



Ares Commercial Real Estate Corporation (ACRE)

Updated February 15th, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	\$11.92	5 Year CAGR Estimate:	12.1%	Market Cap:	\$650.0 M
Fair Value Price:	\$14.50	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	03/30/2023
% Fair Value:	82%	5 Year Valuation Multiple Estimate:	4.0%	Dividend Payment Date:	04/18/2023
Dividend Yield:	11.1%	5 Year Price Target	\$14.50	Years Of Dividend Growth:	N/A
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Buy

Overview & Current Events

Ares Commercial Real Estate Corporation (referred to as ACRE throughout the report) is a specialty finance company primarily engaged in originating and investing in commercial real estate (“CRE”) loans and related investments. The company is externally managed by a subsidiary of the publicly traded Ares Management Corporation (NYSE: ARES), a leading global alternative asset manager. ACRE generated around \$170 million in interest income last year and is headquartered in New York, New York.

The company’s loan portfolio (98% of which are senior loans) comprises 60 market loans across 8 asset types, with an outstanding principal balance of \$2.3 billion. Around 70% of the loans are tied to multifamily, office, and industrial properties. In terms of geographical diversification, ACRE’s highest exposure is in the Southeast, West, and Midwest, which account for 27%, 19%, and 19% of the total principal balance, respectively.

On February 15th, 2023, ACRE reported its Q4-2022 and full-year results for the period ending December 31st, 2022. Interest income came in at \$52.6 million, 38.4% higher year-over-year, driven by incremental investment activity and the positive sensitivity of ACRE’s floating rate loans to rising interest rates. However, interest expense also rose by 55.6% to \$22.1 million. Further, no revenues from ACRE’s previously owned real estate were recognized amid the sale of these assets. Thus, total revenues (interest income - interest expenses) came in essentially flat at \$30.4 million. However, total expenses fell by 34.7% to \$7.8 million, primarily due to the lack of expenses related to ACRE’s previously owned real estate assets. While this would imply growth in earnings, net income declined 83% year-over-year to \$3.2 million due to a \$19.4 million provision for expected credit losses. Thus, GAAP earnings-per-share was just \$0.05. Excluding the effect related to the provision for credit losses, distributable EPS came in at \$0.44, five cents higher year-over-year. For FY2022, distributable EPS grew to \$1.56 from \$1.42 last year.

Book value per share stood at \$13.73 at the end of the year. For FY2023, we expect distributable EPS of \$1.45. This is a prudent estimate as elevated interest rates are likely to yield more substantial results. Note that from FY2021’s beginning, the company has been paying an additional supplemental dividend of \$0.02/quarter - hence FY2021’s and FY2022’s \$1.40 in dividends in the table below. However, the base annual dividend rate remains at \$1.32.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$0.72	\$0.86	\$1.20	\$1.42	\$1.07	\$1.35	\$1.29	\$0.66	\$1.42	\$1.56	\$1.45	\$1.45
DPS	\$1.00	\$1.00	\$1.00	\$1.04	\$1.08	\$1.16	\$1.32	\$1.32	\$1.40	\$1.40	\$1.32	\$1.32
Shares¹	19.0	28.5	28.5	28.5	28.5	28.5	28.6	33.0	42.3	51.7	51.7	100.0

Over the years, ACRE has grown its asset base by increasing its loan commitments. Its diversified loan portfolio has led to a relatively robust EPS performance over the past decade. The fluctuations in EPS are attributable to ACRE’s investment yields, interest rates, the % of contractual payments received, and weighted average remaining life of the underlying portfolio. While the company reported record EPS in FY2021, and rising rates should further boost its performance, we forecast no growth in EPS in the medium-term as higher borrowing costs could offset higher interest income. In terms of

¹ Share count is in millions.

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its dividend, due to its legal status, the company is required to distribute 90% of its taxable net income. Since ACRE's IPO, the dividend has only grown, though only when management assesses that underlying profits can support a hike. We also forecast a DPS CAGR of 0% in the medium term for the same reasons we don't expect any EPS growth ahead. However, future hikes are not unlikely, and the supplemental dividends could be signaling such a potential increase.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	19.4	14.3	10.0	8.9	12.4	10.7	11.8	13.5	10.5	8.1	8.2	10.0
Avg. Yld.	7.1%	8.2%	8.3%	8.2%	8.2%	8.1%	8.7%	14.8%	8.8%	11.0%	11.1%	9.1%

ACRE P/E ratio has historically hovered between the high single to low double-digits, in line with its industry peers. However, due to the fact that its EPS can fluctuate from time to time, investors seem to be pricing the stock mostly in terms of its yield, which has historically hovered between 8% and 9%. With investors requiring a higher yield from a YieldCo these days, ACRE's P/E now stands near an all-time low of 8.2X, and the yield has been pushed to 11.1%. While somewhat justified, we believe the stock is undervalued at its current levels, and expect its P/E to expand toward 10X.

Safety, Quality, Competitive Advantage, & Recession Resiliency

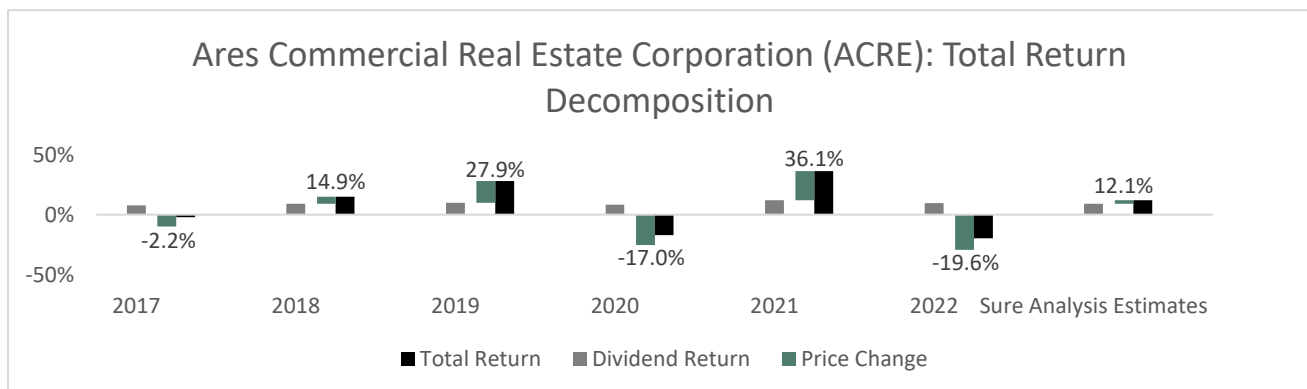
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	139%	116%	83%	73%	101%	86%	102%	200%	99%	90%	91%	91%

ACRE's dividend has historically been covered but by razor-thin margins. The current base rate of \$1.32 should be within the company's EPS generation. Despite that, ACRE's dividend is not entirely trustworthy. In 2020, for example, the company's profitability was severely impacted by the pandemic. ACRE actually used funds from its share issuances to pay the full-year dividend. If adverse economic conditions were to keep impacting the real estate market for longer, a dividend cut would most likely occur. Still, we can't ignore the company's qualities, including a diversified loan portfolio that has historically generated very stable returns in a relatively risky market. This is likely due to Ares's highly regarded management team, whose presence should be considered a competitive advantage in this field. Regardless, we highlight that a prolonged recession is likely to impact ACRE's bottom line materially, and quite certainly, the dividend.

Final Thoughts & Recommendation

ACRE features a strong track record of shareholder returns, primarily through its hefty dividend, which has only grown since its IPO. We estimate annualized returns of 12.1% in the medium-term, powered by the stock's dividend and the possibility of a noteworthy valuation expansion. Hence, we rate ACRE a buy. Returns are likely to be higher if earnings were to grow. Special dividends could further boost returns. Still, we don't ignore that ACRE operates in a risky industry.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	7	34	38	50	45	46	55	77	79	102
SG&A Exp.	5	17	12	12	12	13	14	15	16	20
Net Profit	1	14	24	34	40	30	39	37	22	60
Net Margin	13.0%	40.8%	65.0%	68.6%	89.4%	65.6%	69.8%	47.9%	27.8%	58.8%
Free Cash Flow	2	25	(224)	276	(4)	31	39	31	31	48
Income Tax	-	0	0	(0)	0	0	0	1	0	0.7

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	388	1,177	1,862	1,379	1,374	1,770	1,603	1,784	1,929	2,632
Cash & Equivalents	23	20	17	5	47	28	11	5	75	51
Accounts Receivable		3	3	3	0	1	1	1	1	2.6
Goodwill & Int. Ass.	-	60	59	---	---	---	---	---	---	---
Total Liabilities	222	771	1,381	922	944	1,351	1,178	1,358	1,456	1,953
Accounts Payable		0	0	0		0	1	1	0	0.6
Long-Term Debt	212	727	1,115	605	806	379	1,022	1,204	1,327	1,903
Shareholder's Equity	165	406	403	409	419	419	426	426	473	679
LTD/E Ratio	1.28	1.79	2.77	1.48	1.92	0.90	2.40	2.82	2.81	2.80

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets		1.8%	1.6%	2.1%	2.9%	1.9%	2.3%	2.2%	1.2%	2.7%
Return on Equity	1.0%	4.8%	6.0%	8.4%	9.7%	7.3%	9.1%	8.7%	4.9%	10.5%
ROIC		1.8%	1.8%	2.6%	3.5%	3.0%	3.4%	2.4%	1.3%	2.8%
Shares Out.	6.5	19.0	28.5	28.5	28.5	28.5	28.5	28.6	33.0	42.7
Revenue/Share	1.01	1.77	1.31	1.75	1.58	1.62	1.93	2.68	2.37	2.39
FCF/Share	0.30	1.34	(7.84)	9.63	(0.16)	1.10	1.37	1.07	0.95	1.12

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

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