A Value Investor

An Interview with Leon Black,
Chairman and Chief Executive Officer, Apollo Global Management, LLC


Leon Black

EDITORS' NOTE *Leon Black is also a Director of Apollo Global Management, LLC (together with its consolidated subsidiaries, "Apollo"; NYSE: APO), which he founded in 1990. From 1977 to 1990, Black worked at Drexel Burnham Lambert Incorporated, where he served as Managing Director, Head of the Mergers & Acquisitions Group, and Co-Head of the Corporate Finance Department. In addition to Apollo, he also serves on the boards of directors of The New York City Partnership and the general partner of AP Alternative Assets, L.P. Black is a trustee of The Museum of Modern Art, Mt. Sinai Hospital, The Metropolitan Museum of Art, and The Asia Society. He is also a member of The Council on Foreign Relations. Black is also a member of the boards of FasterCures and the Port Authority Task Force. He graduated summa cum laude from Dartmouth College with a major in Philosophy and History, and received an M.B.A. from Harvard Business School.*

COMPANY BRIEF *Apollo (agm.com) is a leading global alternative investment manager with offices in New York, Los Angeles, Houston, Toronto, London, Frankfurt, Luxembourg, Singapore, Mumbai, and Hong Kong. Apollo had assets under management of approximately $168 billion as of June 30, 2014, in private equity, credit, and real estate funds invested across a core group of nine industries where Apollo has considerable knowledge and resources.*

What is the secret to your company's success?

It comes down to two things: our people and having a differentiated strategy in terms of how we invest.

The people are smart across the board in the private equity industry, but one of the advantages we've had in constructing the type of firm we have operated here for the past 24 years is that most of the culture is represented by experienced professionals who, from the top down, are very credit-oriented. A lot of that came from our Drexel legacy.

Having worked with Mike Milken amid the burgeoning of the high-yield capital structure, we were all schooled in credit analysis, and understanding balance sheets and the risk-reward component of the whole capital structure, and not just looking at the equity component.

This has allowed us to have a differentiated strategy where we believe we can be a fund for all seasons, because we can invest alongside the rest of the industry during more robust periods. This means looking for good value in terms of opportunities with a reasonable economy and the assumptions that go with that. But when the economy reverses, we can find even better values when prices are low and most of the rest of the industry is inactive because they don't have access to capital.

Because we're so comfortable with our expertise that stretches across various industries and goes deep into companies' capital structures, we are confident working through the debt of those companies to perhaps having our funds end up with ownership during distressed periods.

Likewise, for some of the portfolio companies in the funds we manage that stumble during deep economic downturns, our funds are able to recreate value in those companies by being comfortable buying their debt.

This has allowed us to stay true to our core, which is being a value investor, as well as being able to put money to work across all periods. As a result, our private equity funds have outperformed the average returns for the private equity industry by a significant margin.

So at the end of the day, it's all about the people and the culture that was created from the start. We got underway and cut our teeth during a big economic downturn. But in all, we have had four downturns over the past 24 years. Unlike most participants in the industry, which lay dormant during the downturns, we put about 40 percent of the capital in the funds we manage to work during those periods.

Meanwhile, our orientation has also allowed us to build up a big credit operation. Today we manage more than $165 billion of assets, with about $50 billion in private equity, which is the most profitable part of what we do. However, we also now manage $105 billion of different credit products. This is a very scalable arena, and it has more than a dozen different strategies in it ranging from distressed debt to CLOs to aircraft financing and energy credit.

Many firms are getting into some of that now, but it's been natural for us all along.

How have you remained true to the firm's culture as it has grown?

We manage far more assets today than when we started and the firm has grown to about 800 people, but the professional investment group size is just over 300 people. Private equity has stayed relatively small: we have around 85 investment professionals in private equity; credit probably has another 130 or so investment professionals; real estate is 25 or so; and natural resources is a bit more.

Our senior management is represented by myself and others who all came from the culture I just described. Most of the leadership we initially trained, who are now very senior here, have been inculcated with this type of culture for many years now. We also have investment committees that review every potential investment.

But ultimately we're value investors – there is little our funds invest in that has an enterprise value much more than a seven times EBITDA multiple at the time an investment is made.

Apollo's Fund VII, for example, was a large one even before we raised Apollo Fund VIII – it was a $14.7-billion fund. Fund VII is now sitting with a 30 percent Net IRR, or around a 2.4 multiple of invested capital. But what I'm most proud of is that we put that money in Fund VII to work at a 6.1 multiple of EBITDA when the industry average during that period was in the high 8s and low 9s.

I believe that 2.5 multiple point difference enables our funds to generate best-in-class returns, and it highlights that we are truly value investors. This doesn't mean other firms don't have successful deals when they pay multiples of 10 or 11 times EBITDA for an investment. We just like to buy good companies for low prices, and we've tried to create multiple pathways in different environments to do that.

How strong are the opportunities in Europe?

Europe is a few years behind the U.S. in terms of their economies. A lot has had to do with their banking system and the amount of leverage that exists in it.

Looking back at the financial crisis and what has taken place since that time to address the situation, it appears that one of the big advantages the U.S. had was the resilience of its banking system. Also keep in mind that

U.S. GDP was approximately $18 trillion a few years ago, while its whole banking system was around $13 trillion. In Europe, it was about the same size in terms of GDP, but the banking system was around $60 trillion. So it's clear that European bank balance sheets need to shrink relative to their GDP. The U.S. also has a central federal reserve while Europe does not.

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That said, the European Monetary Fund has emerged into a real entity over the past few years. Yet the banking system is way overleveraged there. I think European banks will continue to scale back for the next few years, whereas the U.S. has sorted out most of its banking problems.

As for the Eurozone, it's here to stay. Greece is beginning to address its problems, as is Spain, but there are still issues in Italy and France.

In Europe, Apollo has a large distressed debt business with a number of funds we manage. Our funds have put less in private equity given the state of a lot of those economies and more in consumer loans, real estate loans, and credit card companies; our non-performing loan fund has a large servicing operation in Europe as well. We believe there are still ways to put money to work at rather reasonable returns approaching 20 percent in that type of paper.

Are the emerging markets just experiencing growing pains or are there real systemic issues?

It's hard to tell. For example, so much of the growth engine of natural resources over the past few years has come from China. It's a bit opaque and there are a lot of politics. We've had a great deal of success with minerals and metals companies for a long time, but more recently, as China has slowed down, it has been less so.

In India, we have a joint venture with one of the largest and most respected local banks (ICICI). India uses a lot of leverage, even though everybody talks about it as a BRIC and the growth engine in emerging markets. Our approach in India has been more "Apollo-esque" – meaning that we are deploying the funds we manage through the debt and overleveraged companies that need to be delevered. We are working with ICICI, with whom we have a 50/50 joint venture, to help these companies deleverage.

There is a new government in India that is more pro-business, but the question is how long will it take for them to work through the massive bureaucracy in order to affect a change in the growth.

In general, though, we have not put that much capital to work in emerging markets for two reasons: one is that most of them have been seen as growth markets and, as a value investor, it's hard to buy things at what we would say would be reasonable pricing.

The second reason is that, in many of these countries, we need partners on the ground and we come in as a minority investor. In private equity, our preference has been to try to control our own destiny.

What is your outlook on U.S. growth?

The U.S. is plugging along at a decent 2 to 3 percent growth rate; corporate balance sheets have never been in better shape; inflation has been under control; we're going to keep having low interest rates for a while; the Shale revolution is real; the housing market is in reasonable shape; and we got through our banking issues.

But I worry about overzealous regulation. Following the financial crisis, some things were done correctly, but there is also a morass of regulation that many people don't even understand. Given the ineffectiveness of Congress right now, one of the Administration's only weapons is regulatory and the courts.

So I worry that overregulation has, and may continue to, slow down some of the growth prospects.

Why is being engaged in the community so important to you?

I like that we're getting good returns for pensioners – for government workers, teachers, firemen, and policemen. The model we have is a good one – we only make real money at Apollo if the funds we manage are making money for our investors.

But when you have been fortunate to make money, what do you do with it? Doing something that is worthwhile in terms of helping others is important.

I've always believed in education and culture. I'm involved with museums and have been involved in building the visual arts center at my alma mater, Dartmouth.

Several years ago my wife Debra was struck with melanoma, but thankfully she's okay. The more we learned about it, the more we realized no real work had been done in the field for 40 years. So we formed the Melanoma Research Alliance and it's making a difference today.

Raising awareness is important, but funding the best and the brightest in the field in terms of research and trying to find a cure is equally important. This is the fastest growing cancer among young people, especially women due to tanning beds.

They're also finding that there is a lot of crossover among cancers. We've now had three drugs approved by the FDA, which help a subset of Melanoma patients, but they can also help a percentage of lung cancer patients.

I have always dealt in an industry where one of the real benchmarks is how much money you make. In fields like cancer research, there are committed and brilliant doctors and they aren't about posting financial profits. It's very humbling.

With such a negative perception of the industry, is it ever clear that you're securing the futures of Main Street?

As an industry, we might not be communicating as well as we should be. We've also been living in this situation partly because of the nation's fractured politics and partly because of the financial crisis. Consequently, almost anything to do with money has a bad connotation.

But our business model is a good model. When you look at the underfunded pension situation, there are few financial sectors that have been able to meet the eight percent bogey that is needed to keep pension funds healthy. One of those areas has been private equity, but we get lost in the whole mix of bankers trying to make money.

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Are you surprised by how close the business community is in New York?

There is no place in the world like New York City and we're all willing to pay higher taxes to live here. But it's important to us that it work well, which means there needs to be a productive dialogue among government, labor, and business in addressing things like education, healthcare, and the arts. This is what the Partnership for New York City is all about. ●

