

Ares Capital Corporation

Overall solid quarter; record core EPS and NAV/share +1.3%

Maintain Rating: BUY | PO: 21.00 USD | Price: 19.94 USD

Another solid quarter, GAAP ROE 15%

Ares Capital (ARCC) reported Q4 core EPS of \$0.63, above consensus estimates of \$0.60. Relative to the BofA forecast of \$0.58, the beat was due to higher-than-expected recurring interest income plus higher capital structuring fees given stronger origination volume. GAAP Diluted EPS was \$0.70 (impressive 15% ROE) due to portfolio appreciation. Overall, Q4 was a strong quarter despite the complex market environment. ARCC delivered record core EPS (\$0.63, 13% core ROE) and NAV/share (\$19.24) while credit metrics remain healthy. We think ARCC is one of the best positioned Business Development Companies (BDCs) to continue to gain share and generate excess returns in the current economic backdrop. Maintain Buy.

Credit remains strong; non-accruals relatively stable

Credit remains resilient as non-accruals were fractionally higher at 1.3% of the portfolio at cost, compared to 1.2% the prior quarter (the non-accrual peer average was ~2.6% during Q3, most recent data available). Non-accruals are carried at 46% of cost (51% last quarter), which limits further downside risk to NAV/share, in our view. The portfolio weighted average EBITDA was \$322M (\$313M in Q3, \$275M at 4Q22) and average net leverage was fractionally lower Q/Q at 6.0x (6.1x at Q3). Importantly, weighted average interest coverage remained unchanged q/q at 1.6x, despite higher base rates.

NAV/share+1.3% QoQ, leverage (net) stable at 1.0x

NAV/share increased to a record \$19.24 (\$18.99 in last quarter) due to strong core earnings, portfolio appreciation, and accretive capital issuance. Reported leverage, net was 1.0x, unchanged QoQ. ARCC's stated target leverage range is 0.9x-1.25x and we expect ARCC will remain at or below the midpoint given macro uncertainty. In Q4 ARCC raised \$236M of common stock through "at-the-market" offerings, which was slightly accretive to NAV/share. In November, ARCC issued \$300M of unsecured notes (priced at 7.0%) and raised an additional \$1B of unsecured notes (priced at 5.875%) in January 2024. The Q4 dividend was \$0.48/share. ARCC declared a 1Q24 dividend of \$0.48 (payable March 29), in line with expectations.

Portfolio +4% to \$23B; portfolio yield +10bp to 12.5%

ARCC's portfolio (fair value) increased to \$23B (\$22B at Q3). Originations were \$2.4B and exits/sales were \$1.4B, resulting in net portfolio commitments of \$957M. The BofA forecast assumed \$0 net portfolio growth. The portfolio yield (cost basis) was 12.5% vs 12.4% at Q3. The Senior Direct Lending Program (SDLP) yield was 13.6%, unchanged QoQ and the Ivy Hill yield was 15.1% (14.6% at Q3). Non-recurring dividends were \$1M in Q4 (\$22M during full year 2023).

07 February 2024

Equity

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Stock Data

Price	19.94 USD
Price Objective	21.00 USD
Date Established	24-Oct-2023
Investment Opinion	B-1-7
52-Week Range	16.95 USD -20.65 USD
Mrkt Val / Shares Out (mn)	11,354 USD / 569.4
Free Float	99.0%
Average Daily Value	70.04 USD
BofA Ticker / Exchange	ARCC / NAS
Bloomberg / Reuters	ARCC US / ARCC.OQ
ROE (2023E)	12.7%
ESGMeter™	Medium

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Timestamp: 07 February 2024 09:17AM EST

Flexible capital structure

ARCC has a conservative and flexible liability structure (~70% of funding is unsecured, moderate leverage, etc.), which increases financial flexibility, in our view. Near term debt maturities are \$1.3B in 2024 (ARCC issued \$1.3B of debt in Q4 and Jan 2024), and \$1.9B (or 16% of outstanding debt) in 2025. Available liquidity was \$5.4B (including \$535M of unrestricted cash), subject to borrowing base restrictions vs. \$5.3B at Q3.

Exhibit 1: Record core EPS and NAV/share

4Q23 core EPS of \$0.63 beat the BofA forecast of \$0.58

Variance Table

(in millions)	4Q23A	4Q23E	Actual vs. BofA Estimate Amt	%	EPS Diff	3Q23A	QoQ	4Q22A	YoY
Interest From Investments - Interest Income	477	459	18	3.8%	0.03	452	5.5%	414	15.0%
Interest From Investments - SDLP	45	43	1	3.2%	0.00	44	2.3%	42	6.5%
Capital structuring fees	37	20	17	86.0%	0.03	20	86.0%	52	-29.0%
Capital structuring fees - SDLP	4	-	4	NA	0.01	-	NA	7	-42.4%
Dividend income	65	68	(3)	-4.4%	(0.01)	66	-1.5%	55	18.2%
Dividend income - Ivy Hill	64	60	4	6.6%	0.01	62	3.2%	55	16.4%
Other income	16	12	4	33.3%	0.01	12	33.3%	15	6.7%
Total Investment Income	707	662	45	6.8%	0.08	655	7.9%	640	10.5%
Interest expense	157	149	8	5.5%	(0.01)	145	8.3%	141	11.3%
Net Interest Income	550	513	37	7.2%	0.06	510	7.8%	499	10.2%
Base management fee	84	83	1	1.3%	0.00	81	3.7%	79	6.3%
Incentive fee	90	83	7	8.3%	0.01	83	8.4%	81	11.1%
Capital gains incentive fees	13	-	13	NA	0.02	42	-69.0%	(37)	-135.1%
Administrative fees	3	4	(1)	-25.0%	(0.00)	4	-25.0%	2	50.0%
Other general and administrative fees	6	8	(2)	-25.0%	(0.00)	8	-25.0%	7	-14.3%
Management fees waived	-	-	-	NA	-	-	NA	-	NA
Other/Tax	9	3	6	200.0%	0.01	3	200.0%	18	-50.0%
Total operating expense	205	181	24	13.3%	0.04	221	-7.2%	150	36.7%
Net investment income	358	332	26	7.7%	0.05	331	8.2%	322	11.2%
Net Realized Gain/(Loss) on Investments	28	-	28	NA		(76)	-136.8%	26	7.7%
Net Unrealized Gain/(Loss) on Investments	40	-	40	NA		287	-86.1%	(201)	-119.9%
Net gain on Investments	68	-	68	NA		211	-67.8%	(175)	-138.9%
Net Increase in Net Assets from Operations	413	332	81	24.3%		500	-17.4%	174	137.4%
Diluted Shares Outstanding (thousand)	593	569	24	4.1%	4.1%	582	1.9%	534	11.0%
End of Period Shares (thousand)	582	569	13	2.3%	2.3%	569	2.3%	519	12.1%
GAAP EPS (diluted)	\$0.70	\$0.59	\$0.11	19.1%	0.0%	\$0.87	-18.8%	\$0.34	109.7%
Core EPS	\$0.63	\$0.58	\$0.04	7.2%	0.0%	\$0.59	6.3%	\$0.63	-0.1%
Total investments (FV)	22,874	21,929	945	4.3%		21,929	4.3%	21,780	5.0%
Total cash	564	605	(41)	-6.8%		605	-6.8%	337	67.4%
Total assets	23,800	22,920	880	3.8%		22,920	3.8%	22,398	6.3%
Total debt	11,884	11,498	386	3.4%		11,517	3.2%	12,210	-2.7%
Total shareholders' equity	11,201	10,874	327	3.0%		10,815	3.6%	9,555	17.2%
Book Value (NAV)	\$19.24	\$19.10	0.14	0.7%		\$18.99	1.3%	\$18.40	4.6%
Asset coverage ratio	1.95x	1.95x	NA	0.00x		1.94x	0.00x	1.79x	0.16x
Debt/equity (EOP)	1.06x	1.06x	NA	0.00x		1.06x	0.00x	1.28x	-0.22x
Investments funded	2,384	1,500	884	58.9%		1,598	49.2%	2,518	-5.3%
Repayments	(1,427)	(1,500)	73	-4.9%		(1,280)	11.5%	(2,321)	-38.5%
Net new investments	957	-				318	200.9%	197	385.8%
Total Portfolio Yield at FV (total, calculated)	12.62%	12.08%	NA	0.5%		12.07%	0.6%	11.87%	0.8%
Net investment margin (Margin)	9.82%	9.36%	NA	0.5%		9.40%	0.4%	9.26%	0.6%
Return on average equity (ROE) - GAAP	15.0%	12.3%	NA	22.4%	NA	18.9%	-3.9%	7.3%	7.7%
Return on average equity (ROE) - Core	13.0%	12.3%	NA	6.1%	NA	12.5%	0.5%	13.6%	-0.6%

Source: Company reports and BofA Global Research estimates



Price objective basis & risk

Ares Capital Corporation (ARCC)

Our \$21 price objective is based on a roughly 1.1x multiple to net asset value (NAV), which in our view is achievable in a stable operating backdrop with intensifying demand for yield bearing investments. BDC peers are currently trading at roughly 0.9x NAV. We believe ARCC's premium valuation to peers is justified due to its superior profitability and strong credit performance.

Downside risks to achieving our price objective are 1) material weakening in credit markets, 2) a significant slowdown in investment activity, 3) a deteriorating macroeconomic environment, 4) disruptions in the capital markets, and 5) weaker-than-expected investment performance.

Upside risks to achieving our price objective are 1) material strengthening in credit markets, 2) a significant pickup in investment activity, 3) an improving macroeconomic environment, 4) disruptions in the capital markets, and 5) stronger-than-expected investment performance.

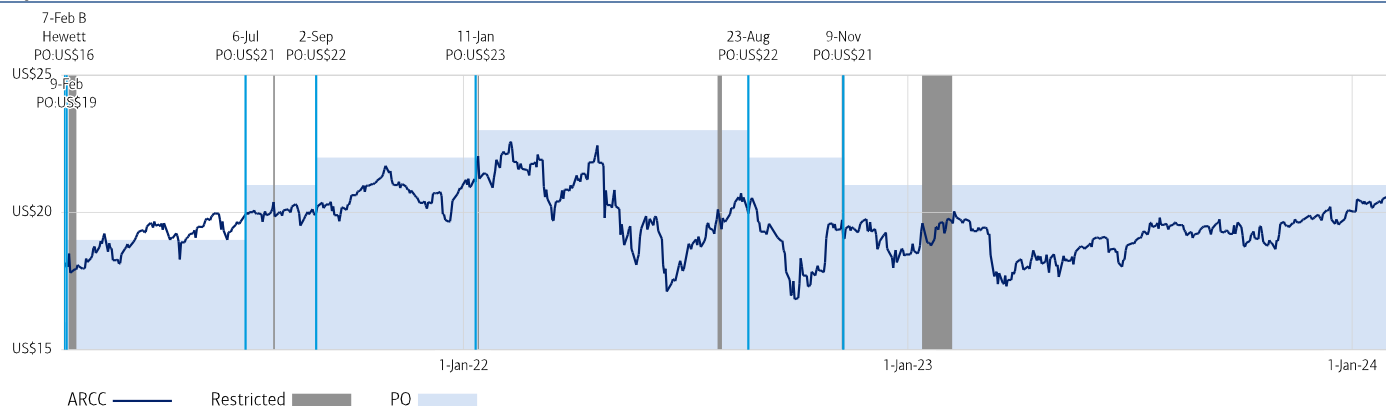
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Ares Capital (ARCC) Price Chart



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Equity Investment Rating Distribution: Financial Services Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	156	53.79%	Buy	94	60.26%
Hold	72	24.83%	Hold	48	66.67%
Sell	62	21.38%	Sell	35	56.45%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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