

ARES CAPITAL CORP

FORM 10-Q (Quarterly Report)

Filed 8/8/2005 For Period Ending 6/30/2005

| | |
|-------------|---|
| Address | 780 THIRD AVENUE 46TH FLOOR NEW YORK, New York 10017 |
| Telephone | 212-750-7300 |
| CIK | 0001287750 |
| Fiscal Year | 12/31 |

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2005

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period to

Commission File No. 000-50697

ARES CAPITAL CORPORATION

(Exact name of Registrant as specified in its charter)

MARYLAND

(State or other jurisdiction of
incorporation or organization)

33-1089684

(I.R.S. Employer
Identification Number)

780 Third Avenue, 46th Floor, New York, NY 10017

(Address of principal executive office) (Zip Code)

(212) 750-7300

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes ☒ No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class

Common stock, \$0.001 par value

Outstanding at August 8, 2005

23,353,454

ARES CAPITAL CORPORATION

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

ARES CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

As of June 30, 2005 and December 31, 2004

| | As of | |
|--|-----------------------|-----------------------|
| | June 30, 2005 | December 31, 2004 |
| | (unaudited) | (unaudited) |
| ASSETS | | |
| Investments at fair value (amortized cost of \$302,413,472 and \$182,329,200, respectively) | | |
| Non-control/Non-affiliate investments | \$ 262,449,541 | \$ 165,126,181 |
| Affiliate investments | 39,848,665 | 17,433,966 |
| Total investments at fair value | 302,298,206 | 182,560,147 |
| Cash and cash equivalents | 53,891,961 | 26,806,160 |
| Receivable for open trades | 497,770 | 8,794,478 |
| Interest receivable | 3,379,843 | 1,140,495 |
| Other assets | 765,935 | 1,154,334 |
| Total assets | <u>\$ 360,833,715</u> | <u>\$ 220,455,614</u> |
| LIABILITIES | | |
| Credit facility payable | \$ — | \$ 55,500,000 |
| Reimbursed underwriting costs payable to the Investment Adviser | 2,475,000 | — |
| Dividend payable | 7,413,950 | 3,320,030 |
| Accounts payable and accrued expenses | 1,006,711 | 1,556,446 |
| Management and incentive fees payable | 2,858,596 | 274,657 |
| Interest and facility fees payable | 62,979 | 96,176 |
| Interest payable to the Investment Adviser | 83,539 | — |
| Total liabilities | <u>13,900,775</u> | <u>60,747,309</u> |
| Commitments and contingencies (Note 6) | | |
| STOCKHOLDERS' EQUITY | | |
| Common stock, par value \$.001 per share, 100,000,000 common shares authorized, 23,168,595 and 11,066,767 common shares issued and outstanding, respectively | 23,169 | 11,067 |
| Capital in excess of par value | 341,443,552 | 159,602,706 |
| Net unrealized (depreciation) appreciation on investments | (115,266) | 230,947 |
| Accumulated net realized gain on sale of investments | 5,581,485 | — |
| Distributions less than (in excess of) net investment income | — | (136,415) |
| Total stockholders' equity | <u>346,932,940</u> | <u>159,708,305</u> |
| Total liabilities and stockholders' equity | <u>\$ 360,833,715</u> | <u>\$ 220,455,614</u> |
| NET ASSETS PER SHARE | <u>\$ 14.97</u> | <u>\$ 14.43</u> |

See accompanying notes to consolidated financial statements.

ARES CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS

As of June 30, 2005 (unaudited)

| Company (1) | Industry | Investment | Interest (10) | Initial Acquisition Date | Amortized Cost | Fair Value | Fair Value Per Unit | Percentage of Net Assets |
|---|---|---|--|--------------------------|----------------|---------------|---------------------|--------------------------|
| Consumer Products - Non-Durable | | | | | | | | |
| Esselte Corporation | Office supply products manufacturer and distributor | Senior notes (\$14,529,600 par due 3/2011) | 7.63% | 12/6/04 | \$ 14,011,162 | \$ 12,786,049 | \$ 0.88(7) (8) | |
| Making Memories Wholesale, Inc. (6) | Scrapbooking branded products manufacturer | Senior secured loan (\$9,381,250 par due 3/2011) | 7.19% (Libor + 4.00%/Q) | 5/5/05 | 9,381,250 | 9,381,250 | 1.00(2) | |
| | | Senior subordinated loan (\$10,038,194 par due 5/2012) | 12.00% cash, 2.50% PIK | 5/5/05 | 10,000,000 | 10,000,000 | 1.00(2) (3) | |
| | | Preferred stock (3,500 shares) | | 5/5/05 | 3,542,000 | 3,542,000 | 1,012.00(3) | |
| Shoes for Crews, LLC | Safety footwear and slip-related mats manufacturer | Senior secured loan (\$1,619,910 par due 7/2010) | 7.17% (Base Rate + 2.00%/Q) | 10/8/04 | 1,629,442 | 1,629,442 | 1.01(2) | |
| Tumi Holdings, Inc. | Branded luggage designer, marketer and distributor | Senior secured loan (\$2,500,000 par due 12/2012) | 6.24% (Libor + 2.75%/Q) | 3/14/05 | 2,500,000 | 2,500,000 | 1.00(2) | |
| | | Senior secured loan (\$5,000,000 par due 12/2013) | 6.34% (Libor + 3.25%/Q) | 3/14/05 | 5,000,000 | 5,000,000 | 1.00(2) | |
| | | Senior subordinated loan (\$12,553,819 par due 12/2014) | 14.49% (Libor + 6.00% cash, 5.00% PIK/Q) | 3/14/05 | 12,684,357 | 12,684,357 | 1.00(2) (3) | |
| | | | | | 58,748,211 | 57,523,098 | | 16.58% |
| Manufacturing | | | | | | | | |
| Arrow Group Industries, Inc. | Residential and outdoor shed manufacturer | Senior secured loan (\$6,000,000 par due 4/2010) | 8.49% (Base Rate + 4.00%/Q) | 3/28/05 | 6,041,250 | 6,120,000 | 1.02 | |
| | | Senior secured loan (\$6,000,000 par due 10/2010) | 12.99% (Base Rate + 8.50%/Q) | 3/28/05 | 6,000,000 | 6,000,000 | 1.00 | |
| The GSI Group, Inc. | Agricultural equipment manufacturer | Senior notes (\$10,000,000 par due 5/2013) | 12.00% | 5/12/05 | 10,000,000 | 10,000,000 | 1.00 | |
| | | Common stock (7,500 shares) | | 5/11/05 | 750,000 | 750,000 | 100.00(4) | |
| Qualitor, Inc. | Automotive aftermarket components supplier | Senior secured loan (\$837,059 par due 12/2009) | 7.21% (Libor + 4.00%/M) | 12/29/04 | 837,059 | 837,059 | 1.00(2) | |
| | | Senior secured loan (\$1,152,941 par due 12/2009) | 7.49 (Base Rate + 2.75%/M) | 12/29/04 | 1,152,941 | 1,152,941 | 1.00(2) | |
| | | Junior secured loan (\$5,000,000 par due 6/2012) | 10.49% (Base Rate + 5.75%/M) | 12/29/04 | 5,000,000 | 5,000,000 | 1.00(2) | |
| Reflexite Corporation | Developer and manufacturer of high visibility reflective products | Senior subordinated loan (\$10,137,969 par due 12/2011) | 11.00% cash, 3.00% PIK | 12/30/04 | 10,151,485 | 10,151,485 | 1.00(2) (3) | |
| Universal Trailer Corporation (5) | Livestock and specialty trailer manufacturer | Senior secured loan (\$1,422,456 par due 3/2007) | 7.65% (Libor + 4.25%/M) | 10/8/04 | 1,430,273 | 1,430,273 | 1.01 | |
| | | Senior secured loan (\$35,644 par due 3/2007) | 9.75% (Base Rate + 3.50%/M) | 10/8/04 | 35,840 | 35,840 | 1.01 | |
| | | Senior subordinated loan (\$7,500,000 par due 9/2008) | 13.50% | 10/8/04 | 7,525,388 | 7,528,881 | 1.00 | |
| | | Common stock (50,000 shares) | | 10/8/04 | 6,424,645 | 6,424,645 | 128.49(4) | |
| | | Warrants to purchase 22,208 shares | | 10/8/04 | 1,505,776 | 1,505,776 | 67.80(4) | |
| | | | | | 56,854,657 | 56,936,900 | | 16.41% |
| Environmental Services | | | | | | | | |
| Mactec, Inc. | Engineering and environmental consulting services | Common stock (186 shares) | | 11/3/04 | — | — | 0.00(4) | |
| United Site Services, Inc. | Portable restroom and site services | Junior secured loan (\$10,000,000 par due 6/2010) | 11.38% (Libor + 8.00%/Q) | 12/2/04 | 9,953,900 | 10,000,000 | 1.00(2) | |
| | | Senior subordinated loan (\$8,587,014 par due 12/2010) | 12.00% cash, 4.00% PIK | 10/8/04 | 8,734,673 | 8,743,435 | 1.02(3) | |
| | | Common stock (216,795 shares) | | 10/8/04 | 1,353,851 | 1,353,851 | 6.24(4) | |
| WCA Waste Systems, Inc. | Waste management services | Junior secured loan (\$25,000,000 par due 10/2011) | 9.49% (Libor + 6.00%/Q) | 4/25/05 | 25,000,000 | 25,000,000 | 1.00(2) | |
| | | | | | 45,042,424 | 45,097,286 | | 13.00% |
| Energy - Service & Equipment | | | | | | | | |
| Mechanical Dynamics & Analysis | Steam power generator repair services | Senior subordinated loan (\$10,880,035 par due 3/2010) | 13.00% cash, 5.00% PIK | 10/8/04 | 10,960,790 | 10,964,177 | 1.01(2) (3) | |
| | | Warrants to purchase 4,067 shares | | 10/8/04 | 150,578 | 889,891 | 218.81(4) | |
| Varel Holdings, Inc. | Drill bit manufacturer | Senior secured loan (\$6,666,667 par due 12/2010) | 8.75% (Base Rate + 2.75%/Q) | 5/18/05 | 6,666,667 | 6,666,667 | 1.00 | |
| | | Senior secured loan (\$2,500,000 par due 12/2010) | 7.40% (Libor + 4.00%/Q) | 5/18/05 | 2,500,000 | 2,500,000 | 1.00 | |

See accompanying notes to consolidated financial statements.

| Company (1) | Industry | Investment | Interest (10) | Initial Acquisition Date | Amortized Cost | Fair Value | Fair Value Per Unit | Percentage of Net Assets |
|--|---|---|------------------------------|--------------------------|----------------|------------|---------------------|--------------------------|
| | | Senior secured loan (\$3,333,333 par due 12/2010) | 11.40% (Libor + 8.00%/Q) | 5/18/05 | 3,333,333 | 3,333,333 | 1.00 | |
| | | Preferred stock (30,738 shares) | | 5/18/05 | 1,006,362 | 1,006,362 | 32.74(3) | |
| | | Common stock (30,451 shares) | | 5/18/05 | 3,045 | 3,045 | 0.10(4) | |
| | | | | | 24,620,775 | 25,363,475 | | 7.31% |
| Services - Other | | | | | | | | |
| Diversified Collection Services, Inc. | Collections services | Senior secured loan (\$6,743,333 par due 2/2011) | 6.99% (Libor + 4.00%/Q) | 2/4/04 | 6,743,333 | 6,743,333 | 1.00(2) | |
| | | Senior secured loan (\$128,333 par due 2/2011) | 6.77% (Libor + 4.00%/Q) | 2/4/04 | 128,333 | 128,333 | 1.00(2) | |
| | | Senior secured loan (\$8,500,000 par due 8/2011) | 8.99% (Libor + 6.00%/Q) | 10/8/04 | 8,500,000 | 8,500,000 | 1.00(2) | |
| | | Preferred stock (114,004 shares) | | 10/8/04 | 295,270 | 295,270 | 2.59(4) | |
| Miller Heiman, Inc. | Sales consulting services | Senior secured loan (\$4,918,326 par due 6/2010) | 6.86% (Libor + 3.75%/Q) | 6/20/05 | 4,918,326 | 4,918,326 | 1.00 | |
| | | Senior secured loan (\$4,078,773 par due 6/2012) | 7.36% (Libor + 4.25%/Q) | 6/20/05 | 4,078,773 | 4,078,773 | 1.00 | |
| | | | | | 24,664,035 | 24,664,035 | | 7.11% |
| Forest Products / Containers- Packaging | | | | | | | | |
| FlexSol Packaging Corporation | Manufacturer of plastic and flexible packaging | Senior secured loan (\$987,500 par due 12/2012) | 7.50% (Base Rate + 1.75%/Q) | 12/7/04 | 987,500 | 987,500 | 1.00(2) | |
| | | Junior secured loan (\$2,000,000 par due 12/2012) | 11.25% (Base Rate + 5.50%/Q) | 12/7/04 | 2,000,000 | 2,000,000 | 1.00(2) | |
| York Label Holdings, Inc. | Consumer product labels manufacturer | Senior subordinated loan (\$10,105,706 par due 2/2010) | 10.00% cash, 4.00% PIK | 11/3/04 | 10,140,881 | 10,144,238 | 1.00(2) (3) | |
| | | Preferred stock (650 shares) | 10.00% | 11/3/04 | 3,558,883 | 3,558,883 | 5,475.20(3) | |
| | | Warrants to purchase 156,000 shares | | 11/3/04 | 5,320,408 | 5,320,408 | 34.11(4) | |
| | | | | | 22,007,672 | 22,011,029 | | 6.34% |
| Printing, Publishing and Broadcasting | | | | | | | | |
| Canon Communications LLC | Print publications services | Junior secured loan (\$16,250,000 par due 11/2011) | 10.99% (Base Rate + 6.50%/Q) | 5/25/05 | 16,250,000 | 16,250,000 | 1.00(2) | |
| | | | | | 16,250,000 | 16,250,000 | | 4.68% |
| Information Technology | | | | | | | | |
| PHNS, Inc. | Information technology and business process outsourcing | Senior subordinated loan (\$16,000,000 par due 11/2011) | 11.50% cash, 2.25% PIK | 11/1/04 | 15,774,053 | 16,000,000 | 1.00(3) | |
| | | | | | 15,774,053 | 16,000,000 | | 4.61% |
| Housing - Building Materials | | | | | | | | |
| HB&G Building Products | Synthetic and wood product manufacturer | Senior subordinated loan (\$8,232,282 par due 3/2011) | 10.00% cash, 5.00% PIK | 10/8/04 | 8,294,541 | 8,296,744 | 1.01(2) (3) | |
| | | Common stock (2,743 shares) | | 10/8/04 | 752,888 | 752,888 | 274.48(4) | |
| | | Warrants to purchase 4,464 shares | | 10/8/04 | 652,503 | 652,503 | 146.17(4) | |
| | | | | | 9,699,932 | 9,702,135 | | 2.80% |
| Aerospace | | | | | | | | |
| Thermal Solutions LLC | Thermal management and electronics packaging manufacturer | Senior secured loan (\$5,991,176 par due 3/2011) | 8.62% (Libor + 5.25%/Q) | 3/28/05 | 5,991,176 | 5,991,176 | 1.00(2) | |
| | | Senior subordinated loan (\$3,021,083 par due 3/2012) | 11.50% cash, 2.75% PIK | 3/28/05 | 3,022,548 | 3,021,083 | 1.00(2) (3) | |
| | | Preferred stock (29,400 shares) | | 3/28/05 | 294,000 | 294,000 | 10.00(4) | |
| | | Common stock (600,000 shares) | | 3/28/05 | 6,000 | 6,000 | 0.01(4) | |
| | | | | | 9,313,724 | 9,312,259 | | 2.68% |
| Consumer Products - Durable | | | | | | | | |
| Berkline/Benchcraft Holdings LLC | Furniture manufacturer and distributor | Junior secured loan (\$5,000,000 par due 5/2012) | 11.02% (Libor + 8.00%/Q) | 11/3/04 | 5,000,000 | 5,000,000 | 1.00(2) | |
| | | Preferred stock (2,536 shares) | | 10/8/04 | 1,046,343 | 1,046,343 | 412.60(4) | |
| | | Warrants to purchase 483,020 shares | | 10/8/04 | 2,752,559 | 2,752,559 | 5.70(4) | |
| | | | | | 8,798,902 | 8,798,902 | | 2.54% |

See accompanying notes to consolidated financial statements.

| Company (1) | Industry | Investment | Interest (10) | Initial Acquisition Date | Amortized Cost | Fair Value | Fair Value Per Unit | Percentage of Net Assets |
|--------------------------------------|--|---|--------------------------|--------------------------|-----------------------|-----------------------|---------------------|--------------------------|
| Financial | | | | | | | | |
| Foxe Basin CLO 2003, Ltd. | Collateralized debt obligation | Preference shares (3,000 shares) | | 10/8/04 | 2,927,555 | 2,927,555 | 975.85(8) (9) | |
| Hudson Straits CLO 2004, Ltd. | Collateralized debt obligation | Preference shares (750 shares) | | 10/8/04 | 739,886 | 739,886 | 986.51(8) (9) | |
| MINCS-Glace Bay, Ltd. | Collateralized debt obligation | Secured notes (\$4,500,000 par due 7/2014) | 6.63% (Libor + 5.00%/Q) | 10/8/04 | 4,517,328 | 4,517,328 | 1.00(8) (9) | |
| | | | | | <u>8,184,769</u> | <u>8,184,769</u> | | 2.36% |
| Healthcare - Medical Products | | | | | | | | |
| Aircast, Inc. | Manufacturer of orthopedic braces, supports and vascular systems | Senior secured loan (\$1,454,318 par due 12/2010) | 6.11% (Libor + 2.75%/Q) | 12/21/04 | 1,454,318 | 1,454,318 | 1.00(2) | |
| | | Junior secured loan (\$1,000,000 par due 6/2011) | 10.36% (Libor + 7.00%/Q) | 12/21/04 | 1,000,000 | 1,000,000 | 1.00(2) | |
| | | | | | <u>2,454,318</u> | <u>2,454,318</u> | | 0.71% |
| Total | | | | | <u>\$ 302,413,472</u> | <u>\$ 302,298,206</u> | | |

(1) We do not “Control” any of our portfolio companies, as defined in the Investment Company Act of 1940. In general, under the 1940 Act, we would “Control” a portfolio company if we owned 25% or more of its voting securities. All of our portfolio company investments are subject to legal restriction on sales which as of June 30, 2005 represented 87% of the Company’s net assets.

(2) Pledged as collateral for the credit facility payable (see Note 7 to the consolidated financial statements).

(3) Has a payment-in-kind interest feature (see Note 2 to the consolidated financial statements).

(4) Non-income producing at June 30, 2005.

(5) As defined in the 1940 Act, we are an “Affiliate” of this portfolio company because we own more than 5% of the portfolio company’s outstanding voting securities. For the period from April 1, 2005 through June 30, 2005, for this portfolio company there were total redemptions of \$1,543,996 (cost), interest income of \$297,303, other income of \$5,303 and net realized losses of \$1,880. For the period from January 1, 2005 through June 30, 2005, for this portfolio company there were total purchases of \$1,200,000, redemptions of \$1,708,551 (cost), interest income of \$607,896, other income of \$131,145 and net realized losses of \$2,030.

(6) As defined in the 1940 Act, we are an “Affiliate” of this portfolio company because we own more than 5% of the portfolio company’s outstanding voting securities. For the period from January 1, 2005 through June 30, 2005, for this portfolio company there were total purchases of \$26,000,000, sales of \$3,000,000 (cost), interest income of \$403,568, capital structuring services fees of \$862,500 and other income of \$1,438.

(7) Principal amount denominated in Euros has been translated into U.S. dollars (see Note 2 to the consolidated financial statements).

(8) Non-U.S. company or principal place of business outside the U.S.

(9) Non-registered investment company.

(10) A majority of the variable rate loans to our portfolio companies bear interest at a rate that may be determined by reference to either Libor or an alternate Base Rate (commonly based on the Federal Funds Rate or the Prime Rate), at the borrower’s option, which reset quarterly (Q) or monthly (M). For each such loan, we have provided the current interest rate in effect at June 30, 2005.

See accompanying notes to consolidated financial statements.

ARES CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED SCHEDULE OF INVESTMENTS

As of December 31, 2004

| Company (1) | Industry | Investment | Interest (9) | Initial Acquisition Date | Amortized Cost | Fair Value | Fair Value Per Unit | Percentage of Net Assets |
|---------------------------------------|---|--|------------------------------|--------------------------|----------------|--------------|---------------------|--------------------------|
| Manufacturing | | | | | | | | |
| Qualitor, Inc. | Automotive aftermarket components supplier | Senior secured loan (\$2,000,000 par due 12/2009) | 8.00% (Base Rate + 2.75%/M) | 12/29/04 | \$ 2,000,000 | \$ 2,000,000 | \$ 1.00(2) | |
| | | Junior secured loan (\$5,000,000 par due 6/2012) | 11.00% (Base Rate + 5.75%/M) | 12/29/04 | 5,000,000 | 5,000,000 | \$ 1.00(2) | |
| Reflexite Corporation | Developer and manufacturer of high visibility reflective products | Senior subordinated loan (\$10,000,833 par due 12/2011) | 11.00% cash, 3.00% PIK | 12/30/04 | 10,000,833 | 10,000,833 | \$ 1.00(2) (3) | |
| Universal Trailer Corporation (5) | Livestock and specialty trailer manufacturer | Senior secured loan (\$1,963,872 par due 3/2007) | 6.42% (Libor + 4.00%/M) (10) | 10/8/04 | 1,974,665 | 1,974,665 | \$ 1.01 | |
| | | Senior subordinated loan (\$7,500,000 par due 9/2008) | 13.50% | 10/8/04 | 7,527,808 | 7,528,880 | \$ 1.00 | |
| | | Common stock (50,000 shares) | | 10/8/04 | 6,424,645 | 6,424,645 | \$ 128.49(4) | |
| | | Warrants to purchase 22,208 shares | | 10/8/04 | 1,505,776 | 1,505,776 | \$ 67.80(4) | |
| | | | | | 34,433,727 | 34,434,799 | | 21.56% |
| Consumer Products - Non-Durable | | | | | | | | |
| Esselte Corporation | Office supply products manufacturer and distributor | Senior notes (\$6,777,000 par due 3/2011) | 7.63% | 12/6/04 | 6,060,352 | 5,997,645 | \$ 0.89(6) (7) | |
| Reef Holdings, Inc. | Shoe designer, marketer and distributor | Senior secured loan (\$17,500,000 par due 12/2009) | 12.50% (Base Rate + 7.25%/Q) | 12/21/04 | 17,500,000 | 17,500,000 | \$ 1.00(2) | |
| | | Common stock (47,118 shares) | | 10/8/04 | 2,258,666 | 2,258,666 | \$ 47.94(4) | |
| | | Warrants to purchase 27,043 shares | | 10/8/04 | 752,888 | 752,888 | \$ 27.84(4) | |
| Shoes for Crews, LLC | Safety footwear and slip-related mats manufacturer | Senior secured loan (\$1,721,154 par due 7/2010) | 6.75% (Base Rate + 2.00%/Q) | 10/8/04 | 1,731,282 | 1,731,282 | \$ 1.01(2) | |
| | | Senior secured revolving loan (\$333,333 par due 7/2010) | 6.75% (Base Rate + 2.00%/Q) | 10/8/04 | 334,617 | 334,617 | \$ 1.00 | |
| | | | | | 28,637,805 | 28,575,098 | | 17.89% |
| Services - Other | | | | | | | | |
| Billing Concepts, Inc. | Billing clearinghouse services | Senior secured loan (\$10,000,000 par due 12/2005) | 10.63% (Libor + 8.50%/Q) | 10/8/04 | 10,042,007 | 10,042,007 | \$ 1.00 | |
| | | Senior subordinated loan (\$5,212,619 par due 6/2008) | 14.00% cash, 4.00% PIK | 10/8/04 | 5,231,589 | 5,232,490 | \$ 1.00(2) (3) | |
| | | Common stock (1,100 shares) | | 10/8/04 | 150,578 | 150,578 | \$ 136.89(4) | |
| Diversified Collection Services, Inc. | Collections services | Senior secured loan (\$4,017,391 par due 1/2009) | 6.02% (Libor + 4.00%/Q) | 10/8/04 | 4,036,107 | 4,036,107 | \$ 1.00(2) | |
| | | Senior subordinated loan (\$2,052,321 par due 7/2010) | 12.00% cash, 3.75% PIK | 10/8/04 | 2,059,964 | 2,060,150 | \$ 1.00(2) (3) | |
| | | Preferred stock (114,004 shares) | | 10/8/04 | 483,709 | 483,709 | \$ 4.24(4) | |
| | | | | | 22,003,954 | 22,005,041 | | 13.78% |
| Forest Products/Containers-Packaging | | | | | | | | |
| FlexSol Packaging Corporation | Manufacturer of value-added plastic and flexible packaging | Senior secured loan (\$1,000,000 par due 12/2012) | 5.78% (Libor + 3.25%/Q) | 12/7/04 | 1,000,000 | 1,000,000 | \$ 1.00(2) | |
| | | Junior secured loan (\$2,000,000 par due 12/2012) | 9.53% (Libor + 7.00%/Q) | 12/7/04 | 2,000,000 | 2,000,000 | \$ 1.00(2) | |
| York Label Holdings, Inc. | Consumer product labels manufacturer | Senior subordinated loan (\$9,897,956 par due 2/2010) | 10.00% cash, 4.00% PIK | 11/3/04 | 9,934,660 | 9,935,689 | \$ 1.00(2) (3) | |
| | | Preferred stock (650 shares) | 10.00% | 11/3/04 | 3,387,069 | 3,387,069 | \$ 5,210.88(3) | |
| | | Warrants to purchase 156,000 shares | | 11/3/04 | 5,320,408 | 5,320,408 | \$ 34.11(4) | |
| | | | | | 21,642,137 | 21,643,166 | | 13.55% |
| Environmental Services | | | | | | | | |
| Mactec, Inc. | Engineering and environmental consulting services | Common stock (186 shares) | | 11/3/04 | — | — | \$ 0.00(4) | |
| United Site Services, Inc. | Portable restroom and site services | Junior secured loan (\$10,000,000 par due 6/2010) | 10.41% (Libor + 8.00%/Q) | 12/2/04 | 9,950,512 | 10,000,000 | \$ 1.00(2) | |
| | | Senior subordinated loan (\$8,456,734 par due 12/2010) | 12.00% cash, 4.00% PIK | 10/8/04 | 8,571,374 | 8,574,034 | \$ 1.01(3) | |
| | | Common stock (216,795 shares) | | 10/8/04 | 1,353,851 | 1,353,851 | \$ 6.24(4) | |
| | | | | | 19,875,737 | 19,927,885 | | 12.48% |

See accompanying notes to consolidated financial statements.

| Company (1) | Industry | Investment | Interest (9) | Initial Acquisition Date | Amortized Cost | Fair Value | Fair Value Per Unit | Percentage of Net Assets |
|---|--|---|--------------------------|--------------------------|-----------------------|-----------------------|---------------------|--------------------------|
| Information Technology | | | | | | | | |
| PHNS, Inc. | Information technology and business process outsourcing | Senior subordinated loan (\$16,000,000 par due 11/2011) | 11.50% cash, 2.25% PIK | 11/1/04 | 15,763,394 | 16,000,000 | \$ 1.00(3) | |
| | | | | | 15,763,394 | 16,000,000 | | 10.02% |
| Energy - Service & Equipment | | | | | | | | |
| Mechanical Dynamics & Analysis | Steam power generator repair services | Senior subordinated loan (\$10,654,348 par due 3/2010) | 13.00% cash, 5.00% PIK | 10/8/04 | 10,693,629 | 10,694,664 | \$ 1.00(2) (3) | |
| | | Warrants to purchase 4,067 shares | | 10/8/04 | 150,578 | 150,578 | \$ 37.02(4) | |
| | | | | | 10,844,207 | 10,845,242 | | 6.79% |
| Housing - Building Materials | | | | | | | | |
| HB&G Building Products | Synthetic and wood product manufacturer | Senior subordinated loan (\$8,112,135 par due 3/2011) | 10.00% cash, 5.00% PIK | 10/8/04 | 8,142,178 | 8,142,855 | \$ 1.00(3) | |
| | | Common stock (2,743 shares) | | 10/8/04 | 752,888 | 752,888 | \$ 274.48(4) | |
| | | Warrants to purchase 4,464 shares | | 10/8/04 | 652,503 | 652,503 | \$ 146.17(4) | |
| | | | | | 9,547,569 | 9,548,246 | | 5.98% |
| Consumer Products - Durable | | | | | | | | |
| Berkline/Benchcraft Holdings LLC | Furniture manufacturer and distributor | Junior secured loan (\$5,000,000 par due 5/2012) | 10.50% (Libor + 8.00%/Q) | 11/3/04 | 5,000,000 | 5,000,000 | \$ 1.00(2) | |
| | | Preferred stock (2,536 shares) | | 10/8/04 | 1,046,343 | 1,046,343 | \$ 412.60(4) | |
| | | Warrants to purchase 483,020 shares | | 10/8/04 | 2,752,559 | 2,752,559 | \$ 5.70(4) | |
| | | | | | 8,798,902 | 8,798,902 | | 5.51% |
| Financial | | | | | | | | |
| Foxe Basin CLO 2003, Ltd. | Collateralized debt obligation | Preference shares (3,000 shares) | | 10/8/04 | 3,011,552 | 3,011,552 | \$ 1,003.85(7) (8) | |
| Hudson Straits CLO 2004, Ltd. | Collateralized debt obligation | Preference shares (750 shares) | | 10/8/04 | 752,888 | 752,888 | \$ 1,003.85(7) (8) | |
| MINCS-Glace Bay, Ltd. | Collateralized debt obligation | Secured notes (\$4,500,000 par due 7/2014) | 6.63% (Libor + 5.00%/Q) | 10/8/04 | 4,517,328 | 4,517,328 | \$ 1.00(7) (8) | |
| | | | | | 8,281,768 | 8,281,768 | | 5.19% |
| Healthcare - Medical Products | | | | | | | | |
| Aircast, Inc. | Manufacturer of orthopedic braces, supports and vascular systems | Senior secured loan (\$1,500,000 par due 12/2010) | 5.19% (Libor + 2.75%/Q) | 12/21/04 | 1,500,000 | 1,500,000 | \$ 1.00(2) | |
| | | Junior secured loan (\$1,000,000 par due 6/2011) | 9.44% (Libor + 7.00%/Q) | 12/21/04 | 1,000,000 | 1,000,000 | \$ 1.00(2) | |
| | | | | | 2,500,000 | 2,500,000 | | 1.57% |
| Total | | | | | \$ 182,329,200 | \$ 182,560,147 | | |

(1) We do not “Control” any of our portfolio companies, as defined in the Investment Company Act of 1940. In general, under the 1940 Act, we would “Control” a portfolio company if we owned 25% or more of its voting securities. All of our portfolio company investments are subject to legal restriction on sales which as of December 31, 2004 represented 114% of the Company’s net assets.

(2) Pledged as collateral for the credit facility payable (see Note 7 to the consolidated financial statements).

(3) Has a payment-in-kind interest feature (see Note 2 to the consolidated financial statements).

(4) Non-income producing at December 31, 2004.

(5) As defined in the 1940 Act, we are an “Affiliate” of this portfolio company because we own more than 5% of the portfolio company’s outstanding voting securities. For the period from June 23, 2004 through December 31, 2004, for this portfolio company there were total purchases of \$17,598,522, a redemption of \$164,555 (cost), interest income of \$285,059, other income of \$5,833 and net realized losses of \$899.

(6) Principal amount denominated in Euros has been translated into U.S. dollars (see Note 2 to the consolidated financial statements).

(7) Non-U.S. company or principal place of business outside the U.S.

(8) Non-registered investment company.

(9) A majority of the variable rate loans to our portfolio companies bear interest at a rate that may be determined by reference to either Libor or an alternate Base Rate (commonly based on the Federal Funds Rate or the Prime Rate), at the borrower’s option, which reset quarterly (Q) or monthly (M). For each such loan, we have provided the current interest rate in effect at December 31, 2004.

(10) At December 31, 2004, a portion of this loan equal to \$3,873 was earning interest at a rate of 8.25% which is equal to Base Rate plus 3.50%, resetting monthly.

ARES CAPITAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENT OF OPERATIONS

| | For the three months ended June 30, 2005 (unaudited) | For the six months ended June 30, 2005 (unaudited) |
|---|---|---|
| INVESTMENT INCOME: | | |
| From non-control/non-affiliate investments: | | |
| Interest from investments | \$ 6,027,175 | \$ 10,947,830 |
| Interest from cash & cash equivalents | 565,412 | 595,768 |
| Dividend income | 744,818 | 744,818 |
| Capital structuring service fees | 631,333 | 935,083 |
| Other income | 62,765 | 122,161 |
| Total investment income from non-control/non-affiliate investments | 8,031,503 | 13,345,660 |
| From affiliate investments: | | |
| Interest from investments | 700,871 | 1,011,464 |
| Capital structuring service fees | 862,500 | 862,500 |
| Other income | 6,741 | 132,583 |
| Total investment income from affiliate investments | 1,570,112 | 2,006,547 |
| Total investment income | 9,601,615 | 15,352,207 |
| EXPENSES: | | |
| Management and incentive fees | 2,826,054 | 3,911,049 |
| Administrative | 256,115 | 489,387 |
| Professional fees | 320,800 | 485,794 |
| Directors fees | 85,643 | 157,808 |
| Insurance | 144,400 | 287,213 |
| Interest and credit facility fees | 62,979 | 438,269 |
| Interest payable to the Investment Adviser | 31,814 | 83,539 |
| Amortization of debt issuance costs | 65,736 | 131,426 |
| Other | 39,940 | 69,759 |
| Total expenses | 3,833,481 | 6,054,244 |
| NET INVESTMENT INCOME | 5,768,134 | 9,297,963 |
| REALIZED AND UNREALIZED GAIN ON INVESTMENTS: | | |
| Net realized gains (losses): | | |
| Net realized gains from non-control/non-affiliate investment transactions | 6,747,262 | 7,156,442 |
| Net realized loss from affiliate investment transactions | (1,880) | (2,030) |
| Net realized gains from investment transactions | 6,745,382 | 7,154,412 |
| Net unrealized gains (losses): | | |
| Investment transactions from non-control/non-affiliate investments | (4,910,024) | (343,793) |
| Investment transactions from affiliate investments | (1,236) | (2,420) |
| Net unrealized losses from investment transactions | (4,911,260) | (346,213) |
| Net realized and unrealized gain on investments | 1,834,122 | 6,808,199 |
| NET INCREASE IN STOCKHOLDERS' EQUITY RESULTING FROM OPERATIONS | \$ 7,602,256 | \$ 16,106,162 |
| BASIC AND DILUTED EARNINGS PER COMMON SHARE (see Note 4) | \$ 0.33 | \$ 0.91 |
| WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING (see Note 4) | 23,164,444 | 17,683,309 |

See accompanying notes to consolidated financial statements.

ARES CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

For the Six Months Ended June 30, 2005 (unaudited)

| | Common Stock | | Capital in Excess of Par Value | Distributions Less Than (in Excess of) Net Investment income | Accumulated Net Realized Gain on Sale of Investments | Net Unrealized Appreciation (Depreciation) of Investments | Total Stockholders' Equity |
|--|---------------------|------------------|---|---|---|--|---|
| | Shares | Amount | | | | | |
| Balance at January 1, 2005 | 11,066,767 | \$ 11,067 | \$ 159,602,706 | \$ (136,415) | \$ — | \$ 230,947 | \$ 159,708,305 |
| Issuance of common stock from add-on offering (net of offering and underwriting costs) | 12,075,000 | 12,075 | 183,859,340 | — | — | — | 183,871,415 |
| Reimbursement of underwriting costs paid by the Investment Adviser (see Note 9) | — | — | (2,475,000) | | | | (2,475,000) |
| Shares issued in connection with dividend reinvestment plan | 26,828 | 27 | 456,506 | | | | 456,533 |
| Net increase in stockholders' equity resulting from operations | — | — | — | 9,297,963 | 7,154,412 | (346,213) | 16,106,162 |
| Dividend declared (\$0.62 per share) | — | — | — | (9,161,548) | (1,572,927) | — | (10,734,475) |
| Balance at June 30, 2005 | <u>23,168,595</u> | <u>\$ 23,169</u> | <u>\$ 341,443,552</u> | <u>\$ —</u> | <u>\$ 5,581,485</u> | <u>\$ (115,266)</u> | <u>\$ 346,932,940</u> |

See accompanying notes to consolidated financial statements.

ARES CAPITAL CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENT OF CASH FLOWS

For the Six Months Ended June 30, 2005 (unaudited)

OPERATING ACTIVITIES:

| | |
|--|---------------------|
| Net increase in stockholders' equity resulting from operations | \$ 16,106,162 |
| Adjustments to reconcile net increase in stockholders' equity resulting from operations: | |
| Realized gain on investment transactions | (7,154,412) |
| Unrealized loss on investment transactions | 346,213 |
| Net amortization of premium on securities | 625 |
| Increase in accrued payment-in-kind dividends and interest | (1,460,731) |
| Amortization of debt issuance costs | 131,426 |
| Proceeds from sale and redemption of investments | 63,881,989 |
| Purchases of investments | (167,055,034) |
| Changes in operating assets and liabilities: | |
| Interest receivable | (2,239,348) |
| Other assets | 256,973 |
| Accounts payable and accrued expenses | (549,735) |
| Management and incentive fees payable | 2,583,939 |
| Interest and facility fees payable | (33,197) |
| Interest payable to the Investment Adviser | 83,539 |
| Net cash used in operating activities | <u>(95,101,591)</u> |

FINANCING ACTIVITIES:

| | |
|--|--------------------|
| Net proceeds from issuance of common stock | 183,871,415 |
| Borrowings on credit facility payable | (55,500,000) |
| Dividends paid in cash | <u>(6,184,023)</u> |
| Net cash provided by financing activities | <u>122,187,392</u> |

CHANGE IN CASH AND CASH EQUIVALENTS 27,085,801

CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD 26,806,160

CASH AND CASH EQUIVALENTS, END OF PERIOD \$ 53,891,961

Supplemental Information:

| | |
|--------------------------------------|---------------|
| Interest paid during the period | \$ 385,265 |
| Dividends declared during the period | \$ 10,734,475 |

See accompanying notes to consolidated financial statements.

ARES CAPITAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of June 30, 2005 (unaudited)

1. ORGANIZATION

Ares Capital Corporation (the “Company” or “ARCC” or “we”) is a closed-end, non-diversified management investment company incorporated in Maryland that is regulated as a business development company under the Investment Company Act of 1940 (“1940 Act”). We were founded on April 16, 2004 and were initially funded on June 23, 2004. The Company has qualified and has elected to be treated for tax purposes as a regulated investment company, or RIC, under the Internal Revenue Code of 1986, as amended. The Company expects to continue to qualify and to elect to be treated for tax purposes as a RIC. Our investment objectives are to generate both current income and capital appreciation through debt and equity investments. We invest primarily in first and second lien senior loans and mezzanine debt, which in some cases may include an equity component, and, to a lesser extent, in equity investments in private middle market companies.

On October 8, 2004, we completed our initial public offering (the “IPO”) of 11,000,000 shares at a price of \$15.00 per share, less an underwriting discount and commissions totaling \$0.675 per share of which \$0.225 was paid on our behalf by our investment adviser (see Note 9). On the same date, we commenced substantial investment operations.

We are externally managed by Ares Capital Management LLC (the “Investment Adviser”), an affiliate of Ares Management LLC, an independent Los Angeles based firm that manages investment funds. Ares Technical Administration LLC (“Ares Administration”), an affiliate of Ares Management LLC, provides the administrative services necessary for us to operate.

Interim financial statements are prepared in accordance with generally accepted accounting principles (“GAAP”) for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain disclosures accompanying financial statements prepared in accordance with GAAP are omitted. In the opinion of management, all adjustments, consisting solely of normal recurring accruals, considered necessary for the fair presentation of financial statements for the interim period, have been included. The current period’s results of operations will not necessarily be indicative of results that ultimately may be achieved for the fiscal year ending December 31, 2005.

2. SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents

Cash and cash equivalents include short-term, liquid investments in a money market fund. Cash and cash equivalents are carried at cost which approximates fair value.

Concentration of Credit Risk

The Company places its cash and cash equivalents with financial institutions and, at times, cash held in money market accounts may exceed the Federal Deposit Insurance Corporation insured limit.

Investments

Investment transactions are recorded on the trade date. Realized gains or losses are computed using the specific identification method. We carry our investments at fair value, as determined by our board of directors. Investments for which market quotations are readily available are valued at such market quotations. Debt and equity securities that are not publicly traded or whose market price is not readily available are valued at fair value as determined in good faith by our board of directors. The types of factors that we may take into account in fair value pricing of our investments include, as relevant, the nature and realizable value of any collateral, the portfolio company’s ability to make payments and its earnings and discounted cash flow, the markets in

which the portfolio company does business, comparison to publicly traded securities and other relevant factors.

When an external event such as a purchase transaction, public offering or subsequent equity sale occurs, we use the pricing indicated by the external event to corroborate our private equity valuation. Because there is not a readily available market value for most of the investments in our portfolio, we value substantially all of our portfolio investments at fair value as determined in good faith by our board under a valuation policy and a consistently applied valuation process. Due to the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments may differ significantly from the values that would have been used had a ready market existed for such investments, and the differences could be material.

With respect to investments for which market quotations are not readily available, our board of directors undertakes a multi-step valuation process each quarter, as described below:

- Our quarterly valuation process begins with each portfolio company or investment being initially valued by the investment professionals responsible for the portfolio investment.
- Preliminary valuation conclusions are then documented and discussed with our senior management.
- The audit committee of our board of directors reviews these preliminary valuations. Where appropriate, the committee may utilize an independent valuation firm selected by the board of directors.
- The board of directors discusses valuations and determines the fair value of each investment in our portfolio in good faith based on the input of our investment adviser and audit committee and, where appropriate, an independent valuation firm.

Interest Income Recognition

Interest income, adjusted for amortization of premium and accretion of discount, is recorded on an accrual basis to the extent that such amounts are expected to be collected. The Company stops accruing interest on its investments when it is determined that interest is no longer collectible. If any cash is received after it is determined that interest is no longer collectible, we will treat the cash as payment on the principal balance until the entire principal balance has been repaid, before any interest income is recognized. Discounts and premiums on securities purchased are accreted/amortized over the life of the respective security using the effective yield method. The amortized cost of investments represents the original cost adjusted for the accretion of discounts and amortizations of premium on bonds.

Payment in Kind Interest

The Company has loans in its portfolio that contain a payment-in-kind ("PIK") provision. The PIK interest, computed at the contractual rate specified in each loan agreement, is added to the principal balance of the loan and recorded as interest income. To maintain the Company's status as a RIC, this non-cash source of income must be paid out to stockholders in the form of dividends, even though the Company has not yet collected the cash. For the three months ended June 30, 2005, \$771,892 in PIK income was recorded. For the six months ended June 30, 2005, \$1,460,731 in PIK income was recorded.

Capital Structuring Service Fees

The Company's Investment Adviser seeks to provide assistance to the portfolio companies in connection with the Company's investments and in return the Company may receive fees for capital structuring services. These fees are normally paid at the closing of the investments, are generally non-recurring and are recognized as revenue when earned upon closing the investment. The services that the Company's Investment Adviser provides vary by investment, but generally

consist of reviewing existing credit facilities, arranging bank financing, arranging equity financing, structuring financing from multiple lenders, structuring financing from equity investors, restructuring existing loans, raising equity and debt capital, and providing general financial advice, which concludes upon closing of the loan. The Company's Investment Adviser may also take a seat on the board of directors of a portfolio company, or observe the meetings of the board of directors without taking a formal seat. Any services of the above nature subsequent to the closing would generally generate a separate fee payable to the Company. In certain instances where the Company is invited to participate as a co-lender in a transaction and in the event that the Company does not provide significant services in connection with the investment, a portion of loan fees paid to the Company in such situations may be deferred and amortized over the estimated life of the loan.

Foreign Currency Translation

The Company's books and records are maintained in U.S. dollars. Any foreign currency amounts are translated into U.S. dollars on the following basis:

- (1) Market value of investment securities, other assets and liabilities — at the exchange rates prevailing at the end of the day.
- (2) Purchases and sales of investment securities, income and expenses — at the rates of exchange prevailing on the respective dates of such transactions.

Although the net assets and the fair values are presented at the foreign exchange rates at the end of the day, the Company does not isolate the portion of the results of the operations resulting from changes in foreign exchange rates on investments from the fluctuations arising from changes in fair value of investments. Such fluctuations are included with the net realized and unrealized gains or losses from investments. Foreign security and currency translations may involve certain considerations and risks not typically associated with investing in U.S. companies and U.S. Government securities. These risks include but are not limited to revaluation of currencies and future adverse political and economic developments which could cause investments in their markets to be less liquid and prices more volatile than those of comparable U.S. companies.

Add-on Offering Expenses

The offering costs were charged against the proceeds from the Add-on Offering (as defined in Note 10) when received and were approximately \$635,000 (see Note 10).

Debt Issuance Costs

Debt issuance costs are being amortized over the life of the credit facility using the straight line method.

Federal Income Taxes

The Company has qualified and elected and intends to continue to qualify and elect for the tax treatment applicable to regulated investment companies under Subchapter M of the Internal Revenue Code of 1986 (the "Code"), as amended, and, among other things, has made and intends to continue to make the requisite distributions to its stockholders which will relieve the Company from Federal income or excise taxes. Therefore, no provision has been recorded for Federal income or excise taxes.

In order to qualify as a RIC, the Company is required to distribute to its stockholders at least 90% of investment company taxable income, as defined by the Code.

Dividends

Dividends and distributions to common stockholders are recorded on the record date. The amount to be paid out as a dividend is determined by the board of directors each quarter and is generally

based upon the earnings estimated by management. Net realized capital gains, if any, are distributed at least annually.

We have adopted a dividend reinvestment plan that provides for reinvestment of our distributions on behalf of our stockholders, unless a stockholder elects to receive cash. As a result, if our board of directors authorizes, and we declare, a cash dividend, then our stockholders who have not “opted out” of our dividend reinvestment plan will have their cash dividends automatically reinvested in additional shares of our common stock, rather than receiving the cash dividends.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of actual and contingent assets and liabilities at the date of the financial statements and the reported amounts of income or loss and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include the valuation of investments.

Fair Value of Financial Instruments

The carrying value of the Company’s financial instruments approximate fair value. The carrying value of interest and open trade receivables, accounts payable and accrued expenses, as well as the credit facility payable approximate fair value due to their short maturity.

3. AGREEMENTS

The Company has entered into an investment advisory agreement (the “Advisory Agreement”) with the Investment Adviser under which the Investment Adviser, subject to the overall supervision of our board of directors, provides investment advisory services to ARCC. For providing these services, the Investment Adviser receives a fee from us, consisting of two components—a base management fee and an incentive fee. The base management fee is calculated at an annual rate of 1.5% of our total assets (other than cash or cash equivalents but including assets purchased with borrowed funds). For services rendered under the Advisory Agreement during the period commencing from October 8, 2004 through and including December 31, 2004, the base management fee is payable monthly in arrears. For services rendered under the Advisory Agreement after that time, the base management fee is payable quarterly in arrears. The base management fee is calculated based on the average value of our total assets (other than cash or cash equivalents but including assets purchased with borrowed funds) at the end of the two most recently completed calendar quarters.

The incentive fee has two parts. One part is calculated and payable quarterly in arrears based on our pre-incentive fee net investment income. Pre-incentive fee net investment income means interest income, dividend income and any other income (including any other fees such as commitment, origination, structuring, diligence and consulting fees or other fees that we receive from portfolio companies but excluding fees for providing managerial assistance) accrued during the calendar quarter, minus operating expenses for the quarter (including the base management fee, any expenses payable under the administration agreement, and any interest expense and dividends paid on any outstanding preferred stock, but excluding the incentive fee). Pre-incentive fee net investment income includes, in the case of investments with a deferred interest feature such as market discount, debt instruments with payment-in-kind interest, preferred stock with payment-in-kind dividends and zero coupon securities, accrued income that we have not yet received in cash. The Investment Adviser is not under any obligation to reimburse us for any part of the incentive fee it received that was based on accrued income that we never received as a result of a default by an entity on the obligation that resulted in the accrual of such income.

Pre-incentive fee net investment income does not include any realized capital gains, realized capital losses or unrealized capital appreciation or depreciation. Pre-incentive fee net investment income, expressed as a rate of return on the value of our net assets at the end of the immediately preceding calendar quarter, is compared to a fixed “hurdle rate” of 2.00% per quarter.

We pay the Investment Adviser an incentive fee with respect to our pre-incentive fee net investment income in each calendar quarter as follows:

- no incentive fee in any calendar quarter in which the pre-incentive fee net investment income does not exceed the hurdle rate;
- 100% of our pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 2.50% in any calendar quarter. We refer to this portion of our pre-incentive fee net investment income (which exceeds the hurdle rate but is less than 2.50%) as the “catch-up” provision. The “catch-up” is meant to provide our Investment Adviser with 20% of the pre-incentive fee net investment income as if a hurdle rate did not apply if this net investment income exceeds 2.50% in any calendar quarter; and
- 20% of the amount of our pre-incentive fee net investment income, if any, that exceeds 2.50% in any calendar quarter.

These calculations are adjusted for any share issuances or repurchases during the quarter.

The second part of the incentive fee is determined and payable in arrears as of the end of each calendar year (or upon termination of the Advisory Agreement, as of the termination date), commencing with the calendar year ending on December 31, 2004, and equals 20% of our realized capital gains for the calendar year, if any, computed net of all realized capital losses and unrealized capital depreciation for such year.

We defer cash payment of any incentive fee otherwise earned by the Investment Adviser if during the most recent four full calendar quarter period ending on or prior to the date such payment is to be made the sum of (a) the aggregate distributions to the stockholders and (b) the change in net assets (defined as total assets less indebtedness) is less than 8.0% of our net assets at the beginning of such period. These calculations are appropriately pro rated during the first three calendar quarters following October 8, 2004 and are adjusted for any share issuances or repurchases.

For the three months ended June 30, 2005, we incurred \$1,027,135 in base management fees and \$1,798,919 in incentive fees. For the six months ended June 30, 2005, we incurred \$1,841,847 in base management fees and \$2,069,202 in incentive fees. As of June 30, 2005, \$2,858,596 was unpaid and included in management and incentive fees payable in the accompanying consolidated balance sheet.

We also entered into a separate administration agreement (the “Administration Agreement”) with Ares Administration under which Ares Administration furnishes us with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities. Under the Administration Agreement, Ares Administration also performs or oversees the performance of our required administrative services, which include, among other things, being responsible for the financial records which we are required to maintain and preparing reports to our stockholders and reports filed with the SEC. In addition, Ares Administration assists us in determining and publishing the net asset value, oversees the preparation and filing of our tax returns and the

printing and dissemination of reports to our stockholders, and generally oversees the payment of our expenses and the performance of administrative and professional services rendered to us by others. Under the Administration Agreement, Ares Administration also provides on our behalf, managerial assistance to those portfolio companies to which we are required to provide such assistance. The Administration Agreement may be terminated by either party without penalty upon 60-days' written notice to the other party.

For the three months ended June 30, 2005, we incurred \$256,115 in administrative fees. For the six months ended June 30, 2005, we incurred \$489,387 in administrative fees. As of June 30, 2005, \$256,115 was unpaid and included in accounts payable and accrued expenses in the accompanying consolidated balance sheet.

4. EARNINGS PER SHARE

The following information sets forth the computation of basic and diluted net increase in stockholders' equity per share resulting from the three months ended June 30, 2005:

| | | |
|---|----|------------|
| Numerator for basic and diluted net increase in stockholders' equity resulting from operations per share: | \$ | 7,602,256 |
| Denominator for basic and diluted net increase in stockholders' equity resulting from operations per share: | | 23,164,444 |
| Basic and diluted net increase in stockholders' equity resulting from operations per share: | \$ | 0.33 |

The following information sets forth the computation of basic and diluted net increase in stockholders' equity per share resulting from the six months ended June 30, 2005:

| | | |
|---|----|------------|
| Numerator for basic and diluted net increase in stockholders' equity resulting from operations per share: | \$ | 16,106,162 |
| Denominator for basic and diluted net increase in stockholders' equity resulting from operations per share: | | 17,683,309 |
| Basic and diluted net increase in stockholders' equity resulting from operations per share: | \$ | 0.91 |

5. INVESTMENTS

For the six months ended June 30, 2005, the Company purchased (A) \$118.1 million aggregate principal amount of senior term debt, (B) \$25.5 million aggregate principal amount of senior subordinated debt, (C) \$18.0 million aggregate principal amount of senior notes and (D) \$5.5 million of investments in equity securities.

In addition, (A) \$34.6 million aggregate principal amount of senior term debt and \$7.3 million aggregate principal amount of senior subordinated debt were redeemed, and (B) \$3.0 million aggregate principal amount senior term debt and \$3.4 million (cost basis) of investments in equity securities were sold.

As of June 30, 2005, investments and cash and cash equivalents consisted of the following:

| | Amortized Cost | Fair Value |
|---------------------------------|-----------------------|-----------------------|
| Cash and cash equivalents | \$ 53,891,961 | \$ 53,891,961 |
| Senior term debt | 143,513,715 | 143,638,563 |
| Senior notes | 24,011,162 | 22,786,048 |
| Senior subordinated debt | 97,288,715 | 97,534,402 |
| Collateralized debt obligations | 8,184,769 | 8,184,769 |
| Equity securities | 29,415,111 | 30,154,424 |
| Total | <u>\$ 356,305,433</u> | <u>\$ 356,190,167</u> |

As of December 31, 2004, investments and cash and cash equivalents consisted of the following:

| | Amortized Cost | Fair Value |
|---------------------------------|-----------------------|-----------------------|
| Cash and cash equivalents | \$ 26,806,160 | \$ 26,806,160 |
| Senior term debt | 63,069,190 | 63,118,678 |
| Senior notes | 6,060,352 | 5,997,645 |
| Senior subordinated debt | 77,925,429 | 78,169,595 |
| Collateralized debt obligations | 8,281,768 | 8,281,768 |
| Equity securities | 26,992,461 | 26,992,461 |
| Total | <u>\$ 209,135,360</u> | <u>\$ 209,366,307</u> |

6. COMMITMENTS AND CONTINGENCIES

As of June 30, 2005, the Company had committed to make a total of approximately \$16.6 million of investments in various revolving senior secured loans. As of June 30, 2005, \$16.6 million was unfunded.

7. CREDIT FACILITY PAYABLE

In accordance with the 1940 Act, with certain limited exceptions, we are only allowed to borrow amounts such that our asset coverage, as defined in the 1940 Act, is at least 200% after such borrowing. On October 29, 2004, we formed Ares Capital CP Funding LLC ("Ares Capital CP"), a wholly-owned subsidiary of the Company, through which we established a revolving credit facility (the "Facility"). On November 3, 2004 (the "Facility Effective Date"), the Company entered into the Facility that allows Ares Capital CP to issue up to \$150.0 million of variable funding certificates ("VFC"). As part of the Facility, we are subject to limitations as to how borrowed funds may be used including restrictions on geographic concentrations, sector concentrations, loan size, payment frequency and status, average life, collateral interests and investment ratings as well as regulatory restrictions on leverage which may affect the amount of VFC that we may issue from time to time. There are also certain requirements relating to portfolio performance, including required minimum portfolio yield and limitations on delinquencies and charge-offs, violation of which could result in the early amortization of the Facility and limit further advances under the Facility and in some cases could be an event of default. Such limitations, requirements, and associated defined terms are as provided for in the documents governing the Facility. As of June 30, 2005 there was zero balance outstanding under the Facility and the Company continues to be in compliance with all of the limitations and requirements of the Facility.

The interest charged on the VFC is based on the commercial paper rate plus 1.25% and payable quarterly. As of June 30, 2005, the commercial paper rate was 3.2088%. For the three months ended June 30, 2005 the average interest rate (i.e. commercial paper rate plus 1.25%) was

4.2688%. For the six months ended June 30, 2005 the average interest rate was 4.0226%. There was no balance outstanding at any time during the three months ended June 30, 2005. For the six months ended June 30, 2005 the average outstanding balance was \$17,127,072. For the three months ended June 30, 2005, no interest expense was incurred. For the six months ended June 30, 2005 the interest expense incurred was \$324,734. Cash paid for interest expense during the six months ended June 30, 2005 was \$385,265.

The Facility expires on November 3, 2005 unless extended prior to such date for an additional 364-day period with the consent of the lender. If the Facility is not extended, any principal amounts then outstanding will be amortized over a 24-month period through a termination date of November 3, 2007. Under the terms of the Facility, we were required to pay a one-time 0.25% structuring fee and a 0.375% renewal fee on each of the two years following the closing date of the Facility. Additionally, we are also required to pay a 0.175% commitment fee for any unused portion of the Facility. For the three months ended June 30, 2005, the commitment fee incurred was \$62,979. For the six months ended June 30, 2005, the commitment fee incurred was \$113,535.

In April 2005, the Company entered into an amendment that increased the amount available for borrowing under the Facility from \$150.0 million to \$225.0 million. As a part of the amendment, the Company was required to pay a one-time structuring fee of 0.25% of the increased available amount equal to \$187,500, and a 0.375% renewal fee on the new total available for borrowing amount. In addition, the commitment fee required to be paid for any unused portion of the Facility was reduced to 0.11% until the earlier of (a) the date the total borrowings outstanding exceed \$150.0 million or (b) October 3, 2005, after which the commitment fee will be 0.175%.

8. DERIVATIVE INSTRUMENTS

As required by the Facility, we entered into a costless collar agreement in order to manage the exposure to changing interest rates related to the Company's fixed rate investments. The costless collar agreement is for a notional amount of \$20 million, has a cap of 6.5%, a floor of 2.72% and matures in 2008. The costless collar agreement allows us to receive an interest payment for any quarterly period when the 3-month LIBOR exceeds 6.5%, and requires us to pay an interest payment for any quarterly period when the 3-month LIBOR is less than 2.72%. The costless collar resets quarterly based on the 3-month LIBOR. As of June 30, 2005, the 3-month LIBOR was 3.52%. As of June 30, 2005 these derivatives had no fair value.

9. RELATED PARTY TRANSACTIONS

Gross underwriting costs related to the IPO were \$7,425,000 or \$0.675 per share. As a part of the IPO, the Investment Adviser, on our behalf, agreed to pay the underwriters \$0.225 of the \$0.675 per share in underwriting discount and commissions for a total of approximately \$2.5 million. We are obligated to repay this amount, together with accrued interest (charged at the 3-month LIBOR plus 2% starting on October 8, 2004) (a) if during any four calendar quarter period ending on or after October 8, 2005 the sum of (i) the aggregate distributions, including return of capital, if any, to the stockholders and (ii) the change in net assets (defined as total assets less indebtedness) equals or exceeds 7.0% of the net assets at the beginning of such period (as adjusted for any share issuances or repurchases) or (b) upon the Company's liquidation. On March 8, 2005, the Company's board of directors approved entering into an amended and restated agreement with the Investment Adviser whereby the Company would be obligated to repay the Investment Adviser for the approximate \$2.5 million only if the conditions for repayment referred to above were met

before the third anniversary of the IPO. If one or more such events do not occur on or before October 8, 2007, we will not be obligated to repay this amount to the Investment Adviser. As of June 30, 2005, such amount was recorded as a payable to the Investment Adviser in the accompanying consolidated balance sheet. Additionally, the Company also recognized the interest expense related to the amount payable to the Investment Adviser in the accompanying consolidated balance sheet and statement of operations.

In accordance with the Advisory Agreement, we bear all costs and expenses of the operation of the Company and reimburse the Investment Adviser for all such costs and expenses incurred in the operation of the Company. For the three months ended June 30, 2005, the Investment Adviser incurred such expenses totaling \$31,220. For the six months ended June 30, 2005, the Investment Adviser incurred such expenses totaling \$41,912. Accordingly, the Company has recorded a liability at June 30, 2005 to the Investment Adviser and it is included in accounts payable and accrued expenses in the accompanying consolidated balance sheet.

As of June 30, 2005, Ares Management LLC, of which Ares Capital Management LLC is a wholly-owned subsidiary, owned 666,667 shares of the Company's common stock representing approximately 2.9% of the total shares outstanding.

See Note 3 for a description of other related party transactions.

10. STOCKHOLDERS' EQUITY

On March 23, 2005, we completed a public add-on offering (the "Add-on Offering") of 12,075,000 shares of common stock (including the underwriters' overallotment of 1,575,000 shares) at \$16.00 per share, less an underwriting discount and commissions totaling \$0.72 per share. Total proceeds received from the Add-on Offering, net of the underwriters' discount and offering costs, were \$183,871,415.

11. DIVIDEND

For the three months ended June 30, 2005, the Company declared a dividend on June 20, 2005 of \$0.32 per share for a total of \$7,413,951. The record date was June 30, 2005 and the dividend was distributed on July 15, 2005. For the three months ended March 31, 2005, the Company declared a dividend on February 23, 2005 of \$0.30 per share for a total of \$3,320,524. The record date was March 7, 2005 and the dividend was distributed on April 15, 2005.

12. FINANCIAL HIGHLIGHTS

The following is a schedule of financial highlights for the six months ended June 30, 2005:

Per Share Data:

| | |
|--|----------------|
| Net asset value, beginning of period (1) | \$ 14.43 |
| Issuance of common stock | 0.42 |
| Effect of antidilution | (0.03) |
| Reimbursement of underwriting costs paid by the Investment Adviser (2) | (0.14) |
| Net investment income for period (2) | 0.91 |
| Net increase in stockholders' equity resulting from operations | 1.16 |
| Distributions from net investment income | (0.53) |
| Distributions from net realized capital gains on securities | (0.09) |
| Total distributions to stockholders | (0.62) |
| Net asset value at end of period (1) | \$ 14.97 |
| Per share market value at end of period | \$ 17.83 |
| Total return based on market value (3) | (5.04)% |
| Total return based on net asset value (4) | 6.18% |
| Shares outstanding at end of period | 23,168,595 |
| Ratio/Supplemental Data: | |
| Net assets at end of period | \$ 346,932,940 |
| Ratio of operating expenses to average net assets (5) | 4.55% |
| Ratio of net investment income to average net assets (5) | 6.98% |
| Portfolio turnover rate (5) | 43% |

(1) The net assets used equals the total stockholders' equity on the consolidated balance sheets.

(2) Weighted average basic per share data.

(3) Total return based on market value equals the decrease of the ending market value at June 30, 2005 of \$17.83 per share over the ending market value at December 31, 2004 of \$19.43, plus the declared dividend of \$0.30 per share for holders of record on March 7, 2005 and the declared dividend of \$0.32 per share for holders of record on June 30, 2005, divided by the market value at December 31, 2004. Total return based on market value is not annualized.

(4) Total return based on net asset value equals the change in net asset value during the period plus the declared dividend of \$0.30 per share for holders of record on March 7, 2005 and the declared dividend of \$0.32 per share for holders of record on June 30, 2005, divided by the beginning net asset value during the period. The calculation was adjusted for shares issued in connection with dividend reinvestment plan, the issuance of common stock in connection with the Add-on Offering, and the reimbursement of underwriting costs paid by the Investment Adviser. Total return based on net asset value is not annualized.

(5) The ratios reflect an annualized amount.

13. IMPACT OF NEW ACCOUNTING STANDARDS

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") 123R, "Share Based Payment," which requires companies to recognize in the statement of operations the grant date fair value of stock options and other equity based compensation issued to employees. SFAS 123R is effective for annual periods beginning after June 15, 2005. As the Company does not have any options or equity based compensation plans, there is no expected impact from the adoption of SFAS 123R.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The information contained in this section should be read in conjunction with our financial statements and notes thereto appearing elsewhere in this quarterly report. In addition, some of the statements in this report constitute forward-looking statements, which relate to future events or the future performance or financial condition of Ares Capital Corporation (the “Company,” “ARCC,” “we,” “us” and “our”). The forward-looking statements contained in this report involve risks and uncertainties, including statements as to:

- our future operating results;
- our business prospects and the prospects of our portfolio companies;
- the impact of investments that we expect to make;
- our contractual arrangements and relationships with third parties;
- the dependence of our future success on the general economy and its impact on the industries in which we invest;
- the ability of our portfolio companies to achieve their objectives;
- our expected financings and investments;
- the adequacy of our cash resources and working capital;
- the timing of cash flows, if any, from the operations of our portfolio companies; and
- the ability of our investment adviser to locate suitable investments for us and to monitor and administer our investments.

We use words such as “anticipates,” “believes,” “expects,” “intends,” “will,” “should,” “may” and similar expressions to identify forward-looking statements. Our actual results could differ materially from those projected in the forward-looking statements for any reason. We have based the forward-looking statements included in this report on information available to us on the date of this report, and we assume no obligation to update any such forward-looking statements. Although we undertake no obligation to revise or update any forward-looking statements, whether as a result of new information, future events or otherwise, you are advised to consult any additional disclosures that we may make directly to you or through reports that we in the future may file with the SEC, including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K.

OVERVIEW

We are a closed-end, non-diversified management investment company incorporated in Maryland that is regulated as a business development company (a “BDC”) under the Investment Company Act of 1940 (“1940 Act”). We were founded on April 16, 2004 and were initially funded on June 23, 2004. On October 8, 2004, we completed our initial public offering (the “IPO”) of 11,000,000 common shares, raising net proceeds of \$159.8 million. On March 23, 2005, we completed an add-on offering of 12,075,000 shares of common stock, raising net proceeds of \$183.9 million.

Our investment objectives are to generate both current income and capital appreciation through debt and equity investments. We invest primarily in first and second lien senior loans and long-term mezzanine debt, which in some cases may include an equity component, and, to a lesser extent, in equity investments in private U.S. middle market companies.

We are externally managed by Ares Capital Management LLC (the “Investment Adviser”), an affiliate of Ares Management LLC, an independent Los Angeles based firm that manages investment funds. Ares Technical Administration LLC (“Ares Administration”), an affiliate of Ares Management LLC, provides the administrative

services necessary for us to operate.

As a BDC, we are required to comply with certain regulatory requirements. For instance, we generally have to invest at least 70% of our total assets in “qualifying assets,” including securities of private U.S. companies, cash, cash equivalents, U.S. government securities and high-quality debt investments that mature in one year or less.

We intend to elect to be treated as a regulated investment company, or a RIC, under Subchapter M of the Internal Revenue Code of 1986, as amended. To qualify as a RIC, we must, among other things, meet certain source-of-income and asset diversification requirements. Pursuant to these elections, we generally will not have to pay corporate-level taxes on any income that we distribute to our stockholders.

PORTFOLIO AND INVESTMENT ACTIVITY

For the three months ended June 30, 2005, we issued nine new commitments in an aggregate amount of \$114.8 million (\$105.6 million to new portfolio companies and \$9.2 million to existing portfolio companies). During the three months ended June 30, 2005, we funded \$110.3 million of such commitments (\$101.1 million to new portfolio companies and \$9.2 million to existing portfolio companies). We have contractual obligations for \$4.5 million with respect to the difference between the \$114.8 million of commitments issued and the \$110.3 million actually funded. The weighted average yield of new debt funded in connection with such investments is approximately 9.71% (computed as (a) annual stated interest rate earned plus the net annual amortization of original issue discount and market discount earned on accruing loans and debt securities, divided by (b) total loans and debt securities at fair value).

For the three months ended June 30, 2005, the Company purchased (a) \$82.9 million aggregate principal amount of senior term debt, (b) \$10.0 million aggregate principal amount of senior subordinated debt, (c) \$12.2 million aggregate principal amount of senior notes and (d) \$5.2 million of investments in equity securities. During the same period, (1) \$27.6 million aggregate principal amount of senior term debt and (2) \$5.3 million aggregate principal amount of senior subordinated debt were redeemed. Additionally, (A) \$3.0 million aggregate principal amount of senior term debt and (B) \$3.2 million of investments in equity securities were sold. As of June 30, 2005, the Company held investments in 27 portfolio companies.

The Investment Adviser employs an investment rating system to categorize our investments. In addition to various risk management and monitoring tools, we grade all loans on a scale of 1 to 4 no less than quarterly. This system is intended to reflect the performance of the borrower’s business, the collateral coverage of the loans and other factors considered relevant. Under this system, loans with a grade of 4 involve the least amount of risk in our portfolio. The borrower is performing above expectations and the trends and risk factors are generally favorable. Loans graded 3 involve a level of risk that is similar to the risk at the time of origination. The borrower is performing as expected and the risk factors are neutral to favorable. All new loans are initially graded 3. Loans graded 2 involve a borrower performing below expectations and indicates that the loan’s risk has increased materially since origination. The borrower is generally out of compliance with debt covenants, however, loan payments are generally not more than 120 days past due. For loans graded 2, we increase procedures to monitor the borrower. A loan grade of 1 indicates that the borrower is performing materially below expectations and that the loan risk has substantially increased since origination. Most or all of the debt covenants are out of compliance and payments are substantially delinquent. Loans graded 1 are not anticipated to be repaid in full.

As of June 30, 2005, the weighted average investment grade of the debt in our portfolio is 3.1 and the weighted average yield of such debt is approximately 11.13% (computed as (a) annual stated interest rate earned plus the net annual amortization of original issue discount and market discount earned on accruing loans and debt securities, divided by (b) total loans and debt securities at fair value). At June 30, 2005, the cost and fair value of loans include the investments in collateralized debt obligations and income producing preferred stock and the yield earned on these investments is included in interest income. The weighted average yield is computed as of the balance sheet date.

RESULTS OF OPERATIONS

We were incorporated on April 16, 2004 and commenced material operations in October 2004. Therefore, there is no comparable period from the prior year with which to compare the results of operations for the three or six months ended June 30, 2005.

For the three months ended June 30, 2005

Operating results for the three months ended June 30, 2005 are as follows:

| | | |
|--|----|--------------------|
| Total Investment Income | \$ | 9,601,615 |
| Total Expenses | | <u>3,833,481</u> |
| Net Investment Income | | 5,768,134 |
| Net Realized Gain | | 6,745,382 |
| Net Unrealized Loss | | <u>(4,911,260)</u> |
| Net Increase in Stockholders' Equity Resulting From Operations | \$ | <u>7,602,256</u> |

Investment Income

Total investment income for the period consisted of approximately \$6.7 million in interest income from investments, \$565,000 in interest income from cash and cash equivalents, \$745,000 in dividend income from investments, \$1,490,000 in capital structuring service fees from the closing of newly originated loans, and \$70,000 in facility fees and other income. Of the approximately \$6.7 million in interest income from investments, non-cash PIK interest income was \$772,000.

Expenses

Total expenses for the period consisted of approximately \$1,027,000 in base management fees, \$1,799,000 in incentive management fees, \$256,000 in general and administrative expenses, \$321,000 in professional fees, \$86,000 for director fees, \$144,000 in insurance expense, \$63,000 in facility fees, \$32,000 in interest expense payable to the Investment Adviser (related to underwriting costs payable to the Investment Adviser), \$66,000 in amortization of debt issuance cost and \$40,000 in other expenses.

Net Unrealized Appreciation on Investments

For the three months ended June 30, 2005, the Company's investments had a decrease in net unrealized appreciation of \$4.9 million. The majority of the decrease is due to the realization of an investment for which we had recorded a \$4.8 million unrealized appreciation as of March 31, 2005.

Net Realized Gains/Losses

During the three months ended June 30, 2005, the Company had \$45.8 million of sales and repayments resulting in \$6.7 million of net realized gains.

Net Increase in Stockholders' Equity Resulting From Operations

Net increase in stockholders' equity resulting from operations for the period was approximately \$7.6 million. Based on the weighted average shares outstanding during the three months ended June 30, 2005, our net increase in stockholders' equity resulting from operations per common share was \$0.33.

For the six months ended June 30, 2005

Operating results for the six months ended June 30, 2005 are as follows:

| | | |
|--|----|------------|
| Total Investment Income | \$ | 15,352,207 |
| Total Expenses | | 6,054,244 |
| Net Investment Income | | 9,297,963 |
| Net Realized Gain | | 7,154,412 |
| Net Unrealized Loss | | (346,213) |
| Net Increase in Stockholders' Equity Resulting From Operations | \$ | 16,106,162 |

Investment Income

Total investment income for the period consisted of approximately \$12.0 million in interest income from investments, \$596,000 in interest income from cash and cash equivalents, \$745,000 in dividend income from investments, \$1.8 million in capital structuring service fees from the closing of newly originated loans, and \$255,000 in facility fees and other income. Of the approximately \$12.0 million in interest income from investments, non-cash PIK interest income was \$1.5 million.

Expenses

Total expenses for the period consisted of approximately \$1.8 million in base management fees, \$2.1 million in incentive management fees, \$489,000 in general and administrative expenses, \$486,000 in professional fees, \$158,000 for director fees, \$287,000 in insurance expenses, \$438,000 in interest expense and facility fees, \$84,000 in interest expense payable to the Investment Adviser (related to underwriting costs payable to the Investment Adviser), \$131,000 in amortization of debt issuance cost and \$70,000 in other expenses.

Net Unrealized Appreciation on Investments

For the six months ended June 30, 2005, the Company's investments had a decrease in net unrealized appreciation of \$346,000.

Net Realized Gains/Losses

During the six months ended June 30, 2005, the Company had \$55.6 million of sales and repayments resulting in \$7.2 million of net realized gains.

Net Increase in Stockholders' Equity Resulting From Operations

Net increase in stockholders' equity resulting from operations for the period was approximately \$16.1 million. Based on the weighted average shares outstanding during the six months ended June 30, 2005, our net increase in stockholders' equity resulting from operations per common share was \$0.91.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

On March 23, 2005, we completed an add-on public offering (the "Add-on Offering") of 12,075,000 shares of common stock (including the underwriters' overallotment of 1,575,000 common shares) at \$16.00 per share, less an underwriting discount and commissions totaling \$.72 per share. We received approximately \$183.9 million in proceeds net of underwriting and offering costs.

A portion of the proceeds from the Add-on Offering was used to repay outstanding indebtedness under our credit facility (the "Facility"). The remaining unused portion of the proceeds from the Add-on Offering has been used to fund investments in portfolio companies in accordance with our investment objectives and strategies.

As of June 30, 2005 and December 31, 2004, the fair value of investments and cash and cash equivalents, and the outstanding borrowings under the Facility were as follows:

| | June 30, 2005 | December 31, 2004 |
|---------------------------------|----------------|-------------------|
| Cash and cash equivalents | \$ 53,891,961 | \$ 26,806,160 |
| Senior term debt | 143,638,563 | 63,118,678 |
| Senior notes | 22,786,048 | 5,997,645 |
| Senior subordinated debt | 97,534,402 | 78,169,595 |
| Collateralized debt obligations | 8,184,769 | 8,281,768 |
| Equity securities | 30,154,424 | 26,992,461 |
| Total | \$ 356,190,167 | \$ 209,366,307 |
| Outstanding borrowings | \$ — | \$ 55,500,000 |

In April 2005, the Company entered into an amendment that increased the available amount for borrowing under the Facility from \$150.0 million to \$225.0 million (see Note 7 to the consolidated financial statements for more detail of the Facility arrangement). As of June 30, 2005, there was no outstanding principal balance under the Facility. The Facility expires on November 3, 2005 unless extended prior to such date for an additional 364-day period with the consent of the lender.

OFF BALANCE SHEET ARRANGEMENTS

As of June 30, 2005, the Company had committed to make a total of approximately \$16.6 million of investments in various revolving senior secured loans. As of June 30, 2005, \$16.6 million was unfunded.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

We are subject to financial market risks, including changes in interest rates and the valuations of our investment portfolio. We are also subject to foreign currency risk as certain of our investments are denominated in Eurodollars.

Interest Rate Risk

As of June 30, 2005, approximately 36% of the investments in our portfolio were at fixed rates while approximately 53% were at variable rates. In addition, the Facility is a variable rate borrowing facility.

To illustrate the potential impact of changes in interest rates, we have performed the following analysis based on our June 30, 2005 balance sheet and assuming no changes in our investment and borrowing structure. Under this analysis, a 100 basis point increase in the various base rates would result in an increase in interest income of approximately \$1,607,000 over the next 12 months. A 100 basis point decrease in the various base rates would result in a decrease in interest income of approximately \$1,607,000 over the next 12 months.

On January 7, 2005, we entered into a costless collar agreement in order to manage the exposure to changing interest rates related to the Company's fixed rate investments. The costless collar agreement was for a notional amount of \$20 million, has a cap of 6.5%, a floor of 2.72% and matures in 2008. The costless collar agreement allows us to receive an interest payment when the 3-month LIBOR exceeds 6.5% and obligates us to pay an interest payment when the 3-month LIBOR is less than 2.72%. The costless collar resets quarterly based on the 3-month LIBOR. As of June 30, 2005, the 3-month LIBOR was 3.52%. As of June 30, 2005, these derivatives had no fair value.

While hedging activities may mitigate our exposure to adverse fluctuations in interest rates, certain hedging transactions that we may enter into in the future, such as interest rate swap agreements, may also limit our ability to participate in the benefits of lower interest rates with respect to our portfolio investments.

We carry our investments at fair value, as determined by our board of directors in good faith based on the input of our investment adviser and audit committee and, where appropriate, an independent valuation firm. Investments for which market quotations are readily available are valued at such market quotations. Debt and equity securities that are not publicly traded or whose market price is not readily available are valued at fair value as determined in good faith by our board of directors. The types of factors that we may take into account in fair value pricing of our investments include, as relevant, the nature and realizable value of any collateral, the portfolio company's ability to make payments and its earnings and discounted cash flow, the markets in which the portfolio company does business, comparison to publicly traded securities and other relevant factors.

When an external event such as a purchase transaction, public offering or subsequent equity sale occurs, we use the pricing indicated by the external event to corroborate our private equity valuation. Because there is not a readily available market value for most of the investments in our portfolio, we value substantially all of our portfolio investments at fair value as determined in good faith by our board under a valuation policy and a consistently applied valuation process. Due to the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments may differ significantly from the values that would have been used had a ready market existed for such investments, and the differences could be material.

In addition, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the valuations currently assigned.

Foreign Currency Risk

As of June 30, 2005, our investment portfolio consisted of 94.2% of investments denominated in U.S. dollars and 5.8% of investments denominated in Euro dollars. We may hedge against foreign exchange rate fluctuations by using standard hedging instruments such as futures, options, and forward contracts. For the quarter ended June 30, 2005, we did not engage in any foreign currency hedging activities.

Item 4. Controls and Procedures.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our President and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15 of the Securities Exchange Act of 1934). Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our current disclosure controls and procedures are effective in timely alerting them of material information relating to the Company that is required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934.

There have been no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2005 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

We are not a defendant in any pending legal proceeding, and no such proceedings are known to be contemplated.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

We did not sell any securities during the period covered in this report that were not registered under the Securities Act.

We did not repurchase any shares issued during the period covered in this report.

Item 3. Defaults Upon Senior Securities.

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders.

On May 24, 2005, we held our Annual Meeting of Stockholders in Los Angeles, California. Stockholders voted on two matters; the substance of these matters and the results of the voting of each such matter are described below. There were no broker non-votes on these matters.

1. Election of Directors: Stockholders elected a Class I director of the Company, who will serve for three years, or until his successor is elected and qualified. Votes were cast as follows:

| | For | Withheld |
|---------------------|------------|----------|
| Douglas E. Coltharp | 21,873,737 | 73,613 |

2. Ratification of the selection of KPMG LLP to serve as independent registered public accounting firm for the year ending December 31, 2005. Votes were cast as follows:

| For | Against | Withheld |
|------------|---------|----------|
| 21,894,982 | 22,144 | 30,224 |

Item 5. Other Information.

None.

Item 6. Exhibits.

EXHIBIT INDEX

| Number | Description |
|--------|--|
| 3.1 | Articles of Amendment and Restatement (1) |
| 3.2 | Amended and Restated Bylaws (1) |
| 4.1 | Form of Stock Certificate (2) |
| 10.1 | Amendment No. 2 to Sale and Servicing Agreement, dated as of April 8, 2005, among Ares Capital CP Funding LLC, Ares Capital Corporation, each of the Conduit Purchasers and Institutional Purchasers from time to time party thereto, each of the Purchaser Agents from time to time party thereto, Wachovia Capital Markets, LLC, as administrative agent, U.S. Bank National Association, as trustee, and Lyon Financial Services, Inc. (D/B/A U.S. Bank Portfolio Services), as the backup servicer (3) |
| 31.1 | Certification by President pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002* |
| 31.2 | Certification by Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002* |

* Filed herewith.

- (1) Previously filed with the Registrant's pre-effective Amendment No. 1 to the Registration Statement under the Securities Act of 1933, as amended, on Form N-2, filed on September 17, 2004.
- (2) Previously filed with the Registrant's pre-effective Amendment No. 2 to the Registration Statement under the Securities Act of 1933, as amended, on Form N-2, filed on September 28, 2004.
- (3) Previously filed with the Registrant's Form 8-K, filed on April 12, 2005.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ARES CAPITAL CORPORATION

Dated: August 8, 2005

By /s/ MICHAEL J. AROUGHETI

Michael J. Arougheti
President

By /s/ DANIEL F. NGUYEN

Daniel F. Nguyen
Chief Financial Officer

Certification of President of Periodic Report Pursuant to Rule 13a-14(a) and Rule 15d-14(a)

I, Michael J. Arougheti, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Ares Capital Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2005

/s/ MICHAEL J. AROUGHETI

Michael J. Arougheti
President

**Certification of Chief Financial Officer
of Periodic Report Pursuant to Rule 13a-14(a) and Rule 15d-14(a)**

I, Daniel F. Nguyen, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Ares Capital Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2005

/s/ DANIEL F. NGUYEN

Daniel F. Nguyen
Chief Financial Officer
(Principal Financial Officer)

**Certification of President and Chief Financial Officer
Pursuant to
18 U.S.C. Section 1350**

In connection with the Quarterly Report on Form 10-Q of Ares Capital Corporation (the "Company") for the quarterly period ended June 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Michael J. Arougheti, as President of the Company, and Daniel F. Nguyen, as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of

operations of the Company.

Date: August 8, 2005

/s/ MICHAEL J. AROUGHETI

Michael J. Arougheti

President

(Principal Executive Officer)

/s/ DANIEL F. NGUYEN

Daniel F. Nguyen

Chief Financial Officer

(Principal Financial Officer)

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Ares Capital Corporation and will be retained by Ares Capital Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

End of Filing

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