



Ares Commercial Real Estate Corporation (ACRE)

Updated February 23rd, 2024 by Nikolaos Sismanis

Key Metrics

Current Price:	\$7.86	5 Year CAGR Estimate:	9.7%	Market Cap:	\$427.4 M
Fair Value Price:	\$7.50	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	03/27/2024
% Fair Value:	105%	5 Year Valuation Multiple Estimate:	-0.9%	Dividend Payment Date:	04/16/2024
Dividend Yield:	12.7%	5 Year Price Target	\$7.50	Years Of Dividend Growth:	N/A
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Hold

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 \$198.6 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 47 market loans across 8 asset types, with an outstanding principal balance of \$2.2 billion. The majority of the loans are tied to multifamily, office, and mixed-use properties. In terms of geographical diversification, ACRE's exposure features a healthy mix between the Southeast, West, and Midwest.

On February 22nd, 2024, ACRE reported its Q4 and full-year results for the period ending December 31st, 2023. Interest income came in at \$44.2 million, 16% lower year-over-year. The decline was due to the company's loans struggling to perform as higher rates of inflation and certain cultural shifts such as work-from-home trends continue to impact the operating performance and the economic values of commercial real estate.

In the meantime, interest expense rose by 1% to nearly \$30.0 million. Thus, total revenues (interest income - interest expenses + \$3.16 million in revenue from ACRE's own real estate) fell by 23.9% to roughly \$17.6 million. Total expenses rose by about 30% to \$8.6 million, primarily due to higher professional fees, and general and administrative expenses. Hence, Ares posted a net loss of \$39.5 million compared to a net income of \$9.1 million in the previous quarter. For the year, the GAAP loss per share was \$0.72. Our past figures in our per-share table reflect GAAP metrics. Distributable EPS for the year was \$1.06.

Due to such weak results and the commercial real estate space remaining turbulent, ACRE slashed its dividend by 24.2% to a quarterly rate of \$0.25. We had previously warned about a potential dividend cut. For FY2024, we see distributable EPS of \$1.00.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$0.86	\$1.20	\$1.42	\$1.07	\$1.35	\$1.29	\$0.66	\$1.42	\$0.57	(\$0.72)	\$1.00	\$1.00
DPS	\$1.00	\$1.00	\$1.04	\$1.08	\$1.16	\$1.32	\$1.32	\$1.40	\$1.40 ¹	\$1.36	\$1.00	\$1.00
Shares²	28.5	28.5	28.5	28.5	28.5	28.6	33.0	42.3	51.7	54.3	54.3	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 percentage of contractual payments received, and weighted average remaining life of the underlying portfolio. While the company reported record EPS in FY2022, and rising rates were supposed to further boost its performance, ACRE is now struggling as demand for commercial real estate remains at rather weak levels. We expect

¹ Note that FY2021 and FY2022 each include supplemental dividends of \$0.08.

² Share count is in millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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no growth in EPS in the medium-term as the commercial real estate market remains highly speculative. We also forecast a DPS CAGR of 0% in the medium-term for the same reason.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	14.3	10.0	8.9	12.4	10.7	11.8	13.5	10.5	8.1	---	7.9	7.5
Avg. Yld.	8.2%	8.3%	8.2%	8.2%	8.1%	8.7%	14.8%	8.8%	11.0%	14.3%	12.7%	13.3%

ACRE's P/E ratio has historically hovered between the high-single to low double-digits, in line with its industry peers. The blend of investors demanding a heftier yield from a YieldCo these days and additional frustration caused by dividend cut has resulted in shares plummeting lately. The stock is currently trading at just 7.9X our projected earnings and trades with a yield of 12.7%, even after the dividend cut. We believe shares are modestly overvalued given ACRE's rather shaky investment case.

Safety, Quality, Competitive Advantage, & Recession Resiliency

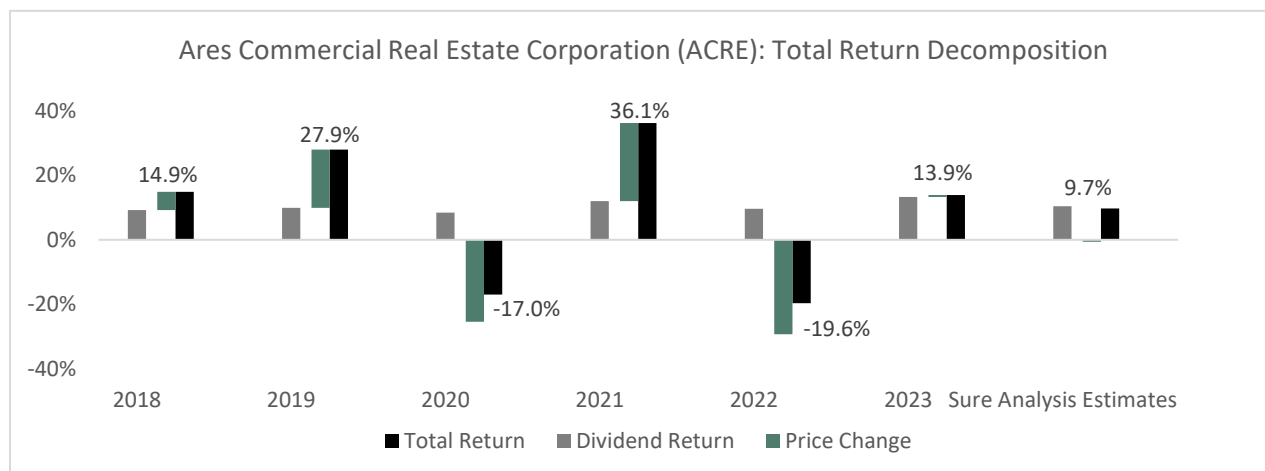
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	116%	83%	73%	101%	86%	102%	200%	99%	246%	---	100%	100%

ACRE's dividend has historically been covered, but by razor-thin margins. Thus, it was always susceptible to a potential cut if earnings were to decline, and this is exactly what happened last year. The post-cut dividend rate of \$1.00 should be within the company's EPS generation this year. Despite that, ACRE's dividend is not entirely trustworthy. If adverse conditions are to keep impacting the commercial real estate market for longer, another dividend cut could 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. However, the stock has had rough start in fiscal 2024. We estimate annualized returns of 9.7% in the medium-term, powered mainly by the new dividend rate, offset by valuation headwinds. We rate ACRE a hold. Still, we remind that ACRE operates in a risky space. You should not rely on the dividend. Another cut could occur if earnings remain weak, as we had previously warned.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	34	38	50	45	46	55	77	79	102	109
SG&A Exp.	17	12	12	12	13	14	15	16	20	10
Net Profit	14	24	34	40	30	39	37	22	60	30
Net Margin	40.8%	65.0%	68.6%	89.4%	65.6%	69.8%	47.9%	27.8%	58.8%	27.5%
Free Cash Flow	25	(224)	276	(4)	31	39	31	31	48	57
Income Tax	0	0	(0)	0	0	0	1	0	0.7	0.5

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	1,177	1,862	1,379	1,374	1,770	1,603	1,784	1,929	2,632	2,523
Cash & Equivalents	20	17	5	47	28	11	5	75	51	141
Accounts Receivable	3	3	3	0	1	1	1	1	2.6	3
Goodwill & Int. Ass.	60	59	---	---	---	---	---	---	---	---
Total Liabilities	771	1,381	922	944	1,351	1,178	1,358	1,456	1,953	1,775
Accounts Payable	0	0	0		0	1	1	0	0.6	1.9
Long-Term Debt	727	1,115	605	806	379	1,022	1,204	1,327	1,903	1,737
Shareholder's Equity	406	403	409	419	419	426	426	473	679	748
LTD/E Ratio	1.79	2.77	1.48	1.92	0.90	2.40	2.82	2.81	2.80	2.32

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	1.8%	1.6%	2.1%	2.9%	1.9%	2.3%	2.2%	1.2%	2.7%	1.2%
Return on Equity	4.8%	6.0%	8.4%	9.7%	7.3%	9.1%	8.7%	4.9%	10.5%	4.2%
ROIC	1.8%	1.8%	2.6%	3.5%	3.0%	3.4%	2.4%	1.3%	2.8%	1.2%
Shares Out.	19.0	28.5	28.5	28.5	28.5	28.5	28.6	33.0	42.7	52.1
Revenue/Share	1.77	1.31	1.75	1.58	1.62	1.93	2.68	2.37	2.39	2.10
FCF/Share	1.34	(7.84)	9.63	(0.16)	1.10	1.37	1.07	0.95	1.12	1.10

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

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