



Alexandrine Armstrong-Cerfontaine

# PRIVATE EQUITY IN LUXEMBOURG

Alexandrine Armstrong-Cerfontaine's practice focuses on advising private equity sponsors on their investments, corporate finance and syndicated financings, including leveraged financing and restructurings. She acts for a wide range of investment houses in the private equity and leveraged finance sectors. She is a member of the partnership board of King & Wood Mallesons in Europe. Recent transactions include advising PAI Partners on its Nuance Group exit and its acquisition of a majority stake in Marcolin; Lion Capital on its investment in Alain Afflelou, the refinancings of Picard and its partial exit from that

group; Altor on the acquisition of Rossignol; and Capital Dynamics on its JV with Clessidra, acquiring a majority stake in Roberto Cavalli.

Alexandrine is triple qualified and is a member of the Luxembourg Bar, Paris Bar and the Law Society (England & Wales). She is also a member of the Luxembourg Private Equity and Venture Capital Association and the Association of the Luxembourg Fund Industry. Alexandrine publishes regularly on regulatory issues in fund formation, corporate finance including leverage finance and private equity issues.



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**GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the past year or so?**

**Alexandrine Armstrong-Cerfontaine:**

Luxembourg is the leading PE jurisdiction in Europe and it is the hub for private equity investments into Europe. In a very pragmatic way, the pulse of PE activity in Europe is felt in Luxembourg given that many structures to optimise private equity investments go through Luxembourg. 2014 witnessed a substantial overall improvement in private equity buyout and investment activities, with a strong focus on the middle market. Buyout investments totalled €28 billion in 2013 and €30 billion in 2014. The first half of 2015 is as strong as 2014, with an improved confidence in the eurozone and growth in the south of Europe, the United Kingdom and Germany. Exit volumes remain as high as 2014, a year for the record books, with a total of 43 flotations. The value of exits for 2014 (€113 billion) was almost the double of investments (€67.3 billion). The trend continues in 2015 given the current low interest rates, strong corporate balance sheets and the rise of stock markets in early 2015, which all contribute to a favourable environment for exits. The European exit market maintained growth momentum with a total of €31.7 billion of exits completed during the first quarter of 2015. As for 2014, the competition for mid-market deals remains fierce for sponsors and most buyout deals are in the €100 million–€500 million bracket.

Many exits were completed by sponsors by the sale or listing of the Luxembourg holding company. For instance, Ardagh, the Luxembourg-headquartered packaging company, received first-round bids for its metal-containers operation, Oressa, from a number of private equity houses in early August 2015, for a business valued at around €2.4 billion according to recent publications. Furthermore, investments in trusts and custodial services in Luxembourg are expected to peak in 2015. The most recent transactions include the acquisition of Orangefield and Vistra by Baring Asia. Other service providers are currently on the market with processes launched with sponsors and corporates.

**GTDT: Looking at types of investment and transaction, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?**

**AA-C:** Buyouts remain the highest volume sector. There is much competition in auctions between sponsors and corporates with a lot of cash in their coffers and, therefore, there is pressure on sponsors to win deals. Buyouts of listed companies in Luxembourg are not common, since few companies have their shares (as opposed to debt instruments) listed on the regulated market of the Luxembourg stock exchange. Many sponsors have been active in continuing to increase the exit value of their portfolio with add-on acquisitions of portfolio companies funded by equity, quasi-equity

and, in some cases, partly by external financing. Recent examples on which King & Wood Mallesons advised in Luxembourg include Cerba European Lab's acquisition of JS Bio and Novescia, Marcolin's acquisition of Viva and Afflelou's acquisition of 3AB Optique Developpement. The typical Luxembourg private equity holding company commonly includes securities or financial instruments with specific financial and voting rights (such as preferred dividend rights). More complex and hybrid instruments can be used, depending on the financial arrangements and ultimate tax planning at sponsor level, and the type of investment in the portfolio company, which enable profit repatriation, capital gains or dividend flows in a tax-efficient manner. The nature of certain hybrid instruments is currently being revised in the light of the OECD's base-erosion and profit-shifting project.

We see a strong appetite for portfolio companies in the financial and trust services, biotechnology, luxury brands, pharmaceutical, medical, new technologies and retirement sectors. In Luxembourg, auctions are common even for smaller and medium-sized buyouts. Most recent transactions for the acquisitions of financial services companies were done by auction. Auctions are not specifically regulated as such, but competition law is always considered.

***GTDT: What were the recent keynote deals? And what made them stand out?***

**AA-C:** Rosneft's investments through Luxembourg-based Long-Term Investments Luxembourg into Pirelli alongside China's state-owned ChemChina for €7.1 billion; the €1.2 billion acquisition of Groupe du Louvre by Sailing Investment Co, Sàrl, wholly-owned by Shanghai Jinjiang International Hotels Development Company Limited, the Shanghai-listed Chinese company that is a subsidiary of Chinese state-owned Jin Jiang International Holdings Co, Limited; or PAI's sale of Swissport to HNA for 2.7 billion Swiss francs continue, of course, to evidence China's strong appetite for European brands. These deals are also a clear signal that Chinese investors, including state-owned investors, are ready to play a leading role in enhancing the market share of European companies in Asia while benefiting from a weak euro.

***GTDT: Does private equity M&A tend to be cross-border? What are some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal. Are those challenges evolving?***

**AA-C:** Most of the acquisitions and exits made by the private equity firms are done as cross-border transactions. Therefore, Luxembourg private equity lawyers work on cross-border deals

every day, structuring acquisitions, management incentive plans and group reorganisations to prepare for exits, and exits. Their work includes the design of investment structures with securities or instruments that are not necessarily known in other jurisdictions, while tackling a challenging tax environment. In addition, the strategy of sophisticated sponsors who are very familiar with Luxembourg structures involves the creation of innovative structures, reinforcing Luxembourg's position of as a leading jurisdiction for private equity investments. This means that the communication and coordination skills of our private equity team in Luxembourg are as critical as its flexibility and ability to deliver new structures and products quickly in line with the fast pace of dealmaking in that sector.

***GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?***

**AA-C:** The current themes are always the same, but with different variations depending on the jurisdictions involved with the cross-border financing. They include lending restrictions, limitations on guarantees and security that may be granted by a Luxembourg entity, hardening periods, the assessment of the security package to provide the fullest possible security cover, the assessment of potential withholding tax issues, thin capitalisation issues and financial assistance, which are universal themes. Material considerations specific to Luxembourg include the place of the central administration, the principal place of business and the centre of main interests of a Luxembourg obligor, which are essential to assess the rights of the lenders in the event of insolvency. Particular care is given to the structure of the transaction and specific representations and undertakings are designed to secure, to the maximum possible extent, the rights of the lenders. Furthermore, the assessment of the substance, from a tax perspective, of the Luxembourg obligor is necessary to assess potential tax issues that the borrower group may incur should such a substance requirement fail to be satisfied.

The availability of credit is not the main concern. Third-party financings usually take the form of senior or mezzanine loans (syndicated or otherwise) and credit is now much more available and with a trend for 'covenant-lite' financings, from European banks and US banks. Bond issues are also an option (parties enjoy a large degree of freedom in their terms and conditions) with bonds becoming very common for financings from €200 million for add-on and refinancing. Debt-to-EBITDA (earnings before interest, taxes, depreciation, and amortisation) ratios have

been, in most cases in 2013 and 2014, around 6–6.3 times EBITDA. Debt volumes have increased significantly over the past two years and unitranche financings granted by debt funds or certain direct lenders as an alternative to senior or mezzanine debt are less common. What has changed and will continue to change are the structures considered for financings. For instance, the double-luxco structures are no longer required for the financing of acquisitions of French targets and debt push-downs, and the positioning of multiple acquisition SPVs are carefully thought through because of tax reforms or tax practices in some jurisdictions.

**GTDT:** *How has the legal and policy landscape changed during the past few years in your country?*

**AA-C:** The AIFMD introduced a harmonised EU regulatory and supervisory framework for AIFMs. Therefore, the regulatory landscape changed in all jurisdictions in the EU with the AIFMD. This is a significant shift towards regulation that increases costs for sponsors. The profound reform of partnerships in Luxembourg, the reform on VAT and the taxation of carried interest are also significant changes implemented since 2013 as part of the transposition of the AIFMD in Luxembourg. New cross-border fund structures have been put into place, many for the private equity industry.

**GTDT:** *What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country, and if so, how has it impacted private equity M&A?*

**AA-C:** The LPEA (Luxembourg Private Equity & Venture Capital Association) and the ALFI (Association of the Luxembourg Fund Industry) promote and protect the interest of the private equity industry and make available to the public much information on this particular industry. The profound corporate and tax reforms that were adopted when the AIFMD was implemented in Luxembourg in response to the private equity industry's needs in Luxembourg are evidence that policymakers welcome the private equity industry in Luxembourg.

**GTDT:** *What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?*

**AA-C:** As mentioned earlier, the European exit market is maintaining the strong momentum seen in 2014: €31.7 billion of exits completed during the

**“This is a significant shift towards regulation that increases costs for sponsors.”**

first quarter of 2015, with an important number of flotations; secondary exits were the most prevalent.

**GTDT:** *Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the past few years?*

**AA-C:** 2013 was the best (recent year) for private equity funds: €45.4 billion was raised. This was much greater than 2012 (€16.78 billion) and 2014 (€33.2 billion). While some managers have seen very few changes to their terms, the market has moved, nonetheless, in favour of sponsors in general: more funds agree to both escrow and clawback, it is becoming increasingly difficult for GPs to retain transaction fees, a vast majority of funds have a no-fault removal remedy and the trend for 2014 is continued pressure by investors regarding compensation for no-fault removal and GP commitment.

**GTDT:** *Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?*

**AA-C:** The fundraising process and structures vary depending on the location of the manager and, if the manager is based in the EU, whether the manager needs only the registration regime or whether it must be authorised. Marketing within the EU is also considered at the outset, when the structure is designed. These considerations are the same as in any other EU jurisdiction. In practice, heads of terms or a teaser are prepared for new funds to test appetite before launching process. New funds in line with previous funds set up by the manager will launch process with the preparation of the private placement memorandum. The ballpark figure regarding timescales is 18 months, although some very successful funds close within 12 months.

Key-man provisions, fees, expenses and remuneration policy, GP commitment, divorce, information rights, distributions, clawback and

## THE INSIDE TRACK

### *What factors make private equity practice in your jurisdiction unique?*

Changes to the regulatory and tax environments have opened the door to new structures in an industry open to flexibility and driven by efficiency. The Luxembourg local accent on legal flexibility provides considerable scope for the development of competitive structures that evolve quickly. This means that a successful private equity team in Luxembourg has the required technical skills in funds, corporate, finance and tax with a deep knowledge of market practice, through constant deal exposure.

### *What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?*

1. The track record of the team advising a client, both in Luxembourg and all the other jurisdictions involved in the transaction.
2. The availability and presence of the Luxembourg team for structuring the transaction and tackling Luxembourg law issues from the outset.
3. Third, the Luxembourg team's commercial acumen and knowledge of the industry of the portfolio company. Exposure to transactions with the relevant counterparty or counterparties of the same region or sector is also a huge advantage.

### *What is the most interesting or unusual matter you have recently worked on, and why?*

I honestly believe that all the matters I work on are interesting. Perhaps the most unusual structure I have worked on in 2015 involves a scheme between European private investors and a non-EU state with a view to entering the private equity market.

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escrows and exits are among the key terms to be negotiated with investors.

The most significant change on the Luxembourg market is the predominance of limited partnerships (with or without legal personality) as the preferred form for setting up private equity funds in Luxembourg. The SCS (as a Scottish limited partnership and a Delaware limited partnership) has separate legal personality. The SCSp (as an English limited partnership and a Cayman limited partnership) does not. Despite the lack of legal personality, the assets contributed to the SCSp are registered in the name of the partnership and can only satisfy the rights of creditors that have been created in relation to the creation, running or liquidation of the SCSp. Therefore, the assets of the SCSp are not available to personal creditors of the general partners or the limited partners, but only to creditors of the SCSp. The introduction of the SCSp with the implementation of the AIFMD in Luxembourg

has led to 523 instances of the establishment of this type of vehicle, from the time of its creation with the AIFM Law up until mid-March 2015. No statistics are currently available on the number of unregulated structures used by PE funds. In practice, 80 per cent of the structures we set up are unregulated funds.

### *GTD: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?*

**AA-C:** Private equity fund managers based in Luxembourg are subject to AIFMD requirements: they must register with the CSSF with assets under management of less than €500 million with no leverage, or less than €100 million with leverage. If these thresholds are exceeded, CSSF authorisation is required and the AIFM will have to comply with all requirements set out in the Directive regarding reporting obligations, disclosures, capital and depositaries. Regarding governance, investor protection has been strengthened as the shareholders of AIFMs have to prove (1) honesty, integrity and transparency, and (2) sufficient financial solidity to ensure the AIFM's long-term equity needs. Conflicts of interest are also reviewed by the CSSF as part of the authorisation process. The vast majority of AIFMs in Luxembourg are registered as small AIFMs as opposed to authorised AIFMs.

### *GTD: What effects has the AIFMD had on fundraising in your jurisdiction?*

**AA-C:** Despite the challenges of more stringent regulation, the AIFMD has had a positive effect! Luxembourg was a leader in implementing the AIFMD, which was an opportunity to roll out a new regime for limited partnerships, matching the expectations of many investors familiar with common law partnerships set up in the United Kingdom, Delaware or the British Virgin Islands. Since the reform, existing funds set up outside Europe have migrated to Luxembourg from offshore jurisdictions; other offshore funds have a parallel structure in Luxembourg to attract European investors. Also, AIFMs set up outside Luxembourg can now obtain their AIFMD passport to manage alternative investments funds in Luxembourg. The number of AIFs set up in Luxembourg continues to increase and Luxembourg, with €2.6 trillion assets under management as at 31 December 2014, remains the second-largest global leader for domiciled funds after the United States. Luxembourg is gaining significant ground against offshore centres.

The PE industry has a strong appetite for Luxembourg limited partnerships – a fund structure that is universally understood by investors. The AIFM reform, with revamped partnerships (the

common limited partnership (SCS) and the new form of limited partnership (the special limited partnership (SCSp)), brought in new players to the Luxembourg market and also attracted to Luxembourg major European sponsors based in other European countries.

**GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?**

**AA-C:** The challenges in Luxembourg are, most likely the same as in many other jurisdictions, caused by the uncertainty of the tax landscape with the OECD's base-erosion and profit-shifting project. Some structures, including structured securities such as a MRPS, have been reorganised given that such securities are challenged nowadays. There are also major positive tax reforms for the PE industry. A new regime was introduced for carried interest, with a reduced tax rate. Broadly, employees of the manager of an alternative investment fund (AIF) and of the AIF management companies can benefit from a full tax exemption on a capital gain realised on the sale or redemption of their interest in the AIF, if the holding period exceeds six months and the interest does not exceed 10 per cent of the AIF; this is a reduced tax rate of about 10 per cent on the

carried interest for a maximum period of 10 years from the year the employee applied for the regime or started his or her functions in the AIF, subject to certain conditions including, among other things, the transfer of the employee's residence to Luxembourg, the structuring of the carried interest as an incentive based on the net assets of the AIF or its profit and the payment of the carry subject to the LP's recovery of its investment in the AIF. Other major tax reforms included an exemption on VAT on management services provided to the AIF and the absence of taxation in Luxembourg for AIFs established outside Luxembourg if these AIFs are managed and controlled in Luxembourg by local managers or a local management company.

**GTDT: Looking ahead, what can we expect? What will be the main themes in the next 12 months for both private equity M&A and for fundraising?**

**AA-C:** 2015 looks close to 2014 in terms of levels of activity for both investments and exits, with the availability of financings. The outlook is therefore positive with variations on themes similar to 2014's. While China is slowing down, we will continue to see major acquisitions by Chinese investors in key sectors such as consumer goods, health, medical and retirement, and food manufacturing.



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