Luxembourg Private Equity
& Venture Capital Association

Newsletter

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Editorial

Dear Member of the LPEA, dear reader,

Regulatory tsunami, that is what the industry widely refers to when commenting on AIFMD, Dodd Frank and the likes. As one speaker pointed out at the recent ALFI London conference, that is probably an inappropriate metaphor. Tsunamis come and go....

Speaking of which, I believe there is a far more serious impact on the industry to be expected from regulation other than AIFMD. While, as a practitioner, I still grapple with the tangible benefits that AIFMD seeks to achieve, its implementation is a surmountable task and the structural and financial impact, while not negligeable, is not going to be unsurmountable. A more pervasive threat to the industry at large, however, could be regulatory initiatives that potentially curtail the availability of capital from, and the deployment of capital within Europe for start-up and growth investments. Not something that I believe Europe can afford in times of economic contraction and financial turmoil that still lay ahead of us.

On an upbeat note, in the context of LPEA's objective to promote the Luxembourg PE framework, a number of LPEA representatives conducted a work shop on private equity at the recent ALFI London event. The subject was received with considerable attention by the London community. Notably the recent legislative initiatives in Luxembourg, confirmed by Minister Frieden in his keynote address, triggered quite a significant level of interest. A step further in the direction to heighten Luxembourg's profile in the heartland of the PE industry.

With the same agenda, the LPEA will conduct its PE first work shops in Germany in June (Munich on the 13th and Frankfurt on the 29th). We will be reporting back to you in due course on the sentiment on that end of the market. Stay tuned.

Hans-Jürgen Schmitz,
Chairman of the LPEA

Events

- **6-8 June 2012**
  IBFL Course: "Understanding business processes and controls in PE"
- **13 June 2012**
  LPEA Road Show in Munich
- **22 June 2012**
  LPEA Roundtable: "Current trends in insurance solutions for PE" Luxembourg
- **29 June 2012**
  LPEA Road Show in Frankfurt
- **2 July 2012**
  LPEA Board of Directors meeting

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Risk management impact of the new SIF law on PE industry

Context
The new article 42 bis of the updated SIF Law now requires SIFs to implement a Risk Management policy and appropriate systems in order to detect, measure, manage and monitor the risks associated with the portfolio positions and their contribution to overall risk profile of the portfolio.

For all SIFs created after the 26th of March 2012 (at the latest on June 30th 2012 for SIFs created before April 2012), the CSSF must be provided with a clear description of the Risk Management policy.

What are the requirements until June 30, 2012?
The Risk Management policy that must be sent to the CSSF has to include a description of the processes that have been put in place to identify, measure, manage and monitor all the risks to which the SIF is materially exposed or could be exposed.

Also, in terms of governance, it will be required to demonstrate the independence of the Risk Management function.

Impact of PE industry
Risk management in the context of Private equity funds needs to be approached in a different manner as what is usually done for the traditional asset management industry.

Hence, a Private Equity SIF should not limit its Risk Management policy to a duplicate of a standard UCITS risk management framework.
Here, Risk Management does not only concern the portfolio but the fund's structure as well as the full investment value chain. Furthermore all best practices linked to the industry (e.g. EVCA) will also need to be part of the analysis.

These last aspects represent a new challenge for the PE industry and are also the first steps to meet AIFMD Risk Management expectations.

F. Vonner and B. Gauthier
Associate LPEA Members

The Global Private Equity Market

Review and trends
The good news first: in 2011, the private equity industry was able to prove, once again, that its model is resilient to adverse market conditions. In fact, 2011 was a year of contrasts. In the first half, as market conditions improved, increasing confidence resulted in new investments and some exits. However, with the second half of the year seeing the sovereign debt crisis picking up in Europe, the rating downgrade in the US and finally a slowdown of Asia's growth rate, investments were negatively impacted. This was reflected with Q4 2011 being the slowest quarter for acquisitions since Q1 2010.

With only 477 PE funds closed in 2011, representing USD230 bn of committed capital, figures were significantly lower than 2010 which saw a close of 522 funds and USD246 bn, respectively. The same applied to announced PE deals, whose value went down 7% from 2010 to 2011. However, valuations did move up as the operating environment for many companies stabilized.

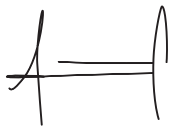
On a more positive note, there were some major PE deals announced in 2011, with, for example, Blackstone's USD9 bn worth acquisition of 600 shopping malls in Australia, representing one of the largest real estate deals since the start of the recession in 2008. This deal is worth being mentioned not only due to its size but also as it is a typical example as to how PE houses are reacting to the changing environment - by seeking out niches, market gaps and new target investment countries. The following trends can be mapped out:

- **Trend 1**: PE houses are branching out into areas that were not previously core to PE houses, such as investments into real estate, distressed debt, or hedge funds.
- **Trend 2**: tapping new sources of capital and seeking out unconventional financing.
- **Trend 3**: increasing flexibility in fund structuring, e.g., by downsizing funds, by seeking partnerships with strategic buyers but also through divestments of non-core assets or through corporate spin-offs.
- **Trend 4**: investments into upcoming markets beyond BRIC, namely the Latin American markets such as Colombia and Peru, Sub-Saharan Africa, Indonesia, Vietnam and Thailand. Next to focusing on new geographical markets, highly specialized funds with sectorial focus promise most success, with oil and gas, healthcare and technology companies offering the largest potential.

Needless to say, however, PE houses also need to run their existing portfolio companies. 2011 confirmed what was already seen in 2010 - value creation is the key success factor for any private equity house.
PE houses focused on organic growth of their portfolio companies, operational improvements and on navigating their portfolio companies through the period of recession. Examples include the introduction of 100-day plans, internal portfolio support teams and the increasing use of external operating partners with sector credentials. This could actually be confirmed by the fact that in Europe, 46% of EBITDA growth was due to organic revenue growth.

PE houses are also investing in their own operations and processes, in particular in their back-office operations in the advent of the AIFMD.

Last but not least, more than ever, GP-LP alignment remains crucial; LPs carefully select the PE houses with which they want to work, increase their due diligence process, demand more, and detailed, reporting. By now, 240 PE houses have already endorsed the ILPA guidelines. In short, LPs become more sophisticated, strategic and demanding. Those GPs that can deliver in terms of performance, consistency, transparency but also in their originality, courage and vision, are those that will continue to perform - also in continuously tough times.



Alain Kinsch,
Associate LPEA member

About LPEA

LPEA is a non-profit organization serving a threefold mission:

- Towards its members, represent and promote the interests of Private Equity and Venture Capital players based in Luxembourg.
- Towards Luxembourg, support government and private initiatives to enhance the attractiveness, competitiveness and efficiency of the Luxembourg economic, legal, regulatory and operational framework as an international hub for carrying out Private Equity and Venture Capital business and / or servicing the industry in all its dimensions.
- Towards the European Venture Capital and Private Equity Association (EVCA) and other relevant international industry bodies, represent the interests of the members of the LPEA and the industry as well as Luxembourg as a place for doing Private Equity and Venture Capital business.

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