



Ares Capital Corporation (ARCC)

Updated May 11th, 2024 by Samuel Smith

Key Metrics

Current Price:	\$21.1	5 Year CAGR Estimate:	6.5%	Market Cap:	\$12.7B
Fair Value Price:	\$21.0	5 Year Growth Estimate:	-1.8%	Ex-Dividend Date:	6/14/24
% Fair Value:	99%	5 Year Valuation Multiple Estimate:	0.1%	Dividend Payment Date:	6/28/24
Dividend Yield:	9.1%	5 Year Price Target	\$19	Years Of Dividend Growth:	2
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Hold

Overview & Current Events

Ares Capital Corporation is a US-based closed-ended specialty finance business development company (BDC). It focuses on generating both current income and capital appreciation through debt and equity investments. The company invests primarily in U.S. middle-market companies, as well as larger companies. Its portfolio is comprised of first and second lien senior secured loans as well as mezzanine debt, diversified by industry and sector. The company was founded in 2004 and has a market capitalization of \$12.7 billion.

On February 13th, 2024, Ares Capital Corp. announced its financial results for the fourth quarter of 2023. Core Earnings per share came in at \$0.63, exceeding market expectations. This result was driven by strong net investment income and continued robust activity in ARCC's investment portfolio. The company reported higher total investment income and fee revenue gains and saw its Net Asset Value (NAV) improve from the previous quarter. While its leverage ticked up slightly, the debt remained primarily fixed rate, a strategy shielding ARCC from rising interest rates. Importantly, the company announced an increase in its regular quarterly dividend payment. This signals consistent value creation and a positive outlook for Ares Capital Corporation, maintaining its focus on delivering reliable income to shareholders. Kipp deVeer, CEO of Ares Capital Corporation, expressed satisfaction with the results in a dynamic marketplace. He reiterated the strength of ARCC's diversified portfolio and its emphasis on strategic investments in recession-resistant businesses. Additionally, deVeer acknowledged headwinds caused by the inflationary environment but confirmed Ares' flexible capital structure, which positions the company to adapt and continue capital deployment.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$1.94	\$1.20	\$1.51	\$1.57	\$2.01	\$2.03	\$1.87	\$2.02	\$2.02	\$2.37	\$2.36	\$2.15
DPS	\$1.52	\$1.52	\$1.52	\$1.52	\$1.54	\$1.60	\$1.60	\$1.62	\$1.92	\$1.92	\$1.92	\$1.92
Shares¹	305	314	314	425	426	431	423	479	531	582.3	607.8	670

The likelihood of future upward pressure on interest rates due to inflation offer a tailwind to earnings power given that the vast majority of their investments are floating interest rate debt.

That said, the current uncertainty and headwinds hanging over the economy combine with the company's choppy earnings history to make us cautious of the company's growth prospects. As a result, we assume an annual growth rate of just -1.8% over the next half decade.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	9.7	8.1	11.8	10.9	10.1	7.7	9.2	9.3	11.9	8.2	8.9	9.0
Avg. Yld.	8.6%	9.7%	10.7%	9.2%	9.6%	10.0%	8.6%	9.2%	7.6%	10.1%	9.1%	9.9%

Ares Capital has a history of strong outperformance of peers and the S&P 500, returning approximately 1.5 times the S&P's total return with average annual total returns of ~12% since the company was formed in 2004. This track record,

¹ Shares in millions

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along with its recent NAV per share growth would normally make it worth paying a small premium for. The stock is currently trading at a slight discount to our estimated Price to Earnings ratio fair value multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	78%	127%	101%	97%	77%	79%	86%	80%	95%	81%	81%	89%

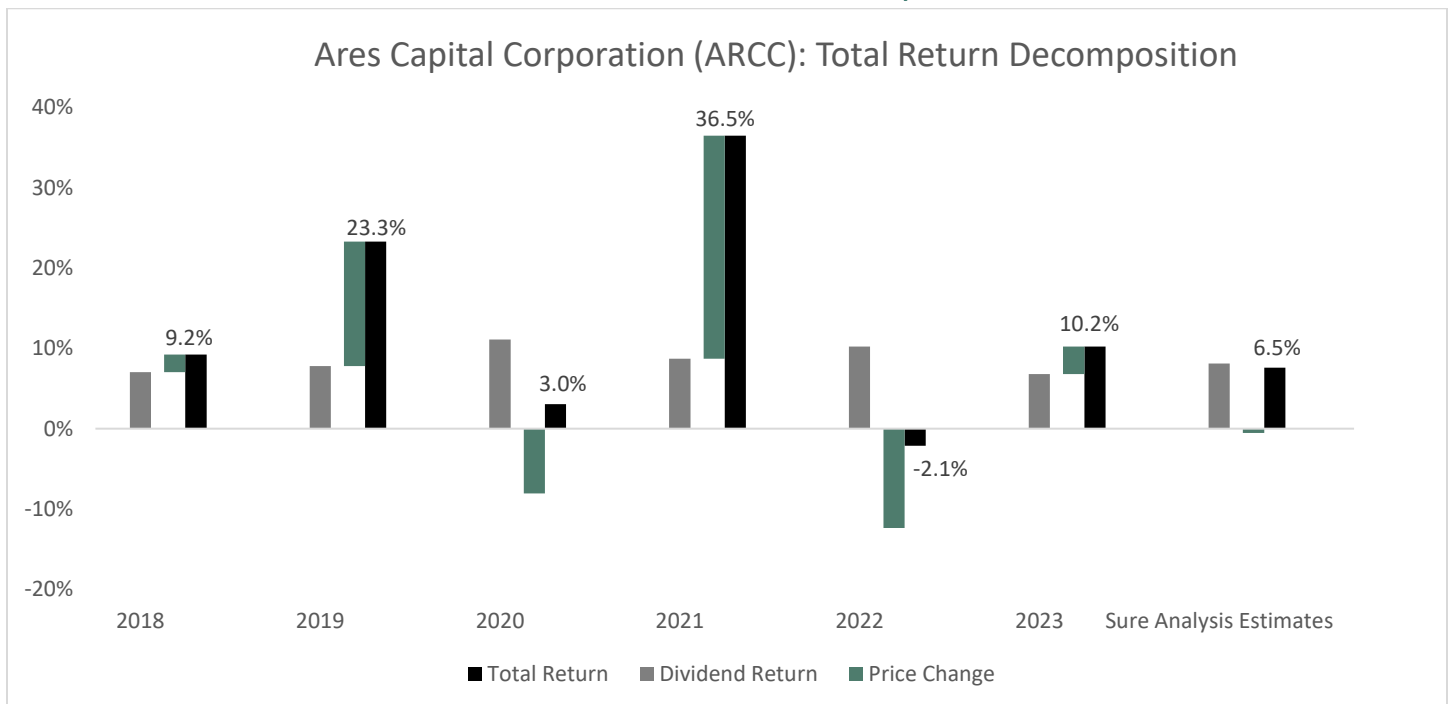
Ares Capital is arguably the safest BDC given that it is the only one with investment-grade ratings from all three major rating agencies. Additionally, its balance sheet is in a very strong position with solid and stable asset quality and a diversified long-duration liability structure. It also has very diversified holdings with weighted average interest coverage of over 2 times, minimizing default risk. Its competitive advantage comes from its superior size and scale as one of the largest BDCs.

While earnings and dividends fell during the last recession, it performed fairly well relative to its peers as the dividend only fell moderately. As a result of management's experience and track record of mitigating losses and rebounding fairly quickly from the last recession, we view Ares Capital as a lower-risk BDC to hold at this stage in the cycle. This conclusion is also supported by its solid balance sheet and diversified portfolio.

Final Thoughts & Recommendation

Given Ares Capital's moderate risk profile, experienced management, and commitment to supporting the share price and growing the dividend, it makes for an interesting investment for income investors. Its 9.1% dividend yield provides investors with attractive income and combines with our expectation of very slight multiple expansion offset by low single-digit annualized earnings per share declines to generate expected total annualized returns of 6.5% for the next half-decade. As a result, we rate it as a hold. That being said, the BDC business model does tend to struggle during recessions, so conservative investors definitely should keep that risk in mind.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	650	451	551	749	879	824	541	1,678	789	1,636
SG&A Exp.	41	44	56	89	42	45	38	39	38	42
Net Profit	591	379	474	667	858	793	484	1,567	600	1,522
Net Margin	90.9%	84.0%	86.0%	89.1%	97.6%	96.2%	89.5%	93.4%	76.0%	93.0%
Free Cash Flow	(659)	360	707	(2,048)	304	(1,235)	(580)	(2,459)	(1,359)	511
Income Tax	18	18	21	19	19	16	19	29	55	20

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	9,498	9,507	9,245	12,347	12,895	14,905	16,196	20,843	22,398	23,800
Cash & Equivalents	195	257	223	316	296	167	254	372	303	535
Total Liabilities	4,214	4,334	4,080	5,249	5,595	7,438	9,020	11,975	12,843	12,599
Accounts Payable	129	113	102	245	155	177	179	427	294	373
Long-Term Debt	3,924	4,114	3,874	4,854	5,247	7,092	8,573	11,137	12,320	11,935
Shareholder's Equity	5,284	5,173	5,165	7,098	7,300	7,467	7,176	8,868	9,555	11,201
LTD/E Ratio	0.74	0.80	0.75	0.68	0.72	0.95	1.19	1.26	1.29	1.07

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	6.7%	4.0%	5.1%	6.2%	6.8%	5.7%	3.1%	8.5%	2.8%	6.6%
Return on Equity	11.6%	7.2%	9.2%	10.9%	11.9%	10.7%	6.6%	19.5%	6.5%	14.7%
ROIC	6.9%	4.1%	5.2%	6.4%	7.0%	5.9%	3.2%	8.8%	2.9%	6.8%
Shares Out.	305	314	314	425	426	431	423	479	531	582.3
Revenue/Share	2.13	1.44	1.75	1.76	2.06	1.93	1.28	3.76	1.52	2.85
FCF/Share	(2.16)	1.15	2.25	(4.82)	0.71	(2.89)	(1.37)	(5.51)	(2.62)	0.89

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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