Goldman Sachs Exchanges: Great Investors
Private credit investing with Ares Management's Mike Arougheti
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Alison Mass: Welcome to Goldman Sachs Exchanges - Great Investors. I'm Alison Mass, chairman of Investment Banking within Goldman Sachs's Global Banking & Markets business and your hose for today's episode.

Today I'm thrilled to be sitting down the Mike Arougheti, the co-founder and CEO of Ares Management. Ares is one of the world's largest and most respected alternative asset managers with more than $400 billion in assets under management and a market cap of over $40 billion. Ares is a top player in real estate, private equity, secondaries, and many other businesses. But what really makes them stand out is their prowess in private credit. Ares is one of the biggest direct lenders in the world. And that's no accident.

Today, I'm so excited to find out how Mike built up that business and where he thinks this red-hot asset class is going next. So, Mike, welcome to the program.

Michael Arougheti: I'm so happy to be here. Thank you.

Alison Mass: So, let's start right at the beginning. You graduated from Yale where you majored in ethics, politics, and economics. Then went onto a storied investment bank called Kidder Peabody. Which I'm probably one of the few people left--

Michael Arougheti: Who still knows what that is.

Alison Mass: On Wall Street who knows what that is. So, what attracted you to a career in finance? And do you have any memories from that first job?

Michael Arougheti: Yeah. It's so funny because now I have a college-aged son and watching him go through his own process, you realize just how little you really know when you get out of college. And I always had an entrepreneurial bent, like a desire to build businesses, but I didn't really know what a career in finance would mean.

Candidly, I graduated early in three years. And I had no friends around me that were actually going through the job process. So, luckily, someone who I was friends with the year prior to me got me this job at Kidder Peabody. Sounded pretty cool. The pay was good. I think it was $26,000 back then, which was quite exciting. And I went for it. And the rest is history.

The funny thing is now sitting here running Ares and talking about culture and the younger generation, the memory I had was just I don't think I've ever worked that hard. I don't know if I ever will. I know that you know this. But it was 100 plus hour weeks constantly.

My first apartment was across the street from the office. So, Kidder Peabody was--

Alison Mass: Not a good strategy.

Michael Arougheti: Right? Bad. But that was how I said I'm going to cope. So, it was 10 Hanover Square. My apartment was 3 Hanover Square. So, I lived for two years in this 100-yard radius.

But the reason it was a good memory is to have a bed that close to the office proved to be quite the asset for the entire group of analysts and associates there. So, it's like that movie *The Apartment* where everyone has a key to Mike's apartment. But it was an incredible training ground. And just the discipline and the work ethic and the attention to detail, it was a great foundation for me.

Alison Mass: Yeah. Did you grow up in New York?

Michael Arougheti: I grew up in New York, yeah. In the northern suburbs. So, I was familiar with the city. But I don't know why I chose it. Hanover Square back then, literally, if I had to go grocery shopping, I had to get on the subway and go to 14th Street.

Alison Mass: No, I remember that. I remember that.

Michael Arougheti: Because there's nothing. Yeah.

Alison Mass: I did the opposite. Like, when I started down at Drexel in 1981, I decided to do the exactly the opposite. I got an apartment on the Upper West Side under the theory that even if I went home at 2 in the morning, I would at least see the city on my ride home and my ride back. And would maybe pass Lincoln Center or something that would give me some joy.

Michael Arougheti: You're probably passed out in the back of the car and missed it anyway.

Alison Mass: I'm sure I did many nights. But I had the exact opposite view because my dad had said, "You should get an apartment downtown because it will be easy." But I took a different tact. But I like the $24,000 a year, actually. Fun fact. Ken Moelis and I started the same year at Drexel. $36,000 a year.

Michael Arougheti: Wow.

Alison Mass: And I was shocked that somebody was willing to pay me that much money.

Michael Arougheti: That's incredible.

Alison Mass: Yeah. All right. So, back to your career. What brought you to Ares in 2004?

Michael Arougheti: So, the short answer is Bennett Rosenthal. And back to the whole Drexel connection, I left Kidder with a bunch of Drexel alums to go to a place called Indosuez Capital, which if you actually look at who was there and what we were doing, a lot of folks that are now actually prominent in private credit did some time there, including my current partners that run credit. And we were very early partnering with a French bank to make middle market loans to private equity firms. But in a way that feels a lot like the business now.

And in 1997, we were looking to expand. And we interviewed Bennett, my now a very close friend and partner, because he had worked for Les Lieberman as an associate at Drexel. And I was working for Les at the time. And so, we sniffed each other out a little bit, and then ultimately, Bennett chose to move to L.A. and go work at Apollo and then, ultimately, spun out Ares.

And he called me in 2003 to say, "Hey, we're building this thing, and we see this opportunity in private credit, do you want to join?" And it just so happens that we had spun out of yet another bank. We had a portfolio of assets. We had a team of about 15 people. And so, we joined forces, and the rest is history.

Alison Mass: I never knew that story about Bennett. I'm glad I asked the question.

Michael Arougheti: Well, Bennett likes to joke. You had two New Yorkers, fairly young at the time, hair gel was still a thing. And we were sizing each other up. And the way he tells it, he goes, "I'm sitting there. I'm looking at this young guy with this slick backed hair and I'm like, I really like this guy. But I-- I don't know." And I tell him I was thinking the exact same thing when I had met him too.

Alison Mass: That's hilarious.

Michael Arougheti: So, but careers are all about the people that you encounter and those relationships. And Bennett, obviously, had good vision to understand the opportunity. But obviously, we trusted each other. And so, it was a big move for him. And it was a big move for us too.

Alison Mass: Yep. All right, so has Ares always been a player in direct lending? Can you give us some of the history there?

Michael Arougheti: So, the answer is yes. The firm actually got its start managing market value CLOs, which again, people don't talk a lot about. But probably the worst investment vehicle ever invented just in the sense of the mark to market and the asset liability mismatch. But what was great about it was it gave you the flexibility to invest in liquid credit, illiquid credit, equities, etcetera.

So, I think one of the reasons that we are as well positioned as we are today is our first funds were go anywhere investment vehicles. And the earliest partners and teams were investing in equities, bonds, and loans, CLO securities, and mezzanine, which in the early days of private credit was how a non-bank which participate in the mezzanine business.

And the way that we came together with Bennett at the time was we were sourcing a ton of private credit at the time and were, effectively, partnering with those early vehicles on these mezzanine investments. So, there was an understanding of that business.

But I think even in the early days, and this is where some of the early mover advantage came in, most people were still wired to the capital markets, right? They were coming at the illiquid credit market from the perspective of the loan and bond market or the private equity market. Where you were the client, right? So, you would sit around. You'd wait for the phone to ring. Someone would show you the deal. You'd evaluate it.

And we were trained through our banking background to go out and really source and originate. So, yeah, Ares has always been buying private credit. But I think the big pivot for us is when we decided to really, you know, invest, grow the BDC, was that early emphasis on going out and sourcing and really creating our own flow.

Alison Mass: So, for our listeners, I want to ask a really basic question. What does it really mean to run a direct lending business? I think our listeners will be familiar with the basic idea. You raise money from investors. You use that money to make loans to businesses, which they hopefully repay with interest. But how does that business function on a day-to-day basis? And where is the value really created?

Michael Arougheti: It's a great question because it's a very simple business as you articulate it that way. But it's complicated because in order to do it well, you have to do it at scale. You have to do it repeatedly. And it seems easier than it is. Because if you think about credit generally, it's great when it works. But the problem with the asset class is if you do everything right, you get your coupon. And if you're wrong, you can actually lose all your money. And so, it is from an asymmetric risk standpoint, it's probably a pretty bad asset class.

So, the goal in direct lending is not to lose money while continuing to capture excess return. And so, the way that you have to think about building value is you have to create broad origination networks in local markets so that you can get to deals before other people see them. And you have to surround those deals with flexible capital, scaled capital, and real client service, right? Because ultimately, the reason that people are borrowing in the private market, they're getting some creativity and structure or terms or some innovation around your ability to grow with them and support their business plan that they're not getting somewhere else.

And so, I think we learned early that the tip of the spear for value creation is origination. And that sounds so simple. But it's really hard to do. And the reason it's hard to do is we say no to our clients 95 percent of the time. And when you're trained in banking, you try to say yes to your clients 95 percent of the time.

And pivoting to the point where we can actually be a real valued partner to our clients, but not get to yes all the time takes some getting used to. And you have to build trust over decades, not years, decades where you're supporting people and helping them make money and going through bad situations, etcetera. So, origination's important. Relationship is key. And I think that's key in all of our businesses. But when people used to say relationship lending, we would cringe because that just means you're mispricing risk, right?

Now when we talk about relationship lending, it's really through the lens of people have choices. They choose to do business with the people that they trust and that are aligned to whatever their vision is. And that's not easy to build.

And then I think you really have to think about these markets as evolving, right? You have to be constantly innovating around the service and the product that you deliver to your client. There are a lot of folks that started in the business when we did who were very anchored in mezzanine because that's what was available. And when the market started to innovate around things like unitranches, right, or even covenant lite, you could get anchored on the old way of doing things.

But today, private credit is not just lending money to middle market companies. It's lending money to infrastructure projects and real estate assets and structured credit and partnering with banks on balance sheet solutions. So, it's become this whole new pillar in the capital markets that's actually a pretty exciting place to be.

Alison Mass: So, I want to get back to innovating later because Ares is certainly at the forefront of innovating in your industry. But before I do that, I want to talk about you as a leader. You became CEO at the start of 2018 taking over from Tony Ressler. So, I want to understand what that transition was like at the Ares level in terms of the company. But as importantly, what was it like for you personally? And did you feel like you had to change from being more of an investor to a leader?

Michael Arougheti: It's a great question. So, I was fortunate when I took the job in 2018. I had been the president and COO of Ares for six years prior. So, I had already gotten a lot of reps in running the company. And a lot of the growth that we enjoyed and the diversification globally came through the credit side of the business. So, I felt connected to a lot of the parts of the business when I took that role.

That said, it's almost like when you get married, things change. I was with my wife for 10 years. And you say to yourself, we're going to get married, it's going to be the same. But when you do, it's serious. Things matter more. They have consequences.

And so, I did experience the transition from COO and president to CEO as a deeper sense of responsibility and a more profound sense of service to the teams and the company. And that was pretty energizing.

It is a tough transition because if you grow up your whole life in the deal business, you get into a rhythm of just transacting. And it's really energizing. Closing deals is incredible.

Alison Mass: Without a doubt. Yep.

Michael Arougheti: And we all get hooked on it. And when you stop doing that, you have to find the way to scratch that itch. So, I'd like to think one of the reasons why we're so growthy in the way that we approach our business is because I have effectively looked at Ares management as my deal, right? I want to invest in it the same way I used to invest in businesses, but do it all in one place.

So, I've been able to find whether it's through M&A or new product development, to go back to my roots on the investing side. Because it's why I got into the business in the first place. But it's a tough transition. And the cadence of business is different too. You don't get the immediate gratification.

Alison Mass: Right, it's longer term, strategic focused.

Michael Arougheti: Yeah. Private equity folks, and I say this lovingly and with a lot of self awareness, we're great at telling other people how to do succession. But we're usually pretty bad at it ourselves, right? I mean, we're kind of experts in organizational design. But we're usually pretty bad at shining the light on ourselves. And I think as we and others in our industry have matured, we've gotten much more professionalized and institutionalized in the way that we think about things.

But the one thing we knew was that any good succession requires forethought and planning and a lot of trust. But it also requires the person who is vacating the seat to actually make room. And Tony, I think better than anybody, understood that. And his transition was probably harder than mine. Right? To go from a CEO to a chairman and really allow for decisions to be getting made and to trust those. But he did what he was supposed to do and gave me a lot of runway and a lot of leeway and a lot of support. And I think it's a really good example of what good succession looks like. And I'm hoping that that now is a pretty good cultural lightning rod for the rest of the firm to understand how we do it in the future.

Alison Mass: Yeah. Sounds like he's a great leader in having recognized that.

Michael Arougheti: Yeah.

Alison Mass: I want to go off piste for a minute and ask you how would you describe your leadership style? And if I was here with the 10 most senior people at Ares who report to you, how would they describe your leadership style?

Michael Arougheti: I'd like to think of myself a little bit as a servant leader. I tend to lead from within as opposed to from without, like in the trenches with people. I am pretty hands on, but not micro manager in the sense that I'm engaged and there to help.

I'd like to think that I'm approaching my leadership with a sense of humility, which is empowering to the people that work for me because I don't think that they perceive me as having interest in anything other than supporting their growth and success.

Our values as a company, it's interesting, one of them is self awareness. Which I always struggled with because sometimes it can sound pretty arrogant to say we're self aware. But what we tried to capture with that was one idea that we have a willingness to fail and not dwell on it, right? And that we've built trust with each other that we can actually make mistakes so that we can move forward. And I think I'm a compassionate leader in that sense where I think I'm trying to push people outside of their comfort zone and doing it in a way where they feel supported to go out and take those types of risks. And I think that mindset around risk taking and growth has been a big part of our success.

Alison Mass: So, your recent growth has been really amazing. Ares carved out a niche in what's become probably the single hottest area in finance.

Michael Arougheti: I think *Forbes* called it the sexiest business on Wall Street, didn't they?

Alison Mass: Okay. Well, you can say that. I just call it hot. And you've done an amazing job of capitalizing on the opportunity. So, you've always had a successful business. But was there a specific moment when you realized you were onto something much bigger? And is there a lesson there? Is it more about foresight? About knowing where the opportunity is coming from? Or is it about capitalizing on it when it comes?

Michael Arougheti: I think it's both. I think it's both. In each of our businesses, we were religious planners, right? So, we are annual strategic plans and budgets and three and five year growth plans. And then what we would call moonshot scenarios where if X, Y or Z happens, what does it mean for us? And so, we go into each of our business builds with a really good roadmap for what we think success looks like. That's important whether you're doing something organically or you're doing something inorganically, because again, everyone needs to know what success looks like in order to celebrate it and know when you got there. And the planning is a big part of it.

And then I guess that's the foresight and being open to things happening. But when you see things opening, you have to have a willingness to invest behind growth. And that goes back to this risk taking because you never really know. I can't say that we knew that direct lending would grow to be what it is today. But we knew what it took to be successful. We had identified how big we thought these addressable markets were. We made the investments.

If I think about our European direct lending business for example, which is a large market player now, we started building teams across the continent in 2006. We didn't make money in that business for, you know, five or six years. And it's hard, especially when you're in a small partnership and you're making investments with a long pay off to really sustain those.

And so, I think we've always had good vision of where we wanted to go and an openness to what the possibilities were. But I don't think anybody in our business, private markets generally, could ever have really appreciated how large the private market opportunity would be with private credit, obviously, at the top of the list.

Alison Mass: Yeah, I would say the same about the private equity business for those of us who were involved in the '80s and '90s. I don't think any of us ever could have imagined that it would be such an important part of the global economy today.

Michael Arougheti: Yeah. Look, you have to trust your own instincts and filter too. So, going back to even private credit, private credit has evolved. You know? It was fairly cottage. It served a purpose in the markets supporting private equity firms. But it was not very innovative, right? It was high-rate coupon mezzanine with warrants. And as the market started to evolve, if you were not willing to evolve with it, and many weren't, you got left behind. So, there were a lot of people that were early to this, but to your point about foresight but seeing the evolution, just kind of missed it.

And so, that goes back to that self awareness point of challenge things. Like, could this be more? Where could we grow? Or is the growth inappropriate and don't chase it? There have been a number of opportunities that we've looked at where we haven't pursued it because we just didn't trust it. And didn't feel like we could bring the competitive advantage or insight to a market where we would actually win. So, part of it is just you hone that filter over time with your partners and, hopefully, it gets better, you know, the more you do.

Alison Mass: Sensible. So, I mentioned Ares's incredible growth. And much of the actual core team has stayed together for 25 years. So, how did you keep the band, so to speak, together for so long? And how much do you think keeping that core DNA of that team, yourself, Kipp deVeer, Mitch Goldstein, Michael Smith, was a driver of Ares' success?

Michael Arougheti: I think it's the biggest driver of our success. And it goes back to my comments about Tony. You know, investing is all about trust because you're not right all the time and you have to defend an idea and take real risk behind it. And if you're doing it with partners, you have to trust one another. And trust is hard, generally as a human. It's hard at scale, right?

Back to what kind of leader am I or what's the culture, we're fortunate that we all grew up in the business together. Right? And so, when your best friends in the world are your business partners and you go through cycles together, it just becomes easier to do things, right? There's no second guessing. There's nobody who's not holding up their end of the bargain. Everybody's just running at speed together.

And so, I go back to those early days of the smaller partnership, and I would add Tony and Bennett and John Kissick and others to that list, deep sense of trust emerged. And so, the people who are partners at Ares now were analysts here 20 years ago. And so, they saw that. And they've role modeled it and repeated it and replicated it. So, I do think the culture here is a really big driver of our success. And unlike others in our business, this is a team sport. I think most people who thrive at Ares want to be part of a team. Like, they want to be part of a team that's winning. But doing it together. Whereas I think certain investment houses are more about who's the star athlete on that team and how do they win? And we've tried, because of this DNA and this friendship, to not let the ego seep into the business. And I think that's been a big benefit to us.

Don't know if it works for everybody. But it's definitely worked for us.

Alison Mass: Yeah. Well, it certainly works here at Goldman. I mean, I think the continuity of leadership and the fact that our partnership can be, I always say, constructively contentious with one another, we get to better outcomes. For sure.

Michael Arougheti: We see that, yeah. We see that too.

Alison Mass: So, what's also amazing is that you have grown without sacrificing the culture. And as a leader, how do you maintain a tight knit culture as you've grown so quickly?

Michael Arougheti: It changes over time. And this has been part of my own evolution as a leader. When you're smaller and younger, you don't really talk about culture, you just model it. Like, this is what good culture looks and feels like. Because you can have a personal relationship with most of the people in your company.

And then as you grow, you begin to understand that you have to define who you are and what you stand for as a company. And we've done that where we've basically articulated who we are, who we want to be, what our mission and values are. And we've tried to align people to that.

And that's been incredibly energizing, productive, and a big leap forward for us. Because you move away from this idea of culture is what happens in the office every day to this sense of higher purpose and calling. Which again, done at scale is really powerful.

So, employees at Ares, we talk about culture and the reason for that is great culture can drive outperformance, right? It can drive outperformance around the investment committee table. It can drive outperformance at the company level. Provide stability. And frankly, it's just a better work environment. You retain talent. People feel more fulfilled. So, we talk about culture a lot.

And it's so interesting now because we've gotten so global and so diverse, but the culture's gotten stronger because we're just finding interesting people from all walks of life and all over the globe that are aligning to our values. And so, the conversation for us always comes back to service and values and understanding why we come to work everyday, and not just what do we do for work. And it's working. But it's hard. At scale it's really hard. You have to really work at it.

And you have to be willing to adjust it too, right? I think we have found what worked ten years ago doesn't work now. And I'm pretty sure ten years from now we're going to have to do different things to make sure that the culture stays intact. But it's been a blessing so far.

Alison Mass: Have you ever read those books, *The Seven Habits of Highly Effective People*? And there's one *Seven Habits of Highly Effective Families*. Somebody should probably write one *Seven Habits of Highly Effective Companies*. But if you read those books, they talk about having a moral based or character based or value-based home or center. And then every decision you make comes from that. And therefore, it's very sensible and thoughtful.

Michael Arougheti: Yeah. And I think people pay us to generate investment returns. So, that is what we do for a living. But what we try to talk about, which makes it very powerful as you think about who benefits from our investment returns, we manage money for state pension plans and insurance companies and retirement portfolios. Like, when you really drill down the tens of millions of lives that are dependent on our returns, that changes the game, right? Now you're not just showing up and saying, how do I generate return and promote. You're saying, how do I actually not mess this up because I've got 20 million people who are relying on me doing my job?

And so, we have created a real sense of responsibility at the company that, I think, is pretty unique in our business.

Alison Mass: So, I'm curious for your view on the outlook for direct lending given the current economic cycle. To a lot of people, the asset class seemed to almost come out of nowhere in the past few years. But of course, it's been around a long time and Ares knows that. But where do you think it's going next?

Michael Arougheti: There is a scientific term. I'm not going to remember the name for it, but I will ping you after this conversation, which is the term to describe when you see something that you haven't seen before that's been there all along, you can't stop seeing it. It's like ocular something. And I only mention that because in every other part of your life, it happens to you every day. Like you see something on the street that's been there for 20 years, and you never noticed it before. You walk by it and all of a sudden you can't stop looking at it. That's what's happening in direct lending right now. This is a market that has been here for 30 years. And it's been just chugging away.

And interestingly, when you look at the growth, private credit has grown a little less than 15 percent compound for the last 10 years. Guess what? So has private equity. Grown 15 percent. The loan and high yield market have grown in the low double digits. The reason I think private credit is being perceived as growing faster is it's just a straight-line compounder. Right? So, there's no ups or downs. You don't have an up 30, a down 20. There are no drawdowns. And so, you know, it just keeps clipping away at a, you know, 10 to 15 percent. And then all of a sudden, the numbers get pretty large. But there's nothing to evidence that it's grown disproportionate to other parts of the capital markets, which is how we get recentered on are people taking appropriate risk or what's the right pricing for the risk that we're taking?

And so, I think direct lending and private credit still have a long, long way to go. There are structural things in play, just in terms of the aging of the population and people's desire for dependable yield that's creating demand for private credit. The private equity ecosystem continues to grow and expand. That's creating demand for private credit. The loan and high yield markets continue to move to scale. And they're servicing ever larger borrowers. That's creating demand. Commercial banks around the globe are dealing with new regulatory capital frameworks and, particularly in this rate environment, that's seeing transition of assets. So, there are a lot of just secular tailwinds for direct lending, putting aside the globalization which is one of the things that excites me the most.

Because when I look at what we've been able to do in Europe in the last 15 years, what we're building in the Asia Pacific markets, these private credit themes are in place in those markets. But the markets aren't nearly as evolved. Even if you allow for some maturation of the US market, it will still be a very large capital market that may not be growing 15 percent. It may be growing 8 or 10 percent. But there are markets that haven't even opened up yet, you know, that if you're early and you're willing to take risk and make investments in those markets, I think there's huge growth.

Alison Mass: How is Ares positioning itself to get ahead of all of those themes that you mentioned?

Michael Arougheti: Yeah. We're making investments and we're executing on the same playbook. We have a fully developed origination and investment footprint across the Asia Pacific region. We're putting people in offices with a really diverse set of product to go find deals.

It's like the old days here, you know? And so, maybe you asked the question earlier about what it was like back then, when you go into these markets, you do get a feel, you get a little taste of the good old days because they're running around these markets in a way that we were here 25 - 30 years ago. So, you've got to do that.

And then in certain parts of the world, for example we have a partnership with Vinci Partners, which is a Latin American based alternative asset manager. We have a long-term view that the Latin American markets will evolve and open up over time. It's a little bit too far a field for us to take on right now. So, we're doing it through partnership. But again, we're keeping those options open, right? We want a front row seat to the development of these markets. And so, if we can't do it directly, we're going to do it through partners who can help educate us so that when those markets turn, we want to be there.

Alison Mass: Whenever something gets really hot, there are inevitably questions. And some people wonder if private credit can stay hot if rates fall. And conversely, some worry that rising rates will be a problem for private credit because borrowers could have a harder time paying back their floating rate loans. But I want your perspective. How do you think about the dynamic between interest rates and direct lending returns?

Michael Arougheti: It's always one of those things to your point when things get, quote/unquote "hot" people always worry that there's risk there that they don't understand. And I get that. Because sometimes it's true. And sometimes when something is too good to be true, it could just be that good, right?

So, the reason that private credit is so attractive is it's a floating rate asset. Short duration. Self structured. Self negotiated. Actively managed in partnership, usually with some sophisticated owner of a company or an asset. And the components of return are upfront fee, base rate, credit spread, and some form of call protection.

And so, the way the asset class functions is when rates go up, credit spreads moderate. And if rates are going down in response to weakening economic fundamentals, credit spreads gap out. So, if you look at the history, at least through the Ares' lens, while you make more money in markets like this. You don't give it back when rates start to recede. Because when they do, you're either restructuring some parts of your book and getting incremental compensation. And then the new loans that you make are coming at significantly wider credit spread that tend to overcompensate for whatever the reduction in the base rate is.

So, it presents a surprisingly stable total return to the investor. And I think that's one of the reasons why it's getting so much uptake in the investor community, because when you go back and you actually underwrite the history of returns: durable. You know? And we're making money when rates are going up. We're making money when rates are going down. We're making money in volatile markets and good markets. But it's the components of return change. You do have to have the full product set and ability to move around those different components, which speaks again to the scale of your capital, how flexible is it to pivot and move. But if you can, you're going to capture whatever the market return is and, generally, it's pretty range bound.

Alison Mass: You've also been leaning into asset based lending or alternative credit as a growth area over the last five years. And for our listeners, can you explain what that is? Where you see that going? And are there other growth areas for Ares that you're looking to build up, including, you talked about Latin America, but from other geographic perspectives?

Michael Arougheti: Yeah. So, alternative credit and asset-based finance is probably one of the hotter corners of the, as you described it, hot private credit market. And I think that's a function of a couple of things. One, it is squarely in the middle of this bank balance sheet conversation that has been happening over the last two years.

Two, with the continued growth in alternative asset manager affiliated insurance platforms, you're beginning to see more linkage between those insurance companies and the growth in the rated side of the asset-based finance market.

And three, as we are getting larger and folks like us are getting larger, we're able to aggregate capital in teams against this market opportunity in a way that we couldn't, you know, 10 years ago.

At its simplest form, the way that we think about it, if direct lending is lending directly to a company or to an asset, alternative credit is lending to a pool of assets, so long as those assets generate cash flow. And so, that's everything from auto receivables, credit card receivables, shipping container leases, music royalties, healthcare royalties, net lease residential solar securitizations. You know, there are 20 plus end markets that we participate in.

And what's so exciting about that, what I've always loved about the private markets business, is everywhere you look is a private company. Whoever makes the components on the microphones that we're speaking into is a family-owned company somewhere. And when you get into the deep world of alternative credit, things you do in your daily life creates an asset with cash flow attached to it. So, when you start to really walk down the street, and in fact, my point about once you see it can't unsee it, I look around and all I see are securitizable assets.

Alison Mass: That's a little sad, just saying.

Michael Arougheti: I know. It's pathetic. That's what makes a market, right?

Alison Mass: Exactly.

Michael Arougheti: But it is amazing because that is why it's getting so much attention. Because I think people are understanding as the comfort level with these structures is improving and the flexibility of the capital that's available to the aggregators of these assets is also improving in terms of the ability to innovate and customize, it's a pretty big world. And so, rightfully so, I think it's getting a lot of attention.

Other places we're spending a lot of time are in and around real assets. So, real estate lending, infrastructure lending. Some of that is around opportunistic where we think that we're just going to see the install base of credit need some form of refinancing to the new rate environment. And some of it is just secular opportunities like the next wave of data center rollouts that will require trillions and trillions of both debt and equity to come into the market that doesn't currently exist.

Alison Mass: All right, before we get away from your core business, I just have to ask you from your seat, how are you thinking about the economic outlook right now? Because you sit atop of an important global firm. And we've seen widespread recession concerns move to a fairly constructive outlook for the economy globally. So, how are you thinking about the economic outlook right now?

Michael Arougheti: It's hard to have a single answer for a global picture. But we do touch a lot of small companies and assets and asset owners. And I would say, generally, the tone's still very constructive.

We have been consistent in that view for at least two plus years, so we were never on the recession train. One of the benefits of having the business we have is we're getting real-time information from our portfolios. And it's been constructive. Our corporate portfolios are still growing in the low double digit EBITDA range. Our real estate portfolios are growing NOI. So, it's clear that growth will slow. It is slowing. The consumer is quite resilient now.

And we're not alone in this view. I think you're probably seeing it in your client base. I think the commercial banks are seeing it in their client base. And most of our private credit peers as well, we've seen some cracks form in certain portfolios, I think are generally running at default rates significantly lower than historical averages. So, I'm still pretty constructive.

Labor market's tight. The system's working. So, we've absorbed a pretty significant rate shock. And nothing has, in fact, broken. And we're running at a good place here. Yeah, I remain constructive.

Alison Mass: Well, I'm happy to hear that.

Michael Arougheti: I'm going to leave here and a piano's going to fall on my head, by the way.

Alison Mass: No, no, that won't happen. Not outside Goldman Sachs. So, you also have a family of funds called the Pathfinder Funds. And I think these are pretty amazing. Can you tell our listeners how they work?

Michael Arougheti: Yeah, this is one of the things I am most proud of. And we had a portfolio manager that joined us, gosh, five or six years ago named Joel Holsinger to start to guide us through the next evolution of the growth of our alternative credit business. And he had an idea which we took to that we wanted to have 10 percent of the carried interest in those funds go to charitable causes that were near and dear to his and his team's heart.

And we had a very long conversation back to the sense of purpose in investing of aligning the profit that we generated to doing good in the world, right? Do good. Do well. And so, that was an eye-opening moment for us because what we saw was it changed the conversation internally back to culture. And these are large funds, right? This is a $40 billion business at this point.

And we very then quickly pivoted to stand up the Ares Charitable Foundation, which was we were going to take a percentage of our promote and contribute it into the charitable foundation. And align our performance to impact work.

And what's so exciting and cool about it is the work that we're doing is in areas where we actually can make a difference. Financial literacy. Entrepreneurship. Social equity. And so, we're going into the communities where we live and work and invest and we're actually able to take our profit and put it back in. And it's been really empowering for our teams and our investors because, again, I think they see our teams approaching their business with a deeper sense of responsibility than they were before.

And it's so funny how when you do something like that and people see it, now I think we have 10 teams around the firm…

Alison Mass: Who are doing the same thing?

Michael Arougheti: …That are doing the same thing. They said, I love what they did, I want to do it too. And they're raising their hand and doing it.

So, back to the culture conversation, that's something that just happened organically, right? We had to make the first step. We had to be pushed to do it. And recognize it. But then once we did it, it just took off.

Alison Mass: That says a lot about the people of Ares because people want to work for mission driven organizations. Right?

Michael Arougheti: Yeah, I think so.

Alison Mass: And it probably helps you attract and retain your talent too.

All right, so I can't let you go without asking you about the Baltimore Orioles baseball team. I will admit I am a Yankees fan. So, just saying. But you're part of a group that bought the baseball team, along with Carlyle Group's co-founder David Rubenstein earlier this year. And are there any lessons that you learned from running Ares that you're applying to the way you manage the Orioles team?

Michael Arougheti: That's a great question. We have a large sports investing business at Ares. So, away from my deep involvement with the Orioles, I've had an opportunity to kind of understand the business of sports.

The first thing I would say is there's a real opportunity just to modernize the business, right? A lot of sports franchises, the Orioles included, for better or for worse are family owned. They've been family owned for decades, if not generations. And so, the ability to come in with a partner like David and bring best practices and business to what was effectively a family run business is pretty exciting. So, there's just a lot to do there.

But maybe back to sense of purpose, both David and I believe that the Baltimore Orioles, while we own them, is a community asset, right? And if done well, and the community's appropriately engaged, you can have a real impact on the City of Baltimore, right? And so, we've tried to take that same sense of responsibility and come in with all humility and just say, if we could do better here, meaning if we can run a better business, if we can continue to sustain great performance and ignite the fans, if we can bring the community around this thing, game changer for the city.

And so, we're having a lot of fun. Don't get me wrong. But we're doing it in a way that I think is somewhat unique in sports ownership in terms of just the way that we're approaching community engagement, the way that we're even engaging with the fans in the stadium, to your point, it's different.

In the old days, owners of sports teams would sit up in some dark--

Alison Mass: Box, yeah.

Michael Arougheti: Window never to be seen. You know? And it was always there was this separation. And the same way I think that the younger generation of workers in our business want mission and they want to be part of something bigger and they want relatable leaders, I think the same is true for sports.

So, when you walk around the stadium as a fan, it's amazing how engaged the fans feel with you and the team. So, that was a big lesson there of just kind of leaning in on that because not necessarily what's been done before. But it's still early. But if the results are any indication, it's working.

Alison Mass: Yeah. Certainly is. So, we like to end these sessions with a lightning round. So, we're going to run through a couple of questions and just to get a quick answer from you.

Michael Arougheti: Like a one-word answer.

Alison Mass: One. Two. Three. Try.

Michael Arougheti: I'm not that good at short answers. But I'm going to try.

Alison Mass: Okay. So, what was your first investment?

Michael Arougheti: First investment was Charms Blow Pops that I would buy for a nickel in large bags. Chop them up. And sell them for 25 cents on the bus. Made a killing.

Alison Mass: Okay. I love that story. How old were you when you did that?

Michael Arougheti: I was probably 12.

Alison Mass: An entrepreneur from a young age.

Michael Arougheti: Yeah.

Alison Mass: What is your greatest strength as an investor?

Michael Arougheti: Healthy skepticism. Taking it slow.

Alison Mass: So, what's the best piece of advice that you have ever received?

Michael Arougheti: All you have is your reputation.

Alison Mass: I 100 percent agree with that. Which investor do you admire most?

Michael Arougheti: Oh gosh. There're so many. I'm going to go with Charlie Munger.

Alison Mass: Amazing how many people I interview on this show that say that. Or Warren himself.

So, how about your biggest mentor? Who's been your biggest mentor?

Michael Arougheti: I've been fortunate to have so many, both peer mentors and senior mentors. This is someone we talked about earlier. I would say John Kissick.

Alison Mass: You were lucky to have him as a mentor.

Michael Arougheti: Yes, I was. One of the highlights of my life.

Alison Mass: So, where do you spend your time outside of the office?

Michael Arougheti: Oh gosh. Golfing. Fishing. Playing the guitar. Camden Yards. Skiing. And, obviously, I have two teenage boys, so I try to spend as much time with them as I can as well.

Alison Mass: Are they baseball fans?

Michael Arougheti: They're Yankee fans. So, we're having a real--

Alison Mass: All right. I like your sons. And I haven't even met them.

Michael Arougheti: We're having a real problem in the Arougheti household right now.

Alison Mass: All right, so finally, what are you most excited about in the world right now?

Michael Arougheti: I tried, and this is not going to be a short answer, but I just, for this one, you know?

Alison Mass: That's okay.

Michael Arougheti: I struggle today just given the pace of information and all of the headlines and speed of news that we're losing the narrative. And so, what I'm actually most excited about is when you just zoom out and you try not to get caught up in the muck. The arc of human progress is actually quite remarkable, right? I mean, we're marking huge strides in global poverty reduction and medical advancements and life expectancy.

And I always try, whenever I'm getting sucked into the headlines and all of the partisan divisiveness just to take a breath and kind of get some historical perspective because there's a lot to be excited about, just in terms of where we are and all of the great things that happen day to day that I think people take for granted.

Alison Mass: That's good advice. So, Mike, it was a pleasure having you on the show. Thank you for joining us and sharing your fascinating perspectives.

Michael Arougheti: It was a real treat. Thank you.

Alison Mass: So, thank you all for listening to this special episode of Goldman Sachs Exchanges - Great Investors. I'm Alison Mass. This podcast was recorded on June 4th, 2024. If you enjoyed the show, we hope you will follow us on Apple Podcasts, Spotify, YouTube, or wherever you listen to your podcasts and leave us a rating and a comment.
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