMENT, BEPS IS NOW A TANGIBLE REALITY. AMONG THE VARIOUS ACTION POINTS OF BEPS, THERE IS ONE KEY ELEMENT OF THIS OECD PROJECT THAT IS LIKELY TO SIGNIFICANTLY IMPACT THE ORGANISATION OF THE ASSET MANAGEMENT INDUSTRY AS A WHOLE. THIS IS ACTION 7.

The OECD modifies Article 5 of its Model tax treaty to make it much less easy for businesses that have only a light footprint in a jurisdiction to be able to use the wording of a tax treaty to justify a failure to file tax returns or pay tax in that jurisdiction. Although these new measures are aimed principally at businesses that use the internet as their primary sales medium, or that have strongly international and centralised value chains distributing consumer goods or industrial products, their wide scope means that the asset management industry will certainly be affected. Given the very wide variety of business models under which fund managers invest and distribute products internationally, and the multitude of ways in which these have evolved differently within fund management groups, it is difficult to pinpoint specific commonly arising problem areas. Whilst not primarily intended to target fund managers, the new measures are, however, likely to raise serious concerns for them, particularly in two main areas involved in the operational set up of fund managers: distribution and portfolio management.

Permanent establishment is not a new concept, but the level of awareness from both the asset management industry and the various tax administrations has not always been what it should have been. That being said, tax authorities were already making challenges based on pre BEPS treaty and local rules. In a recent PwC survey, 25% of the fund managers interviewed said they had already faced at least one challenge somewhere globally. Tax administration will increasingly continue to do so using current rules (post-BEPS treaty rules will not take effect until 2019 or even later). In the private equity world, even some well-regarded private equity houses have been challenged by tax administration in France and other jurisdictions, sometimes attracting very high penalties. As a result of the increasing focus of tax administrations, some major fund houses were pre-empting the move as early as late 2014, by completing risk assessments, or tightening up on «who is allowed to do what, where» working practices. Approximately one-third of the fund managers interviewed in the PwC survey said they were already making detailed reviews.

It should be pointed out that, in some instances, the fact that regulators are demanding more substance can increase the risk of having a PE, almost forcing fund managers to have enough activity locally to cause there to be a tax footprint in a place where it is not wanted.

BEPS IS BRINGING TWO MAIN CHANGES TO THE CURRENT DEFINITION OF WHAT CONSTITUTES A PERMANENT ESTABLISHMENT:

The definition of a dependant agent has been extended to situations where a third party (normally deemed independent) working exclusively or semi exclusively for an asset manager could be deemed to constitute a PE of such asset manager. Another change brought by BEPS is that some functions should no longer be considered individually but instead the whole value chain in a given country should be considered to determine whether or not there is a PE. The reason for the change is that the OECD has realised that there was sometimes a split of various functions to avoid meeting the qualification of a PE. For instance, there may be staff carrying out ancillary functions such as market research, information gathering or initiating contact with potential clients locally in a country. They would not previously have been deemed to constitute a PE, but the new definition looks at the concept of PE more holistically, meaning ancillary functions could also be captured by the extended scope.

While the new Model treaty text will now usually continue to protect in cases where this is the only activity undertaken in a territory, this will not be the case if there are also other activities going on that, overall, go beyond a purely «ancillary» nature. Notably, if the fund manager has more than one entity in the local territory, the new measures will require the overall activity of all the affiliates to be looked at in aggregate. As a result of these changes, it is critical to conduct an assessment of the various functions regarding any potential PE exposures. Having a PE is not an issue in itself but trigger some obligations in terms of tax disclosures. Going forward, processes will have to be put in place to avoid any unwanted PE situations.

Laurent de La Mettrie
EMEA Asset Management Tax Leader, PwC Luxembourg

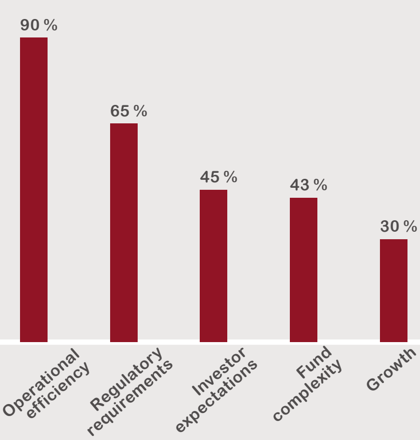
“Permanent establishment is not a new concept, but the level of awareness has not always been what it should have been.”

RIPPING MORE VALUE FROM THE (NEW) SPREADSHEET

FROM COMPLIANCE BURDEN TO DATA EFFICIENCY, IT SERVICES CAN REVEAL A MYRIAD OF OPPORTUNITIES IN THE PE VALUE CHAIN.

Ten years after a crisis induced liquidity dry-up, global demand in private equity (PE) markets has rebounded dramatically, characterised by an increasingly acquisitive investor base. The rapidly evolving private equity market is further subject to a progressively complex web of regulations, fuelling fierce competition among general partners (GPs). As a result, drivers for competitive advantage are evolving: superior investment returns are no longer considered the sole guarantor for success as investors are demanding operational excellence and increased transparency.

WHAT DRIVES THE NEED TO INVEST IN TECHNOLOGY?



Source: 2016 global private equity fund and investor survey (EY/PEI)"

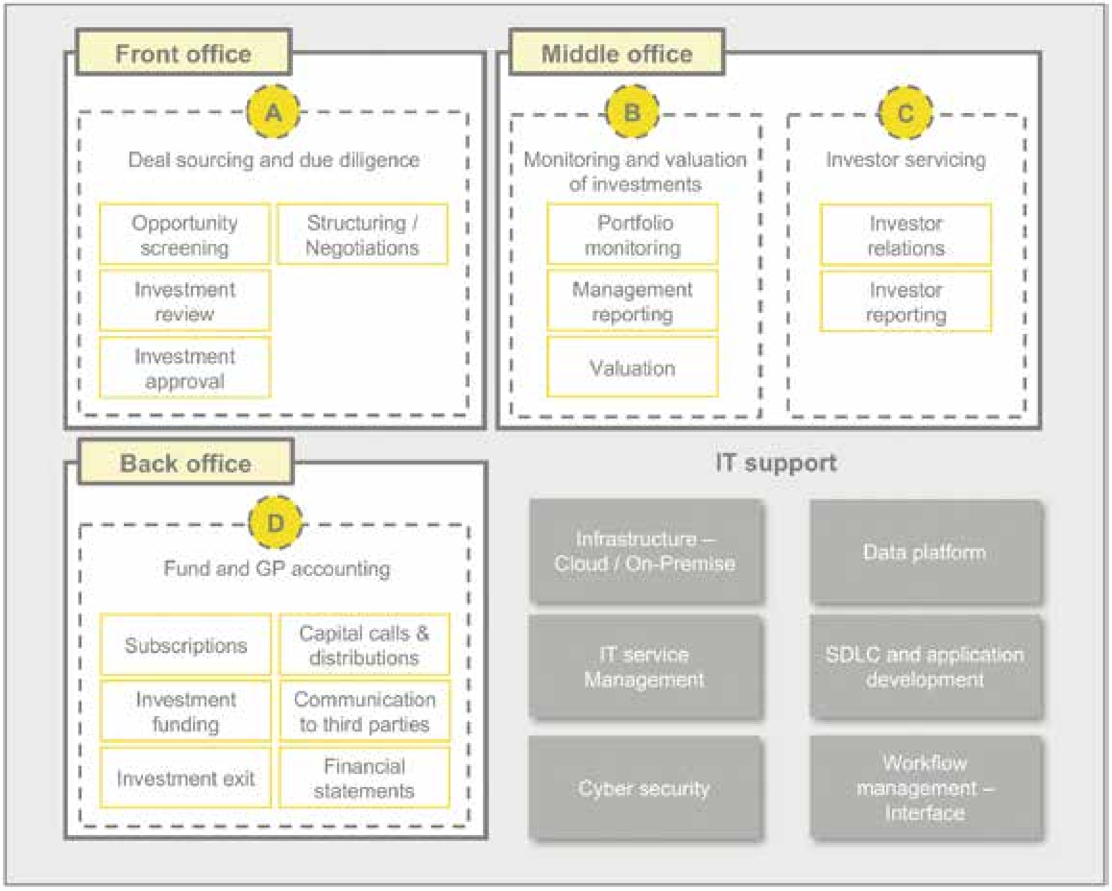
The current operating environment for GPs is a combination of old challenges – complex investment structures and products, legacy skills and over-reliance on spreadsheets – and new expectations by regulators and investors leading to a greater need for readily available data.

The growing compliance burden significantly stresses the GPs' operating infrastructure. Operational efficiency has become a key factor in addressing rising compliance costs. It is further one of the key drivers for technology investments, as GPs are looking for robust and cost-efficient IT systems to support them in their day-to-day execution and process management.

GPs are looking to implement one-stop-shop solutions as part of their adapted IT strategy. While the promise of many dedicated systems remains unfulfilled today, software companies are beginning to catch up with ever more complex requirements.

Certainly, large and established IT companies have concentrated their recent development efforts to achieve an increased flexibility in their accounting tools and accommodate the operational and financial requirements of PE firms. At the same time, new entrants to the market are creating a disruptive service offering tailored to the PE sector (see list). Typically, the adjusted service offering includes integrated workflow management tools which allow for secured processes and streamlined interactions with stakeholders. In addition, PE firms can use data rooms and workspaces to facilitate document sharing and reduce the frequency and volume of emails and calls. Luxembourg's innovative fintech community hosts a number of software providers specifically focusing on new ways of communicating and sharing information, especially in a regulated environment.

TECHNOLOGY



"GPs are looking to implement one-stop-shop solutions as part of their adapted IT strategy."

Data provider	A	B	D
Bloomberg	•	•	
DealMarket	•		
Orbis (Bureau van Dijk)	•		
Palico	•	•	
Pregin	•	•	
S&P Capital IQ	•	•	
The ID Register (IPES)			•
Thomson One	•	•	

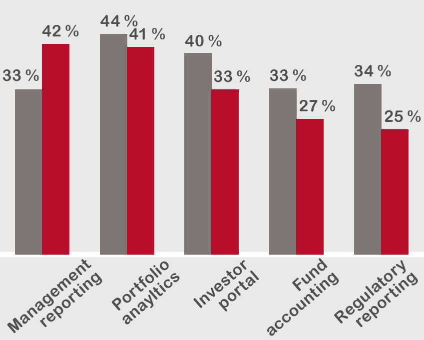
Data provider	A	B	C	D
Advent (SS&C)	•	•		•
AllRounds (Sand Hill)		•		
AltaReturn		•		•
Asset logic				•
Baxon (Pregin)		•		
Burgiss		•		
Comarch Asset Management		•	•	•
Drooms	•			
Dynamo	•	•	•	•
eFront	•	•	•	•
Equitrak (Vitech)	•			•
iDeals Solutions			•	•
iLevel		•		
Intralinks			•	
Investran (FIS)	•	•	•	•
Linedata			•	•
Orbis (Bureau van Dijk)	•			•
Salesforce	•			
TP Catalyst (Bureau van Dijk)	•			•
Zephyre (Bureau van Dijk)	•	•		

“While the promise of many dedicated systems remains unfulfilled today, software companies are beginning to catch up with ever more complex requirements.”

The maturing service offering of software companies should allow GPs to follow a best-of-breed approach to leverage technology beyond the back-office, focusing on investor portals, portfolio analytics and management reporting. The observed shift in technology focus signals that the industry is starting to embrace an analytical mindset to scale and operate more intelligently across the front-, middle- and back-office. Implementing such integrated models is at the forefront of a number of actors in Luxembourg, both from an in-house solution as well as service provider perspective.

To address the growing transparency demand and scrutiny of stakeholders, GPs need to invest in state-of-the-art data and reporting portals. Apart from facilitating information access, sophisticated and interactive solutions enable customised data delivery and self-service capabilities. Although customisation requires a larger initial investment in terms of development costs and implementation time, non-customisable solutions may soon be obsolete.

TECHNOLOGY FOCUS



■ Past two years ■ Next two years

Source: 2016 global private equity fund and investor survey (EY/PEI)”

Research has indicated that the use of advanced investor portals, coupled with industry standards for transparency, can play a substantial role in reducing the number of specific investor queries and improve their overall satisfaction. However, immature operating models and data management issues often create a significant obstacle to responding to complex investor requests and automating the reporting process.

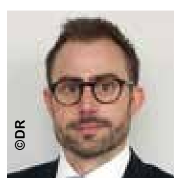
Harnessing data is surely becoming a must-have capability for GPs targeting an integrated governance model and improved data quality. The latest annual EY study amongst top 30 PE firms demonstrates that the majority of GPs consider data management as the most significant constraint to implementing technology solutions. Indeed, PE houses have been facing difficulties in capturing, processing and tracking data across multiple systems, typically relying on non-automated processes and spreadsheets.

A mature data management system should allow efficient data collection and transmission as well as enable the transformation and analysis of data across the complex PE value chain.

Adopting a data-driven approach would not only allow GPs to build a flexible operating platform and centralised data repository but further create an opportunity for added value through the generation of actionable analytics, including market intelligence and performance attribution measures. In order to fully leverage analytics, GPs are looking into specialised software companies offering the possibility to access comprehensive industry databases, screen the market and generate specific data queries and competitor benchmarks. The fact that Luxembourg hosts a number of these innovative technology firms underlines its leading role to service private equity players of all sorts within the European Union.

Although data management is still considered a major barrier to digital transformation, PE firms which attend to this challenge stand to gain the most in terms of competitive advantage, scalability of operations as well as investor experience and confidence.

Kai Braun, Partner, Luxembourg Alternatives Advisory Leader, Ernst & Young Luxembourg



Martin Krist, Manager, FSO Advisory, Ernst & Young Luxembourg

About the 2016 Global Private Equity Fund and Investor Survey: Ernst & Young conducted the research with Private Equity International, collecting information through telephone interviews with 31 private equity funds and 20 investors, and an online survey to which 103 private equity funds and 88 investors responded.”

CLIMATE FINANCE

ALL COLOURS OF MONEY

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> **"It is encouraging to observe that well designed projects and activities aiming at new sources of renewable energy and higher energy efficiency carry the promise of economical viability."**

EFFECTIVE CLIMATE FINANCE ALSO NEEDS PRIVATE EQUITY AND VENTURE CAPITAL

The Climate Policy Initiative estimates the needs for climate finance at more than USD 1 trillion annualy over the next 15 years, if the world is to stand a chance of abiding by terms of the Paris Agreement adopted at the COP21 in December 2015, and limiting global warming at below 2°C the temperatures of pre industrial times. Never before has the political consensus for action been more clearly expressed, and never before has it been more evident that the huge financing necessary to maintain the world as an auspicious place for future generations cannot be met by public budgetary means alone. As a matter of fact it will take the whole range of available funding sources and financing instruments, "all colours of money" – public and private – to meet the political commitments undertaken, and to switch to low carbon and energy-resilient options, away from the fossil fuel dependency on which our world will otherwise be doomed to choke.

On a positive note, it is encouraging to observe that well designed projects and activities aiming at new sources of renewable energy and higher energy efficiency carry the promise of economical viability. The technologies to produce renewable energy (solar, wind, hydro, geothermic) are well mastered and become more competitive by the day in comparison to those involving carbon-intensive fossil fuel (coal, oil, gas). Furthermore, the clean energy output has an intrinsic market value, allowing for pertinent business models with clear perspectives on the financial revenue of an investment, as well as its positive social and environmental impact.

In order to make a meaningful contribution to the international fight against climate change, the Luxembourg government and its private sector partners have formulated a Climate Finance Strategy that will cater to the varying financing needs of climate projects and activities at the different stages of their lifecycle. The initiatives under the strategy provide a promising setting for private equity investors and venture capitalists to support project promoters during the start-up – the bridge – and the growth phases of their projects, and transform their climate-related activities into viable businesses. In doing so, they will contribute to and benefit from the win/win scenario of profitable investment and positive climate impact.

The Luxembourg-EIB Climate Finance Platform uses public funding from Luxembourg to mitigate the private investor's risk involved in participating in projects with high climate impact that are sourced and monitored by the EIB. An Accelerator Facility, funded as a public private partnership, will attract new, climate-savvy investment fund managers to Luxembourg. LuxFLAG's climate finance label vouches for the climate-related nature of compliant investment funds and bonds, while the cutting-edge initiative of the Luxembourg Green Exchange (LGX) is leading the way in listing 100% green bonds. The combined potential of these initiatives is promoted within a controlled legal and regulatory environment and establishes Luxembourg as an international centre for climate finance.

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Marc Bichler, Luxembourg Ambassador-at-Large for Climate Change


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PRIVATE EQUITY: THE CHOICE OF AFRICA

OVER THE LAST FEW YEARS, EMERGING MARKETS HAVE EVOLVED INTO A CRITICAL PILLAR OF GLOBAL INVESTORS' STRATEGIES. PRIVATE EQUITY FIRMS AND OTHER INVESTORS TURNED TO EMERGING MARKETS AS AN ENGINE OF GROWTH. FOR A FEW YEARS NOW, THE AFRICAN CONTINENT HAS BEEN SEEN AS A GROWTH DRIVER FOR PRIVATE EQUITY. IT IS CURRENTLY THE WORLD'S FOURTH MOST ATTRACTIVE DESTINATION FOR INVESTMENT, WHILE JUST FIVE YEARS AGO AFRICA RANKED NEAR THE BOTTOM OF THE LIST.

WHY INVEST IN AFRICA ?

Although there has been a substantial slowdown in growth, in a global context, Sub-Saharan Africa will remain one of the fastest-growing regions in the world for the foreseeable future. For a decade, fostered by an increasing middle-class and favourable demographics, Sub-Saharan Africa's average GDP growth rate was close to 6%[1]. In 2015, growth slowed substantially, to 3.4%[2], and for the year just ended, it is set to be a bit lower. Some of the key economies – including Angola, Nigeria and South Africa – are under pressure and are likely to remain so over the next year. Although economic growth across the region is likely to remain slower than it has been for the past decade, the main reasons for a relative slowdown are not unique to Africa. The negative factors impacting African economies are the same as those weighing down the global economy: a general slowdown in emerging market economies, in particular the rebalancing of China's economy; ongoing stagnation in most developed economies; lower commodity prices; and higher borrowing and capital costs. While some economies struggle, the International Monetary Fund's most recent forecast indicates that the overall Sub-Saharan African economy will be growing at more than 5% per year until at least 2020. According to AVCA's[3] latest Limited Partner Survey, Private Equity investors generally exhibit high confidence towards investments in Africa: 57% of LPs plan to increase their allocation to Private Equity in Africa over the next three years, 66% would be willing to invest with a first-time General Partner in Africa,

REGION PROFILE

“Long-term outlook for economic growth and investment in Africa remains positive.”

and 58% predict that their return will exceed 2.5x over a ten-year period.

WHAT TO KNOW BEFORE INVESTING

Even though African investments often face misperception of risks, especially over-estimated by investors with no exposure to the continent, a common set of barriers and challenges should be kept in mind when investing in African Private Equity. Macroeconomic factors and political risk remain at the top of the list of those challenges. AVCA's Limited Partner Survey reveals that currency risk is the biggest challenge to LPs when investing in Africa. Africa's demographics are possibly one of the most important political factors. Young populations, with little memory of recent historical events, may bring political instability when job creation cannot continue. Usual risks inherent to Private Equity industry are also enhanced in Africa. General Partners hesitate to invest in opportunities, even those that seem to match their strategy, due to the lack of information and transparency in the market. In these conditions, dry powder may take time to elapse in a market where small deals prevail. When it comes to divesting, General Partners have to deal with a shortage of exit options. IPOs are relatively rare, even though there has been progress in linking the stock exchanges of Nigeria, Ghana and the Ivory Coast. It is for this reason that African Private Equity funds tend to hold their portfolios for a longer period. In addition, because the market is still relatively young, Limited Partners may face difficulties in finding a General Partner that meets all of their expectations, especially when it comes to experience of the market and track records of performance. Local regulatory frameworks may also be an obstacle. Multiple tax jurisdictions and legal restrictions on financial operations (including access to local capital such as domestic pension funds, exchange controls, local content requirements and ownership restrictions) slow down the development of Private Equity in the continent. Regional integration is progressing but there is still a long way to go. International regulation has, however, a positive impact, especially with regards to the fight against bribery, and anti-money laundering, transparency and corporate governance.

LUXEMBOURG, THE NEXT EUROPEAN HUB TO INVEST IN AFRICA?

Africa attracts Foreign Direct Investments (FDI) from a diverse and growing group of investors. In 2015, the US retained its position as the largest investor in the continent, despite a 4% fall in FDI projects. Historical investors, including the UK, France, the UAE and India, expressed renewed interest in Africa. New investors also moved up the ranking, especially Luxembourg, which became one of the 15 largest investors in 2015 (source: fDi Markets). Luxembourg is indeed gaining a foothold in the African market. The Grand-Duchy is in negotiations to increase the number of double-tax treaties with African countries and benefits from its proximity with European Institutions, such as the European Investment Bank. This may be a comparative advantage when African LPs see the participation of known or respected LPs as a significant factor when evaluating African GPs. Over the past ten years, Luxembourg has passed a series of laws that are very favourable to the Private Equity industry and represents a reliable alternative to historical players in the African Private Equity market.

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1 Source: EY’s Africa Attractiveness Program 2016
2 Source: EY’s Africa Attractiveness Program 2016
3 The African Private Equity and Venture Capital Association

Rajaa Mekouar,
Maera Capital
Morocco

Africa is increasingly on the radar of international investors keen on exploring PE opportunities on the continent, often seen as the “last frontier”. With its vastness and heterogeneity, it does offer many alternatives to the discerning investor. The sheer number of African GPs (120+) gives a glimpse into how dynamic it is, despite the majority still being based in South Africa. Luxembourg is a solid alternative to an offshore jurisdiction (e.g. Mauritius) for these managers to base their structures, especially when their LPs are from Europe, as it provides safety and great infrastructure across the board.

José Aubourg
Director, Private Equity services,
EY Luxembourg

Aimao Poean
Manager, Private Equity services,
EY Luxembourg

Marie-Laure Mounguia
Manager, Private Equity services,
EY Luxembourg

MARATHON IN LUXEMBOURG
IT IS FAR MORE THAN JUST RUNNING

©ING

A PRESTIGIOUS INTERNATIONAL MEET. A FAMILY EVENT. A TEAM-BUILDING EXERCISE. A SAMBA PARTY. ALONG ITS 42,195 METRES, THE ING NIGHT MARATHON LUXEMBOURG IS SO VERSATILE, IT HAS BECOME A ONE-OF-A-KIND EVENT, MUCH LIKE THE HOST COUNTRY ITSELF – THE ONLY GRAND DUCHY IN THE WORLD.

RUNNING ALL YEAR LONG

Running is a great way to stay in shape and meet new people. It can be practised anytime, anywhere, and by virtually anyone. The perfect sport for an international business hotspot with newcomers arriving on a daily basis. The previous decade saw popular running events emerging and growing throughout the country – a true testimony to the local culture of running as a mainstream sport. They are spread all over the calendar, from the ING Eurocross in Diekirch early in the year to the Escher Kulturlaf and the ING Route du Vin (Remich) in the autumn. The City of Luxembourg alone hosts five different running events during the spring and summer months: Postlaf, Relay for Life, DKV Urban Trail, JP Morgan City Jogging and, of course, the ING Night Marathon Luxembourg – the largest sporting event in the country.

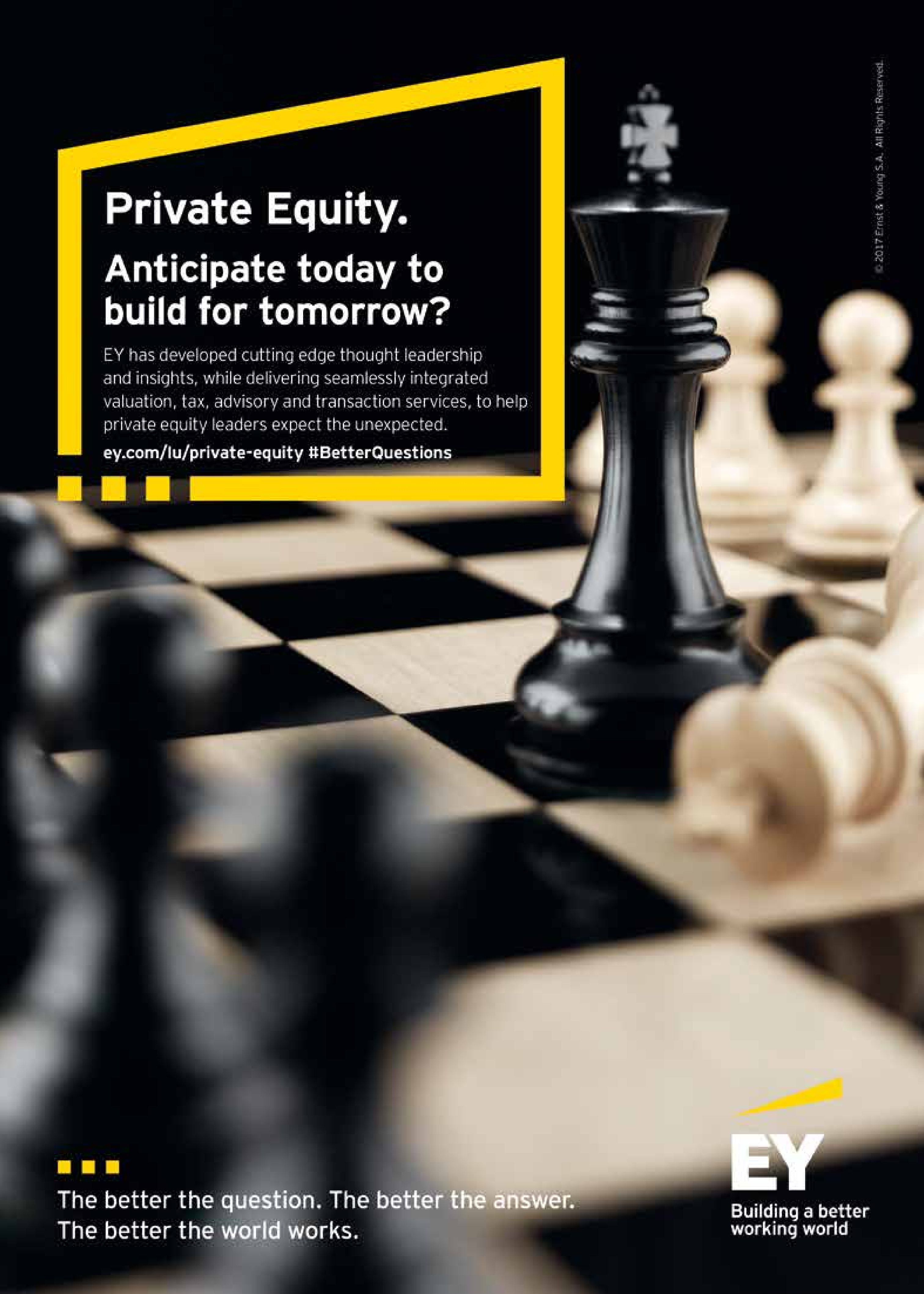
DIFFERENT RACES, DIFFERENT PEOPLE

The more than 1,200 volunteers who make the ING Night Marathon Luxembourg possible work relentlessly from dawn till dusk, till dawn again – the race is a night run and the last runner to cross the finish line usually does so just after 1 am on Sunday. With almost 15,000 runners at the start in Luxexpo, the air vibrates with excitement and energy. The international athletes perform their last preparation routines under the attentive gaze of younger participants, anxious to be allowed behind the starting line. Groups of colleagues from different companies and industries agree on a meeting point after the race and runners 2, 3 and 4 leave for their section start. The marathon, half marathon and team run start at 7 pm sharp, and it takes more than 20 minutes for all the runners to cross the start line. Next are the Mini and Mini Mini Marathon, which begin at around 7:30 pm, while the 5K Run for Success kicks off at 8 pm. And the party is on.

THE SOUL OF THE MARATHON

Fourteen hot air balloons, 1,000 lanterns, 300 samba dancers, 18 DJs, marching bands and even a choir accompany the runners throughout the night. But the true heart and soul of the great atmosphere Luxembourg's marathon is known for are the 100,000 supporters cheering at the side-lines. Friends and family support the competitors, from the youngest runner (3 years old in 2016) to the oldest (83 years old in 2016), chanting their names and encouraging them in dozens of different languages to keep going, despite the significant differences in altitude throughout the course. The ING Night Marathon is a party, a team event, a family outing, an international meet… it is far more than just running.

“The true heart and soul of the great atmosphere Luxembourg’s marathon is known for are the 100,000 supporters cheering at the side-lines.”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GALLERY

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New Year's Event: Danièle Arendt (Cinven), Karl Heinz Horrer (EQT), Jane Wilkinson (KPMG), Eckart Vogler (BI-Invest Advisors) and Andrea Neuböck-Escher (EQT).

Luxembourg Fund Centre Seminar in New York: Jérôme Wittamer (LPEA), Pierre Gramegna (Minister of Finance of Luxembourg), Denise Voss (ALFI) and Paul Junck (LPEA).

London Roadshow: Gilles Dusemon (Arendt & Medernach) and Vincent Lebrun (PwC).

PHOTO GALLERY LPEA

More photos of LPEA events are available on www.lpea.lu

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GP Club Workshop at the House of Finance.

LPEA IN BRIEF

ABOUT LPEA

The Luxembourg Private Equity and Venture Capital Association (LPEA) is the representative body of private equity and venture capital professionals in Luxembourg.
With over 140 members, LPEA plays a leading role in the discussion and development of the investment framework and actively promotes the industry beyond the country's borders.
Luxembourg disposes of a stable tax regime and is today at the forefront of international PE regulation providing a flexible, secure, predictable and multi-lingual jurisdiction to operate in.
LPEA provides a dynamic and interactive platform for its members to discuss and exchange information and organises working meetings and networking opportunities on a regular basis.
If Luxembourg is your location of choice for private equity, LPEA is where you actually join the industry!

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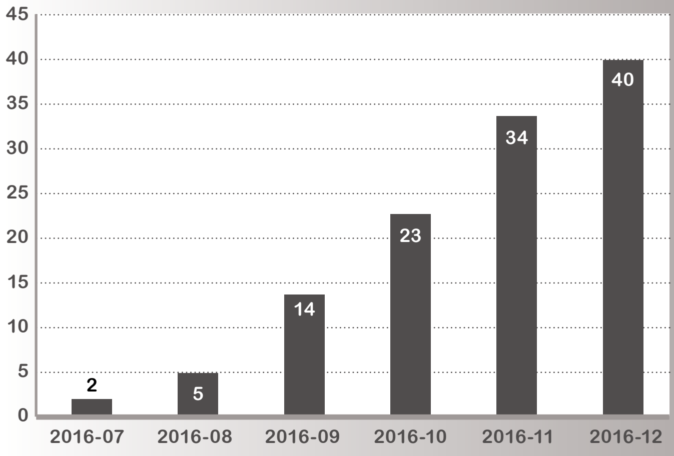
LPEA TEAM

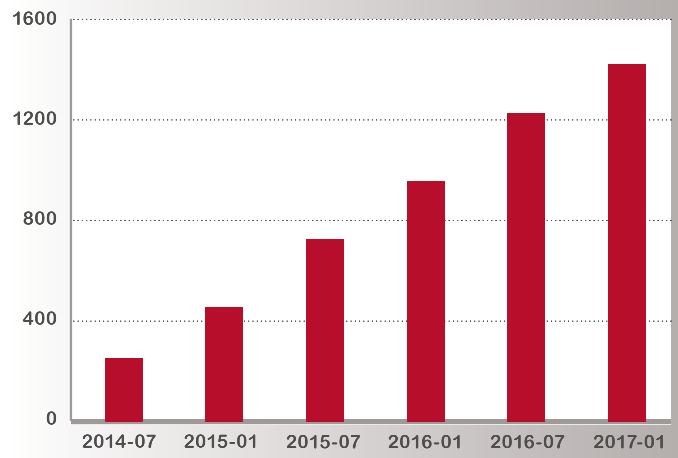
Paul Junck – Managing Director
Luís Galveias – Marketing & Communication Manager
Dušan Gladović - Legal & Regulatory Manager
Kheira Mahmoudi – Executive Assistant to the Managing Director

MARKET FIGURES

RAIF EVOLUTION IN LUXEMBOURG



LIMITED PARTNERSHIPS: SCSP EVOLUTION IN LUXEMBOURG NUMBER OF SCSP -RCSL BASED



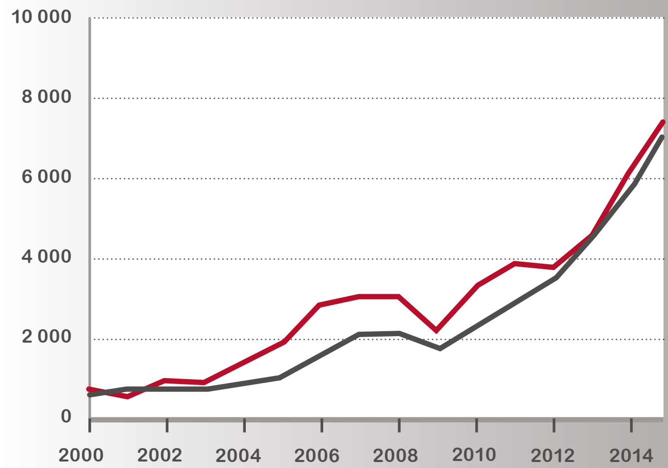
WORKING IN LUXEMBOURG

Key private equity positions requested by PE firms in Luxembourg:

SENIOR LEVEL:
CFO, Compliance Officer, Risk Officer

MANAGEMENT LEVEL: Accountant, Administrator, Auditor, Financial Controller, Legal Officer, Risk analyst

FINANCIAL SERVICES BETWEEN LUXEMBOURG AND THE UNITED KINGDOM



in Million Euros
Exports (LU > UK) Imports (UK > LU)
Source: STATEC

CALENDAR

25-27
JANUARY 2017

CANNES
International Private Equity Marketplace

27
FEBRUARY -
2
MARCH 2017

BERLIN
Super Return International

9
MARCH 2017

ZURICH
LPEA Roadshow

14
MARCH 2017

LUXEMBOURG
Luxembourg, a European gateway for China: update on Private Equity and M&A

16
APRIL 2017

STOCKHOLM
Luxembourg For Finance Seminar

26
APRIL 2017

LUXEMBOURG
LPEA Insights: 360 GP View

23
MAY 2017

LONDON
LPEA Private Equity workshop (ALFI London Conference)

JUNE 2017

NEW YORK
LPEA Roadshow

SEPTEMBER 2017

PARIS
LPEA Roadshow

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