FUNDRAISING

Three-way growth

Hong Kong-based Arch Capital's ownership structure now reflects 'three corners of a triangle', underlining its confidence to launch a bigger second fund

The LPs of Hong Kong-based Arch Capital Management's inaugural real estate fund could be excused for feelings of trepidation when, at the start of the year, they learned that 50 percent of the fund manager was to be sold by original sponsor and seed investor Ayala Corporation. Further trepidation would be understandable given that the acquiring party was a New York-based alternative investments fund manager – The Rohatyn Group.

However, following its annual general meeting in January, Arch's entire 20-strong LP pool approved the transaction. Why? Not only because the "fingerprints" of the Philippines-based conglomerate would remain all over the almost 30-person firm, but because Rohatyn's investment reflected a strategic expansion rather than a fund investment with a finite lifeline.

In March, the three firms announced that Ayala had sold its 50 percent position in Arch to Rohatyn. In exchange, Rohatyn enabled Ayala to increase its existing stake in its $3.2 billion emerging markets asset management business.

"We started with two shareholders, but now we have three corners of a triangle," said Richard Yue, Arch's co-founder and the holder of the other 50 percent stake. "Ayala is basically restructuring its ownership while maintaining all its affiliations and support," he explained, adding that Ayala will continue to support the firm operationally and, crucially, with its capital.

Indeed, as *PERE* revealed last month, Ayala will invest $50 million in Arch Capital Asian Partners II, Arch's follow-on fundraising effort. Ayala had committed $75 million of seed equity to Arch's maiden fund, Arch Capital Asian Partners, which raised $330 million for investment in China, Singapore, Macau, Thailand and India.

Yue and Cosgrove: Key men

With the first fund almost fully invested, Arch is looking to raise up to $500 million in equity for the successor vehicle. The new fund aims to return between 18 percent and 20 percent, similar to the first fund, and will be deployed up to 60 percent in China and up to 20 percent in Singapore. A first closing is expected this month.

In a key nuance, Ayala's strategic shift has afforded Arch the capacity to invest in The Philippines for the first time, using up to 10 percent of the new fund's capital. Yue said: "We didn't touch the Philippines last time because we didn't want people to think we were starting a fund to place Ayala's development assets into." That said, he admitted that access to Ayala's pipeline could result in joint investments with its subsidiary, Ayala Land.

One key factor in convincing Arch's LPs of the growth of its business was the retention of Charles Cosgrove as the fund's key man alongside Yue. Formerly with Ayala, Cosgrove, regarded by peers as one of the firm's best fund managers, has joined Rohatyn as part of the strategic shift among the three firms.

Speaking again of Arch's LPs, made up predominantly of European and Asian institutions, Yue said: "We answered all of their questions, addressed all their concerns and, at the end of the day, got 100 percent approval. You have Ayala fingerprints all over this place, and that is a big assurance for them." □

Natural evolution

The Rohatyn Group's investment in Arch Capital also represents the next step in its growth plans

Rohatyn: increasing its exposure

For Nicolas Rohatyn, the ex-JPMorgan executive who founded emerging markets investment manager The Rohatyn Group, the three-way investment between his firm, Arch Capital Management and Ayala Corporation was a natural evolution for each business.

From Rohatyn's perspective, acquiring 50 percent of Arch provided the 120-staff firm with its first entry into direct real estate in Asia. With only $250 million of its $3.2 billion in assets under management invested in real estate, Rohatyn noted that his firm has had a "long-standing interest" in increasing its exposure to the sector. The firm's prior real estate investments, primarily defaulted real estate loans, land and agriculture, were made via its Special Opportunity fund.

"In general, real estate follows macro evolutions in emerging markets," Rohatyn said. "An interesting set of possibilities stem from the growing middle class, investment in infrastructure and low domestic interest rates. Asia has those things in spades."

Richard Yue, Arch's co-founder, said Rohatyn's ownership will afford it greater resources, including the infrastructure of a global organisation, better macro-research and, most importantly, access to the firm's investor rolodex. "For example, they have sovereign wealth funds among their investors, whereas we do not," he noted. That, he said, would aid it in its fundraising efforts.

Rohatyn would not comment on fundraising matters, but he agreed that his firm's investment would greatly help Arch's expansion plans. "We'll bring an institutional-calibre platform to Arch that, as it evolves, it will need," he said. "Also, being part of a dedicated emerging markets firm should help them in forming macroeconomic views. That's harder for 'bottom-up' private equity businesses."