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Ares Commercial Real Estate Corp
Form 10-Q
May 01, 2019

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 March 31, 2019

OR

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

For the transition period from _____ to _____

Commission File No. 001-35517

ARES COMMERCIAL REAL ESTATE CORPORATION

(Exact name of Registrant as specified in its charter)

Maryland 45-3148087

(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification Number)

245 Park Avenue, 42nd Floor, New York, NY 10167

(Address of principal executive offices) (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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock, \$0.01 par value per share	ACRE	New York Stock Exchange

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 has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act.

Indicate by check mark whether the registrant is a shell company (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	Outstanding at April 26, 2019
Common stock, \$0.01 par value	28,868,735

ARES COMMERCIAL REAL ESTATE CORPORATION

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PART I — FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

	As of	
	March 31, 2019	December 31, 2018
	(unaudited)	
ASSETS		
Cash and cash equivalents	\$12,814	\$11,089
Restricted cash	379	379
Loans held for investment (\$557,000 and \$289,576 related to consolidated VIEs, respectively)	1,548,158	1,524,873
Real estate owned, net	36,814	—
Other assets (\$1,708 and \$843 of interest receivable related to consolidated VIEs, respectively; \$51,582 of other receivables related to consolidated VIEs as of December 31, 2018)	20,275	66,983
Total assets	\$1,618,440	\$1,603,324
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Secured funding agreements	\$621,549	\$777,974
Secured term loan	108,537	108,345
Collateralized loan obligation securitization debt (consolidated VIE)	442,202	270,737
Due to affiliate	2,259	3,163
Dividends payable	9,520	8,914
Other liabilities (\$882 and \$541 of interest payable related to consolidated VIEs, respectively)	9,271	8,604
Total liabilities	1,193,338	1,177,737
Commitments and contingencies (Note 6)		
STOCKHOLDERS' EQUITY		
Common stock, par value \$0.01 per share, 450,000,000 shares authorized at March 31, 2019 and December 31, 2018 and 28,849,070 and 28,755,665 shares issued and outstanding at March 31, 2019 and December 31, 2018, respectively	283	283
Additional paid-in capital	422,231	421,739
Accumulated earnings	2,588	3,565
Total stockholders' equity	425,102	425,587
Total liabilities and stockholders' equity	\$1,618,440	\$1,603,324

See accompanying notes to consolidated financial statements.

ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share data)

	For the three months ended March 31,	
	2019	2018
	(unaudited)	(unaudited)
Revenue:		
Interest income from loans held for investment	\$27,986	\$ 27,436
Interest expense	(15,740)	(14,299)
Net interest margin	12,246	13,137
Operating revenue from real estate owned	1,911	—
Total revenue	14,157	13,137
Expenses:		
Management and incentive fees to affiliate	1,574	1,558
Professional fees	478	482
General and administrative expenses	1,120	774
General and administrative expenses reimbursed to affiliate	659	924
Operating expenses from real estate owned	1,633	—
Depreciation of real estate owned	54	—
Total expenses	5,518	3,738
Income before income taxes	8,639	9,399
Income tax expense, including excise tax	96	81
Net income attributable to common stockholders	\$8,543	\$ 9,318
Earnings per common share:		
Basic and diluted earnings per common share	\$0.30	\$ 0.33
Weighted average number of common shares outstanding:		
Basic weighted average shares of common stock outstanding	28,561,827	28,495,833
Diluted weighted average shares of common stock outstanding	28,780,980	28,598,916
Dividends declared per share of common stock	\$0.33	\$ 0.28

See accompanying notes to consolidated financial statements.

ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands, except share and per share data)

(unaudited)

	Common Stock		Additional Paid-in Capital	Accumulated Earnings (Deficit)	Total Stockholders' Equity
	Shares	Amount			
Balance at December 31, 2017	28,598,916	\$ 283	\$ 420,637	\$ (1,750)	) \$ 419,170
Stock-based compensation	—	—	234	—	234
Net income	—	—	—	9,318	9,318
Dividends declared	—	—	—	(8,008)	) (8,008)
Balance at March 31, 2018	28,598,916	\$ 283	\$ 420,871	\$ (440)	) \$ 420,714
Stock-based compensation	99,684	—	215	—	215
Net income	—	—	—	9,303	9,303
Dividends declared	—	—	—	(8,036)	) (8,036)
Balance at June 30, 2018	28,698,600	\$ 283	\$ 421,086	\$ 827	) \$ 422,196
Stock-based compensation	—	—	329	—	329
Net income	—	—	—	9,956	9,956
Dividends declared	—	—	—	(8,323)	) (8,323)
Balance at September 30, 2018	28,698,600	\$ 283	\$ 421,415	\$ 2,460	) \$ 424,158
Stock-based compensation	57,065	—	324	—	324
Net income	—	—	—	10,019	10,019
Dividends declared	—	—	—	(8,914)	) (8,914)
Balance at December 31, 2018	28,755,665	\$ 283	\$ 421,739	\$ 3,565	) \$ 425,587
Stock-based compensation	93,405	—	492	—	492
Net income	—	—	—	8,543	8,543
Dividends declared	—	—	—	(9,520)	) (9,520)
Balance at March 31, 2019	28,849,070	\$ 283	\$ 422,231	\$ 2,588	) \$ 425,102

See accompanying notes to consolidated financial statements.

ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	For the three months ended March 31,	
	2019	2018
	(unaudited)	(unaudited)
Operating activities:		
Net income	\$8,543	\$ 9,318
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Amortization of deferred financing costs	1,665	1,487
Accretion of deferred loan origination fees and costs	(1,266)	(1,854)
Stock-based compensation	492	234
Depreciation of real estate owned	54	—
Changes in operating assets and liabilities:		
Other assets	(1,694)	194
Due to affiliate	(904)	(97)
Other liabilities	(101)	413
Net cash provided by (used in) operating activities	6,789	9,695
Investing activities:		
Issuance of and fundings on loans held for investment	(120,305)	(77,260)
Principal repayment of loans held for investment	109,894	79,933
Receipt of origination fees	1,426	1,040
Net cash provided by (used in) investing activities	(8,985)	3,713
Financing activities:		
Proceeds from secured funding agreements	107,019	54,672
Repayments of secured funding agreements	(263,444)	(83,178)
Payment of secured funding costs	(3,413)	(322)
Proceeds from issuance of debt of consolidated VIEs	172,673	—
Dividends paid	(8,914)	(7,722)
Net cash provided by (used in) financing activities	3,921	(36,550)
Change in cash, cash equivalents and restricted cash	1,725	(23,142)
Cash, cash equivalents and restricted cash, beginning of period	11,468	28,722
Cash, cash equivalents and restricted cash, end of period	\$13,193	\$ 5,580

See accompanying notes to consolidated financial statements.

ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of March 31, 2019

(in thousands, except share and per share data, percentages and as otherwise indicated)
(unaudited)

1. ORGANIZATION

Ares Commercial Real Estate Corporation (together with its consolidated subsidiaries, the “Company” or “ACRE”) is a specialty finance company primarily engaged in originating and investing in commercial real estate loans and related investments. Through Ares Commercial Real Estate Management LLC (“ACREM” or the Company’s “Manager”), a Securities and Exchange Commission (“SEC”) registered investment adviser and a subsidiary of Ares Management Corporation (NYSE: ARES) (“Ares Management” or “Ares”), a publicly traded, leading global alternative asset manager, it has investment professionals strategically located across the United States and Europe who directly source new loan opportunities for the Company with owners, operators and sponsors of commercial real estate (“CRE”) properties. The Company was formed and commenced operations in late 2011. The Company is a Maryland corporation and completed its initial public offering (the “IPO”) in May 2012. The Company is externally managed by its Manager, pursuant to the terms of a management agreement (the “Management Agreement”).

The Company is primarily focused on directly originating and managing a diversified portfolio of CRE debt-related investments for the Company’s own account. The Company’s target investments include senior mortgage loans, subordinated debt, preferred equity, mezzanine loans and other CRE investments, including commercial mortgage backed securities. These investments are generally held for investment and are secured, directly or indirectly, by office, multifamily, retail, industrial, lodging, senior-living, self storage, student housing, residential and other commercial real estate properties, or by ownership interests therein.

The Company has elected and qualified to be taxed as a real estate investment trust (“REIT”) for U.S. federal income tax purposes under the Internal Revenue Code of 1986, as amended (the “Code”), commencing with its taxable year ended December 31, 2012. The Company generally will not be subject to U.S. federal income taxes on its REIT taxable income, determined without regard to the deduction for dividends paid and excluding net capital gains, to the extent that it annually distributes all of its REIT taxable income to stockholders and complies with various other requirements as a REIT.

2. SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements and the related management’s discussion and analysis of financial condition and results of operations included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2018 filed with the SEC.

Refer to the Company’s Annual Report on Form 10-K for a description of the Company’s recurring accounting policies. The Company has included disclosure below regarding basis of presentation and other accounting policies that (i) are required to be disclosed quarterly or (ii) the Company views as critical as of the date of this report.

Basis of Presentation

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in conformity with United States generally accepted accounting principles (“GAAP”) and include the accounts of the Company, the consolidated variable interest entities (“VIEs”) that the Company controls and of which the Company is

the primary beneficiary, and the Company's wholly-owned subsidiaries. The consolidated financial statements reflect all adjustments and reclassifications that, in the opinion of management, are necessary for the fair presentation of the Company's results of operations and financial condition as of and for the periods presented. All intercompany balances and transactions have been eliminated.

Interim financial statements are prepared in accordance with GAAP and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. The current period's results of operations will not necessarily be indicative of results that ultimately may be achieved for the year ending December 31, 2019.

Variable Interest Entities

The Company evaluates all of its interests in VIEs for consolidation. When the Company's interests are determined to be variable interests, the Company assesses whether it is deemed to be the primary beneficiary of the VIE. The primary beneficiary of a VIE is required to consolidate the VIE. Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 810, Consolidation, defines the primary beneficiary as the party that has both (i) the power to direct the activities of the VIE that most significantly impact its economic performance, and (ii) the obligation to absorb losses and the right to receive benefits from the VIE which could be potentially significant. The Company considers its variable interests, as well as any variable interests of its related parties in making this determination. Where both of these factors are present, the Company is deemed to be the primary beneficiary and it consolidates the VIE. Where either one of these factors is not present, the Company is not the primary beneficiary and it does not consolidate the VIE.

To assess whether the Company has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, the Company considers all facts and circumstances, including its role in establishing the VIE and its ongoing rights and responsibilities. This assessment includes first, identifying the activities that most significantly impact the VIE's economic performance; and second, identifying which party, if any, has power over those activities. In general, the parties that make the most significant decisions affecting the VIE or have the right to unilaterally remove those decision makers are deemed to have the power to direct the activities of a VIE.

To assess whether the Company has the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE, the Company considers all of its economic interests, including debt and equity investments, servicing fees, and other arrangements deemed to be variable interests in the VIE. This assessment requires that the Compa