

ARES CAPITAL CORP  
Form N-2  
March 25, 2009

[QuickLinks](#) -- Click here to rapidly navigate through this document

As filed with the Securities and Exchange Commission on March 25, 2009

Registration No. 333-

**U.S. SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM N-2**  
REGISTRATION STATEMENT  
UNDER  
THE SECURITIES ACT OF 1933

- o PRE-EFFECTIVE AMENDMENT NO.
- o POST-EFFECTIVE AMENDMENT NO.

**ARES CAPITAL CORPORATION**

(Exact Name of Registrant as Specified in Charter)

**280 Park Avenue, 22<sup>nd</sup> Floor**  
**Building East**  
**New York, New York 10017**  
(Address of Principal Executive Offices)

Registrant's Telephone Number, including Area Code: **(212) 750-7300**

**Michael D. Weiner**  
**c/o Ares Management LLC**  
**2000 Avenue of the Stars, 12<sup>th</sup> Floor**  
**Los Angeles, CA 90067**  
**(310) 201-4200**  
(Name and Address of Agent for Service)

*Copies of information to:*

**Michael A. Woronoff**  
**Monica J. Shilling**  
**Proskauer Rose LLP**  
**2049 Century Park East, 32<sup>nd</sup> Floor**  
**Los Angeles, CA 90067-3206**  
**(310) 557-2900**

**Approximate Date of Proposed Public Offering:** From time to time after the effective date of this Registration Statement.

If any securities being registered on this form will be offered on a delayed or continuous basis in reliance on Rule 415 under the Securities Act of 1933, other than securities offered in connection with a dividend reinvestment plan, check the following box.

**CALCULATION OF REGISTRATION FEE UNDER THE SECURITIES ACT OF 1933**

Edgar Filing: ARES CAPITAL CORP - Form N-2

Title of Securities Being Registered	Amount Being Registered	Proposed Maximum Offering Price Per Unit	Proposed Maximum Aggregate Offering Price(1)	Amount of Registration Fee(2)
Common Stock, \$0.001 par value per share(3)(4)				
Preferred Stock, \$0.001 par value per share(3)				
Subscription Rights(3)				
Warrants(5)				
Debt Securities(6)				
Total			\$400,000,000(7)	\$22,320

- (1) Estimated pursuant to Rule 457(o) solely for the purpose of determining the registration fee.
- (2) Prior to the filing of this registration statement, \$600,000,000 aggregate principal amount of securities remained registered and unsold, pursuant to Registration Statement No. 333-149139, which was initially filed by the Registrant on February 11, 2008. Pursuant to Rule 457(p), the entire fee of \$22,320 required under this registration statement is offset against the \$23,580 filing fee (of which \$1,260 will remain) associated with the unsold securities registered under Registration Statement No. 333-149139.
- (3) Subject to Note 7 below, there is being registered hereunder an indeterminate number of shares of common stock or preferred stock, or subscription rights to purchase shares of common stock as may be sold, from time to time separately or as units in combination with other securities registered hereunder.
- (4) Includes such indeterminate number of shares of common stock as may, from time to time, be issued upon conversion or exchange of other securities registered hereunder, to the extent any such securities are, by their terms, convertible or exchangeable for common stock.
- (5) Subject to Note 7 below, there is being registered hereunder an indeterminate number of warrants as may be sold, from time to time separately or as units in combination with other securities registered hereunder, representing rights to purchase common stock, preferred stock or debt securities.
- (6) Subject to Note 7 below, there is being registered hereunder an indeterminate principal amount of debt securities as may be sold, from time to time separately or as units in combination with other securities registered hereunder. If any debt securities are issued at an original issue discount, then the offering price shall be in such greater principal amount as shall result in an aggregate price to investors not to exceed \$400,000,000.
- (7) In no event will the aggregate offering price of all securities issued from time to time pursuant to this registration statement exceed \$400,000,000.

**THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(a) OF THE SECURITIES ACT OF 1933, AS AMENDED, OR UNTIL THIS REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SECTION 8(a), MAY DETERMINE.**

**The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.**

**Subject to Completion, dated March 25, 2009**

**PROSPECTUS**

**\$400,000,000**

**Common Stock  
Preferred Stock  
Debt Securities  
Subscription Rights  
Warrants**

---

Ares Capital Corporation is a specialty finance company that is a closed-end, non-diversified management investment company incorporated in Maryland. We have elected to be regulated as a business development company under the Investment Company Act of 1940. Our investment objective is 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 includes an equity component. To a lesser extent, we also make equity investments.

We are externally managed by Ares Capital Management LLC, an affiliate of Ares Management LLC, an independent international investment management firm that currently manages investment funds that have approximately \$29 billion of committed capital. Ares Operations LLC, an affiliate of Ares Management LLC, provides the administrative services necessary for us to operate.

Our common stock is traded on The NASDAQ Global Select Market under the symbol "ARCC." On [ ], 2009, the last reported sales price of our common stock on The NASDAQ Global Select Market was \$[ ] per share. The net asset value per share of our common stock at December 31, 2008 (the last date prior to the date of this prospectus on which we determined net asset value) was \$11.27.

**Investing in our securities involves risks that are described in the "Risk Factors" section beginning on page 20 of this prospectus, including the risk of leverage.**

We may offer, from time to time, in one or more offerings or series, up to \$400,000,000 of our common stock, preferred stock, debt securities, subscription rights to purchase shares of our common stock or warrants representing rights to purchase shares of our common stock, preferred stock or debt securities, separately or as units comprised of any combination of the foregoing, which we refer to, collectively, as the "securities." The preferred stock, debt securities, subscription rights and warrants offered hereby may be convertible or exchangeable into shares of our common stock. The securities may be offered at prices and on terms to be described in one or more supplements to this prospectus. In the event we offer common stock, the offering price per share of our common stock less any underwriting commissions or discounts will generally not be less than the net value per share of our common stock at the time we make the offering. However, we may issue shares of our common stock pursuant to this prospectus at a price per share that is less than our net asset value per share (i) in connection with a rights offering to our existing stockholders, (ii) with the prior approval of the majority of our common stockholders or (iii) under such circumstances as the Securities and Exchange Commission (the "SEC") may permit. This prospectus and the accompanying prospectus supplement concisely provide important information you should know before investing in our securities. Please read this prospectus and the accompanying prospectus supplement before you invest and keep it for future reference. We file annual, quarterly and current reports, proxy statements and other information with the SEC. This information is available free of charge by calling us collect at (310) 201-4200 or on our website at [www.arescapitalcorp.com](http://www.arescapitalcorp.com). The SEC also maintains a website at [www.sec.gov](http://www.sec.gov) that contains such information.

---

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

Edgar Filing: ARES CAPITAL CORP - Form N-2

**This prospectus may not be used to consummate sales of securities unless accompanied by a prospectus supplement.**

The date of this prospectus is \_\_\_\_\_, 2009.

---

## Edgar Filing: ARES CAPITAL CORP - Form N-2

You should rely only on the information contained in this prospectus and the accompanying prospectus supplement. We have not authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus and the accompanying prospectus supplement is accurate only as of the date on the front cover of this prospectus and the accompanying prospectus supplement, as applicable. Our business, financial condition, results of operations and prospects may have changed since that date.

### TABLE OF CONTENTS

	<b>Page</b>
Prospectus Summary	1
The Company	1
Offerings	10
Fees and Expenses	12
Selected Financial and Other Data	16
Risk Factors	20
Forward-Looking Statements	42
Use of Proceeds	43
Price Range of Common Stock and Distributions	44
Ratios of Earnings to Fixed Charges	46
Management's Discussion and Analysis of Financial Condition and Results of Operations	47
Senior Securities	65
Business	66
Portfolio Companies	80
Management	89
Certain Relationships	108
Control Persons and Principal Stockholders	109
Determination of Net Asset Value	111
Dividend Reinvestment Plan	113
Material U.S. Federal Income Tax Considerations	115
Description of Securities	124
Description of Our Capital Stock	124
Sales of Common Stock Below Net Asset Value	131
Description of Our Preferred Stock	137
Description of Our Subscription Rights	138
Description of Our Warrants	139
Description of Our Debt Securities	141
Regulation	153
Custodian, Transfer and Dividend Paying Agent and Registrar	158
Brokerage Allocation and Other Practices	159
Plan of Distribution	159
Legal Matters	160
Independent Registered Public Accounting Firm	160
Available Information	160
Financial Statements	F-1

**ABOUT THIS PROSPECTUS**

This prospectus is part of a registration statement that we have filed with the SEC, using the "shelf" registration process. Under the shelf registration process, we may offer, from time to time, up to \$400,000,000 of our common stock, preferred stock, debt securities, subscription rights to purchase shares of our common stock or warrants representing rights to purchase shares of our common stock, preferred stock or debt securities, separately or as units comprised of any combination of the foregoing, on terms to be determined at the time of the offering. The securities may be offered at prices and on terms described in one or more supplements to this prospectus. This prospectus provides you with a general description of the securities that we may offer. Each time we use this prospectus to offer securities, we will provide a prospectus supplement that will contain specific information about the terms of that offering. The prospectus supplement may also add, update or change information contained in this prospectus. Please carefully read this prospectus and the prospectus supplement together with any exhibits and the additional information described under the headings "Available Information" and "Risk Factors" before you make an investment decision.

## PROSPECTUS SUMMARY

*This summary highlights some of the information in this prospectus. It is not complete and may not contain all of the information that you may want to consider. You should read carefully the more detailed information set forth under "Risk Factors" and the other information included in this prospectus. Except where the context suggests otherwise, the terms "we," "us," "our," "the Company" and "Ares Capital" refer to Ares Capital Corporation and its subsidiaries; "Ares Capital Management" or "investment adviser" refers to Ares Capital Management LLC; "Ares Administration" refers to Ares Operations LLC; and "Ares" refers to Ares Partners Management Company LLC and its subsidiary companies, including Ares Management LLC.*

## THE COMPANY

Ares Capital Corporation, a Maryland corporation, is a specialty finance company that is a closed-end, non-diversified management investment company. We have elected to be regulated as a business development company, or a "BDC," under the Investment Company Act of 1940, or the "Investment Company Act." We were founded on April 16, 2004, were initially funded on June 23, 2004 and completed our initial public offering on October 8, 2004. Ares Capital's investment objective is to generate both current income and capital appreciation through debt and equity investments. We invest primarily in U.S. middle market companies, where we believe the supply of primary capital is limited and the investment opportunities are most attractive. However, we may from time to time invest in larger companies. In this prospectus, we generally use the term "middle market" to refer to companies with annual EBITDA between \$5 million and \$100 million. EBITDA represents net income before net interest expense, income tax expense, depreciation and amortization.

We invest primarily in first and second lien senior loans and mezzanine debt, which in some cases includes an equity component like warrants. First and second lien senior loans generally are senior debt instruments that rank ahead of subordinated debt of a given portfolio company. These loans also have the benefit of security interests on the assets of the portfolio company, which may rank ahead of or be junior to other security interests. Mezzanine debt is subordinated to senior loans and is generally unsecured. Our investments have ranged between \$10 million and \$100 million each, although the investment sizes may be more or less than the targeted range and are expected to grow with our capital availability. We also, to a lesser extent, make equity investments. Our equity investments have generally been less than \$20 million each but may grow with our capital availability and are usually made in conjunction with loans we make to these companies.

The proportion of these investments will change over time given our views on, among other things, the economic and credit environment we are operating in. In connection with our investing activities, we may make commitments with respect to indebtedness or securities of a potential portfolio company substantially in excess of our final investment. In such situations, while we may initially agree to fund up to a certain dollar amount of an investment, we may syndicate a portion of such amount to third parties prior to closing such investment, such that we make a smaller investment than what was reflected in our original commitment.

The first and second lien senior loans generally have stated terms of three to 10 years and the mezzanine debt investments generally have stated terms of up to 10 years, but the expected average life of such first and second lien loans and mezzanine debt is generally between three and seven years. However, we may invest in securities with any maturity or duration. The debt that we invest in typically is not initially rated by any rating agency, but we believe that if such investments were rated, they would be below investment grade (rated lower than "Baa3" by Moody's Investors Service or lower than "BBB-" by Standard & Poor's Corporation). We may invest without limit in debt of any rating, as well as debt that has not been rated by any nationally recognized statistical rating organization.

## Edgar Filing: ARES CAPITAL CORP - Form N-2

We believe that our investment adviser, Ares Capital Management, is able to leverage Ares' current investment platform, resources and existing relationships with financial sponsors, financial institutions, hedge funds and other investment firms to provide us with attractive investments. In addition to deal flow, the Ares investment platform assists our investment adviser in analyzing, structuring and monitoring investments. Ares has been in existence for more than 11 years and its senior principals have an average of over 20 years experience investing in senior loans, high yield bonds, mezzanine debt and private equity. The Company has access to the Ares staff of approximately 100 investment professionals and to the approximately 150 administrative professionals employed by Ares who provide assistance in accounting, legal, compliance, technology and investor relations.

While our primary focus is to generate current income and capital appreciation through investments in first and second lien senior loans and mezzanine debt and, to a lesser extent, equity securities of eligible portfolio companies, we also may invest up to 30% of our portfolio in opportunistic investments of non-eligible portfolio companies. Specifically, as part of this 30% basket, we may invest in debt of middle market companies located outside of the United States, in investment funds that are operating pursuant to certain exceptions to the Investment Company Act, in advisers to similar investment funds and in debt and equity of public companies that do not meet the definition of eligible portfolio companies because their market capitalization of publicly traded equity securities exceeds the levels provided for in the Investment Company Act. We expect that these public companies generally will have debt that may be non-investment grade. From time to time we may also invest in high yield bonds, which, depending on the issuer, may or may not be included in the 30% basket.

In addition to making investments in the Ares Capital portfolio, our wholly owned subsidiary, Ivy Hill Asset Management L.P. ("Ivy Hill Management"), manages two unconsolidated senior debt funds, Ivy Hill Middle Market Credit Fund, Ltd. ("Ivy Hill I") and Ivy Hill Middle Market Credit Fund II, Ltd. ("Ivy Hill II" and, together with Ivy Hill I, the "Ivy Hill Funds").

### About Ares

Founded in 1997, Ares is an independent international investment management firm with approximately \$29.0 billion of total committed capital and over 250 employees as of the date of this prospectus.

Ares specializes in originating and managing assets in both the leveraged finance and private equity markets. Ares' leveraged finance activities include the acquisition and management of senior loans, high yield bonds, mezzanine debt and special situation investments. Ares' private equity activities focus on providing flexible, junior capital to middle market companies. Ares has the ability to invest across a capital structure, from senior floating rate debt to common equity. This flexibility, combined with Ares' "buy and hold" philosophy, enables Ares to structure an investment to meet the specific needs of a company rather than the less flexible demands of the public markets.

Ares is comprised of the following groups:

**Private Debt Group.** The Ares Private Debt Group manages the assets of Ares Capital and Ares' private debt middle market financing activities in Europe, Ares Capital Europe ("ACE"). The Private Debt Group focuses primarily on non-syndicated first and second lien senior loans and mezzanine debt, which in some cases may include an equity component. The Private Debt Group also makes equity investments in private middle market companies, usually in conjunction with loans.

**Capital Markets Group.** The Ares Capital Markets Group currently manages a variety of funds and investment vehicles that managed approximately \$17.0 billion of committed capital as of December 31, 2008, focusing primarily on syndicated senior secured loans, high yield bonds, distressed debt, other liquid fixed income investments and other publicly traded debt securities.

**Private Equity Group.** The Ares Private Equity Group manages Ares Corporate Opportunities Fund L.P., Ares Corporate Opportunities Fund II, L.P. and Ares Corporate Opportunities Fund III, L.P. (collectively referred to as "ACOF"), which together managed approximately \$6.2 billion of committed capital as of December 31, 2008. ACOF generally makes private equity investments in companies in amounts substantially larger than the private equity investments anticipated to be made by the Company. The Private Equity Group generally focuses on control-oriented equity investments in under-capitalized companies or companies with capital structure issues.

Ares' senior principals have been working together as a group for many years and have an average of over 20 years of experience in leveraged finance, private equity, distressed debt, investment banking and capital markets. They are backed by a large team of highly-disciplined professionals. Ares' rigorous investment approach is based upon an intensive, independent financial analysis, with a focus on preservation of capital, diversification and active portfolio management. These fundamentals underlie Ares' investment strategy and have resulted in large pension funds, banks, insurance companies, endowments and high net worth individuals investing in Ares' funds.

### **Ares Capital Management**

Ares Capital Management, our investment adviser, is served by a dedicated origination and transaction development team of approximately 30 investment professionals led by the partners of Ares Capital Management, Michael Arougheti, Eric Beckman, Kipp deVeer, Mitchell Goldstein and Michael Smith. Ares Capital Management leverages off of Ares' entire investment platform and benefits from the significant capital markets, trading and research expertise of all of Ares' investment professionals. Ares funds currently hold over 600 investments in over 30 different industries and have made investments in over 1,600 companies since inception. Ares Capital Management's investment committee has nine members, including Founding Members of Ares.

### **MARKET OPPORTUNITY**

We believe there are opportunities for us to invest in middle market companies for the following reasons:

We believe that as of the date of this prospectus, the severe dislocation in the credit markets has resulted in reduced competition, a widening of interest spreads, increased fees and generally more conservative capital structures and deal terms.

We believe that many senior lenders have, in recent years, de-emphasized their service and product offerings to middle market businesses in favor of lending to large corporate clients and managing capital markets transactions. In addition, commercial and investment banks are severely limited in their ability to underwrite new financings as they seek to replenish their capital bases and reduce leverage, resulting in opportunities for alternative funding sources.

We believe there is increased demand among private middle market companies for primary capital. Many middle market firms have faced increased difficulty raising debt in the capital markets, as commercial and investment banks are capital-constrained and largely unable to underwrite and syndicate bank loans and high yield securities, particularly for middle market issuers.

We believe there is a large pool of uninvested private equity capital for middle market companies. We expect private equity firms will seek to leverage their investments by combining capital with senior secured loans and mezzanine debt from other sources.

We believe that as of the date of this prospectus, the current economic downturn has resulted (and will continue to result) in defaults and covenant breaches by middle market companies, which will require new junior capital to shore up liquidity or provide new capital through restructuring.

## **COMPETITIVE ADVANTAGES**

We believe that we have the following competitive advantages over other capital providers to middle market companies:

### **Existing investment platform**

Ares currently manages approximately \$29.0 billion of committed capital in the related asset classes of syndicated loans, high yield bonds, mezzanine debt and private equity. We believe Ares' current investment platform provides a competitive advantage in terms of access to origination and marketing activities and diligence for Ares Capital. Specifically, the Ares platform provides the Company an advantage through its deal flow generation and investment evaluation process. Ares' professionals maintain extensive financial sponsor and intermediary relationships, which provide valuable insight and access to transactions and information.

### **Seasoned management team**

Ares' senior professionals have an average of over 20 years experience in leveraged finance, including substantial experience in investing in leveraged loans, high yield bonds, mezzanine debt, distressed debt and private equity securities. Ares Capital Management's investment professionals and members of its investment committee also have significant experience investing across market cycles. As a result of Ares' extensive investment experience and the history of its seasoned management team, Ares has developed a strong reputation across U.S. and European capital markets. We believe that Ares' long history in the leveraged loan market and the extensive experience of the principals investing across market cycles provides Ares Capital Management with a competitive advantage in identifying, investing in, and managing a portfolio of investments in middle market companies.

### **Experience and focus on middle market companies**

Ares has historically focused on investments in middle market companies and we benefit from this experience. In sourcing and analyzing deals, our investment adviser uses Ares' extensive network of relationships with intermediaries focused on middle market companies to attract well-positioned prospective portfolio company investments. Our investment adviser works closely with the Ares investment professionals, who oversee a portfolio of investments in over 600 companies, and provide access to an extensive network of relationships and special insights into industry trends and the state of the capital markets.

### **Disciplined investment philosophy**

In making its investment decisions, our investment adviser has adopted Ares' long-standing, consistent credit-based investment approach that was developed over 18 years ago by its founders. Specifically, Ares Capital Management's investment philosophy, portfolio construction and portfolio management involve an assessment of the overall macroeconomic environment, financial markets and company-specific research and analysis. Its investment approach emphasizes capital preservation, low volatility and minimization of downside risk.

**Extensive industry focus**

We concentrate our investing activities in industries with a history of predictable and dependable cash flows and in which the Ares investment professionals have had extensive investment experience. Since its inception in 1997, Ares investment professionals have invested in over 1,600 companies in over 30 different industries. Ares investment professionals have developed long-term relationships with management teams and management consultants in these industries, and have accumulated substantial information concerning these industries and identified potential trends within these industries. The experience of Ares' investment professionals investing across these industries throughout various stages of the economic cycle provides our investment adviser with access to market insights and investment opportunities.

**Flexible transaction structuring**

We are flexible in structuring investments, including the types of securities in which we invest and the terms associated with such investments. The principals of Ares have extensive experience in a wide variety of securities for leveraged companies with a diverse set of terms and conditions. We believe this approach and experience enables our investment adviser to identify attractive investment opportunities throughout the economic cycle and across a company's capital structure so we can make investments consistent with our stated investment objective and preserve principal while seeking appropriate risk adjusted returns. In addition, we have the ability to provide "one stop" financing with the ability to invest capital across the balance sheet and hold larger investments than many of our competitors. The ability to underwrite, syndicate and hold larger investments (i) increases flexibility, (ii) may increase net fee income and earnings through syndication, (iii) broadens market relationships and deal flow and (iv) allows us to optimize our portfolio composition. We believe that the ability to provide capital at every level provides a strong value proposition to middle market borrowers and our senior debt capabilities provide superior deal origination and relative value analysis capabilities compared to traditional "mezzanine only" lenders.

**Broad origination strategy**

Our investment adviser focuses on self-originating most of our investments, by identifying a broad array of investment opportunities across multiple channels. It also leverages off of the extensive relationships of the broader Ares platform to identify investment opportunities. We believe that this allows for asset selectivity and that there is a significant relationship between proprietary deal origination and credit performance. Our focus on generating proprietary deal flow and lead investing also gives us greater control over capital structure, deal terms, pricing and documentation and results in active portfolio management of investments. Moreover, by leading the investment process, our investment adviser is able to secure controlling positions in credit tranches providing additional control in investment outcomes. Our investment adviser also has originated substantial proprietary deal flow from middle market intermediaries, which often allows us to act as the sole or principal source of institutional junior capital to the borrower.

**OPERATING AND REGULATORY STRUCTURE**

Our investment activities are managed by Ares Capital Management and supervised by our board of directors, a majority of whom are independent of Ares and its affiliates. Ares Capital Management is an investment adviser that is registered under the Investment Advisers Act of 1940, or the "Advisers Act." Under our amended and restated investment advisory and management agreement, referred to herein as our "investment advisory and management agreement," we have agreed to pay Ares Capital Management an annual base management fee based on our total assets, as defined under the Investment Company Act (other than cash and cash equivalents but including assets purchased with borrowed funds), and an incentive fee based on our performance. See "Management Investment Advisory and Management Agreement."

## Edgar Filing: ARES CAPITAL CORP - Form N-2

As a BDC, we are required to comply with certain regulatory requirements. While we are permitted to finance investments using debt, our ability to use debt is limited in certain significant respects. See "Regulation." We have elected to be treated for U.S. federal income tax purposes as a regulated investment company, or a "RIC," under Subchapter M of the Internal Revenue Code of 1986, or the "Code." See "Material U.S. Federal Income Tax Considerations."

### MARKET CONDITIONS

Due to increasing volatility in global markets, the availability of capital and access to capital markets has been limited. Until constraints on raising new capital ease, we intend to pursue other avenues of liquidity such as adjusting the pace of our investments, becoming more selective in evaluating investment opportunities, pursuing asset sales, and/or recycling lower yielding investments. We also intend to pursue additional opportunities to manage third party funds. As the global liquidity situation and market conditions evolve, we will continue to monitor and adjust our approach to funding accordingly. However, given the unprecedented nature of the volatility in the global markets, there can be no assurances that these activities will be successful. Moreover, if current levels of market disruption and volatility continue or worsen, we could face materially higher financing costs. Consequently, our operating strategy could be materially and adversely affected.

Consistent with the depressed market conditions of the general economy, the stocks of BDCs as an industry have been trading at near historic lows as a result of concerns over liquidity, leverage restrictions and distribution requirements. As a result of the deterioration of the market, several of our peers are no longer active in the market and are winding down their investments, have defaulted on their indebtedness, have decreased their distributions to stockholders or have announced share repurchase programs. We cannot assure you that the market pressures we face will not have a material adverse effect on our business, financial condition and results of operations.

See "Risk Factors Risks Related to Our Business."

### LIQUIDITY

We are party to a Revolving Credit Facility (as defined herein) that provides for up to \$510.0 million of borrowings and up to \$765.0 million if we exercise the "accordion" feature, which expires on December 28, 2010. The Revolving Credit Facility has a current capacity of \$525.0 million. In addition, our wholly owned subsidiary, Ares Capital CP Funding LLC, is party to a separate CP Funding Facility (as defined herein) (together with the Revolving Credit Facility, the "Facilities") that provides for up to \$350.0 million of borrowings, which expires on July 21, 2009, unless extended prior to such date with the consent of the lenders. As of [ ], 2009 we had [ ] available for borrowing under our Facilities. We also have outstanding \$314.0 million of CLO Notes (as defined herein) that mature on December 20, 2019. See "Management's Discussion and Analysis of Financial Condition and Results of Operations Financial Condition, Liquidity and Capital Resources."

### RISK FACTORS

Investing in Ares Capital involves risks. The following is a summary of certain risks that you should carefully consider before investing in our securities. In addition, see "Risk Factors" beginning on page 17 for a more detailed discussion of the factors you should carefully consider before deciding to invest in our securities.

#### Risks Relating to our Business

Capital markets are currently in a period of disruption and instability. These market conditions have materially and adversely affected debt and equity capital markets in the United States, which has had, and may continue to have, a negative impact on our business and operations.

## Edgar Filing: ARES CAPITAL CORP - Form N-2

A failure on our part to maintain our status as a BDC would significantly reduce our operating flexibility.

We are dependent upon Ares Capital Management's key personnel for our future success and upon their access to Ares investment professionals.

Our financial condition and results of operations depend on our ability to manage future growth effectively.

Our ability to grow depends on our ability to raise capital.

Regulations governing our operation as a BDC affect our ability to, and the way in which we, raise additional capital.

We borrow money, which magnifies the potential for gain or loss on amounts invested and may increase the risk of investing with us.

In addition to regulatory restrictions that restrict our ability to raise capital, the Revolving Credit Facility and the CP Funding Facility contain various covenants which, if not complied with, could accelerate repayment under these facilities, thereby materially and adversely affecting our liquidity, financial condition and results of operations.

We operate in a highly competitive market for investment opportunities.

We will be subject to corporate-level income tax if we fail to qualify as a RIC.

We may have difficulty paying our required distributions if we recognize income before or without receiving cash representing such income.

We may in the future determine to fund a portion of our investments with preferred stock, which would magnify the potential for gain or loss and the risks of investing in us in the same way as our borrowings.

We are exposed to risks associated with changes in interest rates.

Many of our portfolio investments are not publicly traded and, as a result, there is uncertainty as to the value of our portfolio investments.

The lack of liquidity in our investments may adversely affect our business.

We may experience fluctuations in our quarterly results.

There are significant potential conflicts of interest that could impact our investment returns.

Our investment adviser's liability is limited under the investment advisory and management agreement, and we are required to indemnify our investment adviser against certain liabilities, which may lead our investment adviser to act in a riskier manner on our behalf than it would when acting for its own account.

## Edgar Filing: ARES CAPITAL CORP - Form N-2

We may be obligated to pay our investment adviser incentive compensation even if we incur a loss.

Changes in laws or regulations governing our operations, or changes in the interpretation thereof, and any failure by us to comply with laws or regulations governing our operations may adversely affect our business.

The Company may not replicate Ares' historical success and our ability to enter into transactions with Ares and our other affiliates is restricted.

**Risks Relating to our Investments**

Price declines and illiquidity in the corporate debt markets have adversely affected, and may continue to adversely affect, the fair value of our portfolio investments, reducing our net asset value through increased net unrealized depreciation.

Economic recessions or downturns could impair our portfolio companies and harm our operating results.

Investments in privately held middle market companies involve significant risks.

Our debt investments may be risky, and we could lose all or part of our investment.

Investments in equity securities involve a substantial degree of risk.

There may be circumstances where our debt investments could be subordinated to claims of other creditors or we could be subject to lender liability claims.

Our portfolio companies may incur debt or issue equity securities that rank equally with, or senior to, our investments in such companies.

When we are a debt or minority equity investor in a portfolio company, we may not be in a position to control the entity, and management of the company may make decisions that could decrease the value of our portfolio holdings.

Our portfolio companies may be highly leveraged.

Our investment adviser's incentive fee may induce Ares Capital Management to make certain investments, including speculative investments.

Our investments in foreign debt may involve significant risks in addition to the risks inherent in U.S. investments. We may expose ourselves to risks if we engage in hedging transactions.

We may initially invest a portion of the net proceeds of offerings pursuant to this prospectus primarily in high-quality short-term investments, which will generate lower rates of return than those expected from the interest generated on first and second lien loans and mezzanine debt.

**Risks Relating to Offerings Pursuant to this Prospectus**

Our shares of common stock currently trade at a discount from net asset value and may continue to do so in the future, which limits our ability to raise additional equity capital.

There is a risk that investors in our equity securities may not receive dividends or that our dividends may not grow over time and that investors in our debt securities may not receive all of the interest income to which they are entitled.

Provisions of the Maryland General Corporation Law and of our charter and bylaws could deter takeover attempts and have an adverse impact on the price of our common stock.

## Edgar Filing: ARES CAPITAL CORP - Form N-2

Investing in our securities may involve an above average degree of risk.

The market price of our common stock may fluctuate significantly.

Stockholders may incur dilution if we sell shares of our common stock in one or more offerings at prices below the current net asset value per share of our common stock or securities to subscribe for or convertible into shares of our common stock.

## Edgar Filing: ARES CAPITAL CORP - Form N-2

Your interest in us may be diluted if you do not fully exercise your subscription rights in any rights offering. In addition, if the subscription price is less than our net asset value per share, then you will experience an immediate dilution of the aggregate net asset value of your shares.

Investors in offerings of our common stock will incur immediate dilution upon the closing of such offering.

Stockholders will experience dilution in their ownership percentage if they do not participate in our dividend reinvestment plan.

There is a risk that you may receive shares of our common stock as dividends.

Sales of substantial amounts of our common stock in the public market may have an adverse effect on the market price of our common stock.

The trading market or market value of our publicly issued debt securities may fluctuate.

Terms relating to redemption may materially adversely affect your return on any debt securities that we may issue.

Our credit ratings may not reflect all risks of an investment in our debt securities.

### **OUR CORPORATE INFORMATION**

Our administrative offices are located at 2000 Avenue of the Stars, 12th Floor, Los Angeles, California 90067, telephone number (310) 201-4200, and our executive offices are located at 280 Park Avenue, 22nd Floor, Building East, New York, New York 10017, telephone number (212) 750-7300.

**OFFERINGS**

We may offer, from time to time, up to \$400,000,000 of our common stock, preferred stock, debt securities, subscription rights to purchase shares of our common stock or warrants representing rights to purchase shares of our common stock, preferred stock or debt securities, or units comprised of any combination of the foregoing, on terms to be determined at the time of the offering. We will offer our securities at prices and on terms to be set forth in one or more supplements to this prospectus. The offering price per share of our common stock, less any underwriting commissions or discounts, generally will not be less than the net asset value per share of our common stock at the time of an offering. However, we may issue shares of our common stock pursuant to this prospectus at a price per share that is less than our net asset value per share (i) in connection with a rights offering to our existing stockholders, (ii) with the prior approval of the majority of our common stockholders or (iii) under such other circumstances as the SEC may permit. Any such issuance of shares of our common stock below net asset value may be dilutive to stockholders. See "Risk Factors Risks Relating to Offerings Pursuant to this Prospectus."

We may offer our securities directly to one or more purchasers, including existing stockholders in a rights offering, through agents that we designate from time to time or to or through underwriters or dealers. The prospectus supplement relating to each offering will identify any agents or underwriters involved in the sale of our securities, and will set forth any applicable purchase price, fee, commission or discount arrangement between us and our agents or underwriters or among our underwriters or the basis upon which such amount may be calculated. See "Plan of Distribution." We may not sell any of our securities through agents, underwriters or dealers without delivery of a prospectus supplement describing the method and terms of the offering of our securities.

Set forth below is additional information regarding offerings of our securities:

Use of proceeds	Unless otherwise specified in a prospectus supplement, we intend to use the net proceeds from the sale of our securities for general corporate purposes, which includes among other things, (i) investing in portfolio companies in accordance with our investment objective and strategies and market conditions and (ii) repaying indebtedness. Each supplement to this prospectus relating to an offering will more fully identify the use of the proceeds from such offering. See "Use of Proceeds."
Distributions	We intend to distribute quarterly dividends to our stockholders out of assets legally available for distribution. Our quarterly dividends, if any, will be determined by our board of directors. For more information, see "Price Range of Common Stock and Distributions."
Taxation	We have elected to be treated for U.S. federal income tax purposes as a RIC. As a RIC, we generally will not pay corporate-level U.S. federal income taxes on any ordinary income or capital gains that we distribute to our stockholders as dividends. To maintain our RIC status, we must meet specified source-of-income and asset diversification requirements and distribute annually an amount equal to at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, reduced by deductible expenses, out of assets legally available for distribution. See "Risk Factors Risks Relating to our Business We will be subject to corporate-level income tax if we are unable to qualify as a RIC" and "Price Range of Common Stock and Distributions."

## Edgar Filing: ARES CAPITAL CORP - Form N-2

Dividend reinvestment plan	We have a dividend reinvestment plan for our stockholders. This is an "opt out" dividend reinvestment plan. As a result, if we declare a cash dividend, then stockholders' dividends will be automatically reinvested in additional shares of our common stock, unless they specifically "opt out" of the dividend reinvestment plan so as to receive cash. Stockholders whose cash dividends are reinvested in additional shares of our common stock will be subject to the same U.S. federal, state and local tax consequences as stockholders who elect to receive their dividends in cash. See "Dividend Reinvestment Plan."
NASDAQ Global Select Market symbol	"ARCC"
Anti-takeover provisions	Our board of directors is divided into three classes of directors serving staggered three-year terms. This structure is intended to provide us with a greater likelihood of continuity of management, which may be necessary for us to realize the full value of our investments. A staggered board of directors also may serve to deter hostile takeovers or proxy contests, as may certain other measures adopted by us. See "Description of our Capital Stock."
Leverage	We borrow funds to make additional investments. We use this practice, which is known as "leverage," to attempt to increase returns to our common stockholders, but it involves significant risks. See "Risk Factors," "Senior Securities" and "Regulation Indebtedness and Senior Securities." With certain limited exceptions, we are only allowed to borrow amounts such that our asset coverage, as defined in the Investment Company Act, equals at least 200% after such borrowing. The amount of leverage that we employ at any particular time will depend on our investment adviser's and our board of directors' assessment of market and other factors at the time of any proposed borrowing.
Management arrangements	Ares Capital Management serves as our investment adviser. Ares Administration serves as our administrator. For a description of Ares Capital Management, Ares Administration, Ares and our contractual arrangements with these companies, see "Management Investment Advisory and Management Agreement," and " Administration Agreement."
Available information	We are required to file periodic reports, proxy statements and other information with the SEC. This information is available free of charge by calling us collect at (310) 201-4200 or on our website at <a href="http://www.arescapitalcorp.com">www.arescapitalcorp.com</a> . The SEC also maintains a website at <a href="http://www.sec.gov">www.sec.gov</a> that contains this information.

## FEES AND EXPENSES

The following table is intended to assist you in understanding the costs and expenses that an investor in our common stock will bear directly or indirectly. We caution you that some of the percentages indicated in the table below are estimates and may vary. Except where the context suggests otherwise, whenever this prospectus contains a reference to fees or expenses paid by "you," "us," "the Company" or "Ares Capital," or that "we" will pay fees or expenses, stockholders will indirectly bear such fees or expenses as investors in Ares Capital.

<b>Stockholder transaction expenses (as a percentage of offering price):</b>	
Sales load paid by us	(1)
Offering expenses borne by us	(2)
Dividend reinvestment plan expenses	None (3)
<b>Total stockholder transaction expenses paid by us</b>	<b>(4)</b>
<b>Estimated annual expenses (as a percentage of consolidated net assets attributable to common stock)(5):</b>	
Management fees	2.87%(6)
Incentive fees payable under investment advisory and management agreement (20% of realized capital gains and 20% of pre-incentive fee net investment income, subject to certain limitations)	2.90%(7)
Interest payments on borrowed funds	3.33%(8)
Other expenses	1.32%(9)
Acquired fund fees and expenses	0.50%(10)
<b>Total annual expenses (estimated)</b>	<b>10.92%(11)</b>

- 
- (1) In the event that the securities to which this prospectus relates are sold to or through underwriters, a corresponding prospectus supplement will disclose the applicable sales load.
- (2) The related prospectus supplement will disclose the estimated amount of offering expenses, the offering price and the offering expenses borne by us as a percentage of the offering price.
- (3) The expenses of the dividend reinvestment plan are included in "other expenses."
- (4) The related prospectus supplement will disclose the offering price and the total stockholder transaction expenses as a percentage of the offering price.
- (5) "Consolidated net assets attributable to common stock" equals net assets at December 31, 2008.
- (6) Our management fee is currently 1.5% of our total assets other than cash and cash equivalents (which includes assets purchased with borrowed amounts). For the purposes of this table, we have assumed that we maintain no cash or cash equivalents and that the management fee will remain at 1.5% as set forth in our current investment advisory and management agreement. We may from time to time decide it is appropriate to change the terms of the agreement. Under the Investment Company Act, any material change to our investment advisory and management agreement must be submitted to stockholders for approval. The 2.87% reflected on the table is calculated on our net assets (rather than our total assets). See "Management Investment Advisory and Management Agreement."
- (7) This item represents our investment adviser's incentive fees based on pre-incentive fee net income for the year ended December 31, 2008 and based on the actual realized capital gains as of December 31, 2008, computed net of realized capital losses and unrealized capital depreciation. We expect to invest or otherwise utilize all of the net proceeds from securities registered under the registration statement of which this prospectus is a part pursuant to a particular prospectus supplement within three months of the date of the

offering pursuant to such prospectus supplement and may have capital gains and interest income that could result in the payment of an

## Edgar Filing: ARES CAPITAL CORP - Form N-2

incentive fee to our investment adviser in the first year after completion of offerings pursuant to this prospectus. Since our inception, the average quarterly incentive fee payable to our investment adviser has been approximately 0.60% of our weighted net assets (2.40% on an annualized basis). For more detailed information about incentive fees previously incurred by us, please see Note 3 to our consolidated financial statements.

The incentive fee consists of two parts:

The first, payable quarterly in arrears, equals 20% of our pre-incentive fee net investment income (including interest that is accrued but not yet received in cash), subject to a 2.00% quarterly (8% annualized) hurdle rate and a "catch-up" provision measured as of the end of each calendar quarter. Under this provision, in any calendar quarter, our investment adviser receives no incentive fee until our net investment income equals the hurdle rate of 2.00% but then receives, as a "catch-up," 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%. The effect of this provision is that, if pre-incentive fee net investment income exceeds 2.50% in any calendar quarter, our investment adviser will receive 20% of our pre-incentive fee net investment income as if a hurdle rate did not apply.

The second part, payable annually in arrears for each calendar year ending on or after December 31, 2004, equals 20% of our realized capital gains on a cumulative basis from inception through the end of the year, if any, computed net of all realized capital losses and unrealized capital depreciation on a cumulative basis, less the aggregate amount of any previously paid capital gain incentive fees.

We will defer cash payment of any incentive fee otherwise earned by our 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) our aggregate distributions to our stockholders and (b) our change in net assets (defined as total assets less indebtedness and before taking into account any incentive fees payable during the period) is less than 8.0% of our net assets at the beginning of such period. These calculations will be adjusted for any share issuances or repurchases.

See "Management Investment Advisory and Management Agreement."

- (8) "Interest payments on borrowed funds" represents our annualized interest expenses based on actual interest and credit facility expense incurred for the year ended December 31, 2008. During the year ended December 31, 2008, our average borrowings were \$819.0 million and cash paid for interest expense was \$34.4 million. We had outstanding borrowings of \$908.8 million at December 31, 2008. This item is based on our assumption that our borrowings and interest costs after an offering will remain similar to those prior to such offering. The prospectus supplement related to the offering of any debt securities pursuant to this prospectus will calculate this item based on the effects of our borrowings and interest costs after the issuance of such debt securities. The amount of leverage that we employ at any particular time will depend on, among other things, our investment adviser's and our board of directors' assessment of market and other factors at the time of any proposed borrowing. See "Risk Factors Risks Relating to our Business We borrow money, which magnifies the potential for gain or loss on amounts invested and may increase the risk of investing with us."
- (9) Includes our overhead expenses, including payments under the administration agreement based on our allocable portion of overhead and other expenses incurred by Ares Administration in performing its obligations under the administration agreement. Such expenses are based on "Other expenses" for the year ended December 31, 2008. See "Management Administration Agreement." The holders of shares of our common stock (and not the holders of our debt securities or preferred stock, if any) indirectly bear the cost associated with our annual expenses.
- (10) The Company's stockholders indirectly bear the expenses of underlying investment companies in which the Company invests. This amount includes the fees and expenses of investment companies

## Edgar Filing: ARES CAPITAL CORP - Form N-2

in which the Company is invested in as of December 31, 2008. Certain of these investment companies are subject to management fees, which generally range from 1% to 2.5% of total net assets, or incentive fees, which generally range between 15% to 25% to net profits. When applicable, fees and expenses are based on historic fees and expenses for the investment companies and for those investment companies with little or no operating history, fees and expenses are based on expected fees and expenses stated in the investment companies' offering memorandum, private placement memorandum or other similar communication without giving effect to any performance. Future fees and expenses for these investment companies may be substantially higher or lower because certain fees and expenses are based on the performance of the investment companies, which may fluctuate over time. The amount of the Company's average net assets used in calculating this percentage was based on average monthly net assets of \$1.2 billion for the year ended December 31, 2008.

(11)

"Total annual expenses" as a percentage of consolidated net assets attributable to common stock are higher than the total annual expenses percentage would be for a company that is not leveraged. We borrow money to leverage our net assets and increase our total assets. The SEC requires that the "Total annual expenses" percentage be calculated as a percentage of net assets (defined as total assets less indebtedness and before taking into account any incentive fees payable during the period), rather than the total assets, including assets that have been funded with borrowed monies. If the "Total annual expenses" percentage were calculated instead as a percentage of consolidated total assets, our "Total annual expenses" would be 5.76% of consolidated total assets.

### Example

The following example demonstrates the projected dollar amount of total cumulative expenses over various periods with respect to a hypothetical investment in our common stock. In calculating the following expense amounts, we have assumed we would have no additional leverage, that none of our assets are cash or cash equivalents, and that our annual operating expenses would remain at the levels set forth in the table above. Transaction expenses are not included in the following example. In the event that shares to which this prospectus relates are sold to or through underwriters, a corresponding prospectus supplement will restate this example to reflect the applicable sales load.

	1 year	3 years	5 years	10 years
You would pay the following expenses on a \$1,000 investment, assuming a 5% annual return(1)	\$ 82	\$ 239	\$ 385	\$ 713

(1)

The above illustration assumes that we will not realize any capital gains computed net of all realized capital losses and unrealized capital depreciation. The expenses you would pay, based on a \$1,000 investment and assuming a 5% annual return resulting entirely from net realized capital gains (and therefore subject to the capital gain incentive fee), and otherwise making the same assumptions in the example above, would be: 1 year, \$92; 3 years, \$267; 5 years, \$428; and 10 years, \$783. However, cash payment of the capital incentive fee would be deferred if during the most recent four full calendar quarter period ending on or prior to the date the payment set forth in the example is to be made, the sum of (a) our aggregate distributions to our stockholders and (b) our change in net assets (defined as total assets less indebtedness and before taking into account any incentive fees payable during the period) was less than 8.0% of our net assets at the beginning of such period (as adjusted for any share issuances or repurchases).

The foregoing table is to assist you in understanding the various costs and expenses that an investor in our common stock will bear directly or indirectly. While the example assumes, as required by the SEC, a 5% annual return, our performance will vary and may result in a return greater or less than 5%. The incentive fee under the investment advisory and management agreement, which, assuming a 5% annual return, would either not be payable or have an insignificant impact on the expense amounts shown above, is not included in the example. If we achieve sufficient returns on our investments, including through the realization of capital gains, to trigger an incentive fee of a material amount, our expenses, and returns to our investors, would be higher. In addition, while the example assumes reinvestment of all dividends and distributions at net asset value, if our board of directors

authorizes and we declare a cash dividend, participants in our dividend reinvestment plan who have not otherwise elected to receive cash will receive a number of shares of our common stock, determined by dividing the total dollar amount of the dividend payable to a participant by the market price per share of our common stock at the close of trading on the valuation date for the dividend. See "Dividend Reinvestment Plan" for additional information regarding our dividend reinvestment plan.

**This example and the expenses in the table above should not be considered a representation of our future expenses, and actual expenses (including the cost of debt, if any, and other expenses) may be greater or less than those shown.**

**SELECTED FINANCIAL AND OTHER DATA**

The following selected financial and other data for the years ended December 31, 2008, 2007, 2006 and 2005, and for the period from June 23, 2004 (inception) through December 31, 2004 are derived from our consolidated financial statements, which have been audited by KPMG LLP, an independent registered public accounting firm whose report thereon is included elsewhere in this prospectus. The data should be read in conjunction with our consolidated financial statements and notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Senior Securities," which are included elsewhere in this prospectus.

Edgar Filing: ARES CAPITAL CORP - Form N-2

ARES CAPITAL CORPORATION AND SUBSIDIARIES  
SELECTED FINANCIAL DATA

As of and For the Years Ended December 31, 2008, 2007, 2006 and 2005 and As of and For the  
Period June 23, 2004 (inception) Through December 31, 2004

(dollar amounts in thousands, except per share data and as otherwise indicated)

	As of and For the Year Ended December 31, 2008	As of and For the Year Ended December 31, 2007	As of and For the Year Ended December 31, 2006	As of and For the Year Ended December 31, 2005	As of and For the Period June 23, 2004 (inception) Through December 31, 2004
Total Investment Income	\$ 240,461	\$ 188,873	\$ 120,021	\$ 41,850	\$ 4,381
Net Realized and Unrealized Gains (Losses) on Investments and Foreign Currencies	(266,447)	(4,117)	13,064	14,727	475
Total Expenses	113,221	94,751	58,458	14,569	1,666
Income Tax Expense (Benefit), Including Excise Tax	248	(826)	4,931	158	
Net Increase (Decrease) in Stockholders' Equity Resulting from Operations	\$ (139,455)	\$ 90,832	\$ 69,695	\$ 41,851	\$ 3,190
Per Share Data:					
Net Increase (Decrease) in Stockholder's Equity Resulting from Operations:					
Basic(1):	\$ (1.56)	\$ 1.34	\$ 1.58	\$ 1.75	\$ 0.28
Diluted(1):	\$ (1.56)	\$ 1.34	\$ 1.58	\$ 1.75	\$ 0.28
Cash Dividend Declared:	\$ 1.68	\$ 1.66	\$ 1.64	\$ 1.30	\$ 0.30
Total Assets	\$ 2,091,333	\$ 1,829,405	\$ 1,347,991	\$ 613,645	\$ 220,456
Total Debt	\$ 908,786	\$ 681,528	\$ 482,000	\$ 18,000	\$ 55,500
Total Stockholders' Equity	\$ 1,094,879	\$ 1,124,550	\$ 789,433	\$ 569,612	\$ 159,708
Other Data:					
Number of Portfolio Companies at Period End(2)	91	78	60	38	20
Principal Amount of Investments Purchased(3)	\$ 925,945	\$ 1,251,300	\$ 1,087,507	\$ 504,299	\$ 234,102
Principal Amount of Investments Sold and Repayments(4)	\$ 485,270	\$ 718,695	\$ 430,021	\$ 108,415	\$ 52,272
Total Return Based on Market Value(5)	(45.25)%	(14.76)%	29.12%	(10.60)%	31.53%
Total Return Based on Net Asset Value(6)	(11.17)%	8.98%	10.73%	12.04%	(1.80)%
Weighted Average Yield of Debt and Income Producing Equity Securities at Fair Value(7):	12.79%	11.68%	11.95%	11.25%	12.36%
Weighted Average Yield of Debt and Income Producing Equity Securities at Amortized Cost(7):	11.73%	11.64%	11.63%	11.40%	12.25%

(1) In accordance with Statement of Financial Accounting Standards No. 128, Earnings Per Share, the weighted average shares of common stock outstanding used in computing basic and diluted earnings per common share have been adjusted retroactively by a factor of 1.02% to recognize the bonus element associated with rights to acquire shares of common stock that we issued to stockholders of record as of March 24, 2008 in connection with a rights offering.

(2)

## Edgar Filing: ARES CAPITAL CORP - Form N-2

Includes commitments to portfolio companies for which funding has yet to occur.

(3)

The information presented for the period June 23, 2004 (inception) through December 31, 2004 includes \$140.8 million of the assets purchased from Royal Bank of Canada and excludes \$9.7 million of publicly traded fixed income securities.

## Edgar Filing: ARES CAPITAL CORP - Form N-2

- (4) The information presented for the period June 23, 2004 (inception) through December 31, 2004 excludes \$9.7 million of publicly traded fixed income securities.
- (5) Total return based on market value for the year ended December 31, 2008 equals the decrease of the ending market value at December 31, 2008 of \$6.33 per share over the ending market value at December 31, 2007 of \$14.63 per share plus the declared dividends of \$1.68 per share for the year ended December 31, 2008. Total return based on market value for the year ended December 31, 2007 equals the decrease of the ending market value at December 31, 2007 of \$14.63 per share over the ending market value at December 31, 2006 of \$19.11 per share plus the declared dividends of \$1.66 per share for the year ended December 31, 2007. Total return based on market value for the year ended December 31, 2006 equals the increase of the ending market value at December 31, 2006 of \$19.11 per share over the ending market value at December 31, 2005 of \$16.07 per share plus the declared dividends of \$1.64 per share for the year ended December 31, 2006. Total return based on market value for the year ended December 31, 2005 equals the decrease of the ending market value at December 31, 2005 of \$16.07 per share over the ending market value at December 31, 2004 of \$19.43 per share plus the declared dividends of \$1.30 per share for the year ended December 31, 2005. Total return based on market value for the period June 23, 2004 (inception) through December 31, 2004 equals the increase of the ending market value at December 31, 2004 of \$19.43 per share over the offering price of \$15.00 per share plus the declared dividend of \$0.30 per share (includes return of capital of \$0.01 per share) for holders of record on December 27, 2004, divided by the offering price. Total return based on market value is not annualized.
- (6) Total return based on net asset value for the year ended December 31, 2008 equals the change in net asset value during the period (adjusted for share issuances) plus the declared dividends of \$1.68 per share for the year ended December 31, 2008, divided by the beginning net asset value. Total return based on net asset value for the year ended December 31, 2007 equals the change in net asset value during the period (adjusted for share issuances) plus the declared dividends of \$1.66 per share for the year ended December 31, 2007, divided by the beginning net asset value. Total return based on net asset value for the year ended December 31, 2006 equals the change in net asset value during the period (adjusted for share issuances) plus the declared dividends of \$1.64 per share for the year ended December 31, 2006, divided by the beginning net asset value. Total return based on net asset value for the year ended December 31, 2005 equals the change in net asset value during the period (adjusted for share issuances) plus the declared dividends of \$1.30 per share for the year ended December 31, 2005, divided by the beginning net asset value. Total return based on net asset value for the period June 23, 2004 (inception) through December 31, 2004 equals the change in net asset value during the period plus the declared dividend of \$0.30 per share (includes return of capital of \$0.01 per share) for holders of record on December 27, 2004, divided by the beginning net asset value. Total return based on net asset value is not annualized.
- (7) Weighted average yield on debt and income producing equity securities at fair value is computed as (a) the annual stated interest rate or yield earned plus the net annual amortization of original issue discount and market discount on accruing debt divided by (b) total income producing equity securities and debt at fair value. Weighted average yield on debt and income producing equity securities at amortized cost is computed as (a) the annual stated interest rate or yield earned plus the net annual amortization of original issue discount and market discount on accruing debt divided by (b) total income producing equity securities and debt at amortized cost.

Edgar Filing: ARES CAPITAL CORP - Form N-2

**SELECTED QUARTERLY DATA (Unaudited)**  
**(dollar amounts in thousands, except per share data)**

**2008**

	<b>Q4</b>	<b>Q3</b>	<b>Q2</b>	<b>Q1</b>
Total Investment Income	\$ 62,723	\$ 62,067	\$ 63,464	\$ 52,207
Net investment income before net realized and unrealized gain (losses) and incentive compensation	\$ 40,173	\$ 41,025	\$ 45,076	\$ 32,466
Incentive compensation	\$ 8,035	\$ 8,205	\$ 9,015	\$ 6,493
Net investment income before net realized and unrealized gain (losses)	\$ 32,138	\$ 32,820	\$ 36,061	\$ 25,973
Net realized and unrealized gains (losses)	\$(142,638)	\$(74,213)	\$(32,789)	\$(16,807)
Net increase (decrease) in stockholders' equity resulting from operations	\$(110,500)	\$(41,393)	\$ 3,272	\$ 9,166
Basic and diluted earnings per common share	\$ (1.14)	\$ (0.43)	\$ 0.04	\$ 0.13
Net asset value per share as of the end of the quarter	\$ 11.27	\$ 12.83	\$ 13.67	\$ 15.17

**2007**

	<b>Q4</b>	<b>Q3</b>	<b>Q2</b>	<b>Q1</b>
Total Investment Income	\$ 53,828	\$47,931	\$47,399	\$39,715
Net investment income before net realized and unrealized gain (losses) and incentive compensation	\$ 33,677	\$29,875	\$31,220	\$23,699
Incentive compensation	\$ 6,573	\$ 5,966	\$ 6,229	\$ 4,755
Net investment income before net realized and unrealized gain (losses)	\$ 27,104	\$23,909	\$24,991	\$18,944
Net realized and unrealized gains (losses)	\$(16,353)	\$ (984)	\$ 8,576	\$ 4,645
Net increase (decrease) in stockholders' equity resulting from operations	\$ 10,752	\$22,924	\$33,567	\$23,589
Basic and diluted earnings per common share	\$ 0.15	\$ 0.32	\$ 0.48	\$ 0.44
Net asset value per share as of the end of the quarter	\$ 15.47	\$ 15.74	\$ 15.84	\$ 15.34

**2006**

	<b>Q4</b>	<b>Q3</b>	<b>Q2</b>	<b>Q1</b>
Total Investment Income	\$ 37,508	\$31,832	\$30,490	\$20,191
Net investment income before net realized and unrealized gain (losses) and incentive compensation	\$ 23,508	\$21,792	\$16,233	\$14,614
Incentive compensation	\$ 5,189	\$ 4,464	\$ 6,940	\$ 2,923
Net investment income before net realized and unrealized gain (losses)	\$ 18,319	\$17,328	\$ 9,293	\$11,692
Net realized and unrealized gain (losses)	\$ 2,699	\$ 813	\$ 7,400	\$ 2,151
Net increase (decrease) in stockholders' equity resulting from operations	\$ 21,018	\$18,141	\$16,693	\$13,843
Basic and diluted earnings per common share	\$ 0.42	\$ 0.38	\$ 0.43	\$ 0.36
Net asset value per share as of the end of the quarter	\$ 15.17	\$ 15.06	\$ 15.10	\$ 15.03

## RISK FACTORS

*Before you invest in our securities, you should be aware of various risks, including those described below. You should carefully consider these risk factors, together with all of the other information included in this prospectus including our consolidated financial statements and the related notes thereto, before you decide whether to make an investment in our securities. The risks set out below are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results. If any of the following events occur, our business, financial condition and results of operations could be materially adversely affected. In such case, the net asset value of our common stock and the trading price of our securities could decline, and you may lose all or part of your investment.*

### RISKS RELATING TO OUR BUSINESS

**Capital markets are currently in a period of disruption and instability. These market conditions have materially and adversely affected debt and equity capital markets in the United States, which has had, and may continue to have, a negative impact on our business and operations.**

Beginning in 2007 and continuing as of the date of this prospectus, the U.S. capital markets entered into a period of disruption as evidenced by a lack of liquidity in the debt capital markets, significant write-offs in the financial services sector, the re-pricing of credit risk in the broadly syndicated credit market and the failure of major financial institutions. Despite actions of the United States federal government, these events have contributed to worsening general economic conditions that are materially and adversely impacting the broader financial and credit markets and reducing the availability of debt and equity capital for the market as a whole and financial services firms in particular. These conditions could continue for a prolonged period of time or worsen in the future. While these conditions persist, we and other companies in the financial services sector may have to access (if available) alternative markets for debt and equity capital in order to grow. Equity capital may be difficult to raise because, subject to some limited exceptions, as a BDC, we are generally not able to issue additional shares of our common stock at a price less than net asset value without first obtaining approval for such issuance from our stockholders and our independent directors. In addition, our ability to incur indebtedness is limited by applicable regulations such that our asset coverage, as defined in the Investment Company Act, must equal at least 200% immediately after each time we incur indebtedness. The debt capital that will be available, if at all, may be at a higher cost and on less favorable terms and conditions in the future. Any continued inability to raise capital could have a negative effect on our business, financial condition and results of operations.

Moreover, current market conditions may make it difficult to extend the maturity of or refinance our existing indebtedness and any failure to do so could have a material adverse effect on our business. For example, the CP Funding Facility is scheduled to mature on July 21, 2009. We are currently discussing an extension of the maturity date of this Facility. If we are unable to obtain an extension, after the maturity of the CP Funding Facility the administrative agent or the trustee may elect to exercise various remedies, including the sale of all or a portion of the collateral securing the Facility after providing us with at least 90-days prior notice of its intention to sell collateral. The illiquidity of our investments may make it difficult for us to sell such investments if required. As a result, we may realize significantly less than the value at which we have recorded our investments.

Capital markets volatility also affects our investment valuations. While most of our investments are not publicly traded, applicable accounting standards require us to assume as part of our valuation process that our investments are sold in a principal market to market participants (even if we plan on holding an investment through its maturity). As a result, volatility in the capital markets can adversely affect our valuations.

## Edgar Filing: ARES CAPITAL CORP - Form N-2

Given the extreme volatility and dislocation in the capital markets, many BDCs are facing a challenging environment in which to raise capital. As a result of the recent significant changes in the capital markets affecting our ability to raise capital, the pace of our investment activity has slowed. In addition, significant changes in the capital markets, including the recent extreme volatility and disruption, has had and may continue to have a negative effect on the valuations of our investments, and on the potential for liquidity events involving our investments. An inability to raise capital (including to renew or replace the CP Funding Facility with other indebtedness), and any required sale of all or a portion of our investments as a result, could have a material adverse impact on our business, financial condition or results of operations.

### **A failure on our part to maintain our status as a BDC would significantly reduce our operating flexibility.**

If we do not continue to qualify as a BDC, we might be regulated as a closed-end investment company under the Investment Company Act, which would subject us to additional regulatory restrictions and significantly decrease our operating flexibility. In addition, any such failure could cause an event of default under our outstanding indebtedness, which could have a material adverse impact on our business, financial condition or results of operations.

### **We are dependent upon Ares Capital Management's key personnel for our future success and upon their access to Ares investment professionals.**

We depend on the diligence, skill and network of business contacts of the members of Ares Capital Management's investment committee. We also depend, to a significant extent, on Ares Capital Management's access to the investment professionals of Ares and the information and deal flow generated by Ares' investment professionals in the course of their investment and portfolio management activities. Our future success depends on the continued service of Ares Capital Management's investment committee. The departure of any of the members of Ares Capital Management's investment committee, or of a significant number of the investment professionals or partners of Ares, could have a material adverse effect on our business, financial condition or results of operations. In addition, we cannot assure you that Ares Capital Management will remain our investment adviser or that we will continue to have access to Ares' investment professionals or its information and deal flow.

### **Our financial condition and results of operations depend on our ability to manage future growth effectively.**

Our ability to achieve our investment objective depends on our ability to acquire suitable investments and monitor and administer those investments, which depends, in turn, on Ares Capital Management's ability to identify, invest in and monitor companies that meet our investment criteria.

Accomplishing this result on a cost-effective basis is largely a function of Ares Capital Management's structuring of the investment process and its ability to provide competent, attentive and efficient services to us. Our executive officers and the members of Ares Capital Management's investment committee have substantial responsibilities in connection with their roles at Ares and with the other Ares funds as well as responsibilities under the investment advisory and management agreement. They may also be called upon to provide managerial assistance to our portfolio companies on behalf of our administrator. These demands on their time, which will increase as the number of investments grow, may distract them or slow the rate of investment. In order to grow, Ares Capital Management will need to hire, train, supervise and manage new employees. However, we cannot assure you that any such employees will be retained. Any failure to manage our future growth effectively could have a material adverse effect on our business, financial condition and results of operations.

## Edgar Filing: ARES CAPITAL CORP - Form N-2

In addition, as we grow, we may open up new offices in new geographic regions that may increase our direct operating expenses without corresponding revenue growth.

### **Our ability to grow depends on our ability to raise capital.**

We will need to periodically access the capital markets to raise cash to fund new investments. In order to maintain our RIC status, we must distribute to our stockholders on a timely basis an amount equal to at least 90% of our ordinary income and net short-term capital gain in excess of net long-term capital loss, if any, reduced by deductible expenses, for each year and, as a result, such earnings are not available to fund investment originations. We must continue to borrow from financial institutions and issue additional securities to fund our growth. Unfavorable economic conditions like the ones we are currently experiencing increase our funding costs, limit our access to the capital markets or could result in a decision by lenders not to extend credit to us. An inability to successfully access the capital markets could limit our ability to grow our business and fully execute our business strategy and could decrease our earnings, if any.

In addition, with certain limited exceptions, we are only allowed to borrow amounts or issue debt securities or preferred stock such that our asset coverage, as defined in the Investment Company Act, equals at least 200% immediately after such borrowing, which, in certain circumstances, may restrict our ability to borrow or issue debt securities or preferred stock. The amount of leverage that we employ will depend on our investment adviser's and our board of directors' assessment of market and other factors at the time of any proposed borrowing or issuance of debt securities or preferred stock. We cannot assure you that we will be able to maintain our current Facilities or obtain other lines of credit at all or on terms acceptable to us.

### **Regulations governing our operation as a BDC affect our ability to, and the way in which we, raise additional capital.**

We may issue debt securities or preferred stock, which we refer to collectively as "senior securities," and/or borrow money from banks or other financial institutions, up to the maximum amount permitted by the Investment Company Act. Under the provisions of the Investment Company Act, we are permitted, as a BDC, to incur indebtedness or issue senior securities only in amounts such that our asset coverage, as defined in the Investment Company Act, equals at least 200% after each such incurrence or issuance. If the value of our assets declines, we may be unable to satisfy this test, which may prohibit us from paying dividends and could prevent us from maintaining our status as a RIC or may prohibit us from repurchasing shares of our common stock. If we cannot satisfy this test, we may be required to sell a portion of our investments at a time when such sales may be disadvantageous and, depending on the nature of our leverage, repay a portion of our indebtedness. As of December 31, 2008, our asset coverage for senior securities was 220%.

We are not generally able to issue and sell our common stock at a price below net asset value per share. We may, however, sell our common stock, or warrants, options or rights to acquire our common stock, at a price below the current net asset value per share of the common stock if our board of directors determines that such sale is in our best interests and the best interests of our stockholders, and, in certain instances, our stockholders approve such sale. Any such sale would be dilutive to existing stockholders. In any such case, the price at which our securities are to be issued and sold may not be less than a price which, in the determination of our board of directors, closely approximates the market value of such securities (less any commission or discount). If our common stock trades at a discount to net asset value, this restriction could adversely affect our ability to raise capital.

To generate cash for funding new investments, we have also securitized, and may in the future seek to securitize, our loans. To securitize loans, we may create a separate, wholly owned subsidiary and contribute or sell a pool of loans to such subsidiary (or one of its subsidiaries). Such subsidiary may

then sell equity, issue debt or sell interests in the pool of loans, on a limited-recourse basis, the payments on which are generally limited to the pool of loans and the proceeds therefrom. We may also retain a portion of the equity interests in the securitized pool of loans. Any retained equity would be exposed to losses on the related pool of loans before any of the related debt securities. An inability to securitize successfully our loan portfolio could limit our ability to grow our business and fully execute our business strategy. The securitization market is subject to changing market conditions (including the recent, unprecedented dislocation of the securitization and finance markets generally) and we may not be able to access this market when we would otherwise deem appropriate. Moreover, the successful securitization of our loan portfolio might expose us to losses as the residual loans in which we do not sell interests may be those that are riskier and more apt to generate losses. The Investment Company Act may also impose restrictions on the structure of any securitization.

**We borrow money, which magnifies the potential for gain or loss on amounts invested and may increase the risk of investing with us.**

As of December 31, 2008, we had \$594.8 million of outstanding borrowings under our Facilities and \$314.0 million of CLO Notes (as defined herein). In order for us to cover our annual interest payments on indebtedness, we must achieve annual returns on our December 31, 2008 total assets of at least 1.75%. The weighted average interest rate charged on our borrowings as of December 31, 2008 was 3.03%. We intend to continue borrowing under the Facilities in the future and we may increase the size of the Facilities or issue debt securities or other evidences of indebtedness. Our ability to service our debt depends largely on our financial performance and is subject to prevailing economic conditions and competitive pressures. The amount of leverage that we employ at any particular time will depend on our investment adviser's and our board of directors' assessment of market and other factors at the time of any proposed borrowing.

Our Facilities and the CLO Notes (as defined herein) impose financial and operating covenants that restrict our business activities, including limitations that could hinder our ability to finance additional loans and investments or to make the distributions required to maintain our status as a RIC. A failure to renew our Facilities or to add new or replacement debt facilities could have a material adverse effect on our business, financial condition and results of operations.

Borrowings, also known as leverage, magnify the potential for gain or loss on amounts invested and, therefore, increase the risks associated with investing in our securities. We currently borrow under our Facilities and in the future may borrow from or issue senior debt securities to banks, insurance companies and other lenders. Holders of such senior debt securities have fixed dollar claims on our consolidated assets that are superior to the claims of our common stockholders or any preferred stockholders. If the value of our consolidated assets increases, then leveraging would cause the net asset value per share of our common stock to increase more sharply than it would have had we not leveraged. Conversely, if the value of our consolidated assets decreases, leveraging would cause net asset value to decline more sharply than it otherwise would have had we not leveraged. Similarly, any increase in our consolidated income in excess of consolidated interest payable on the borrowed funds would cause our net income to increase more than it would without the leverage, while any decrease in our consolidated income would cause net income to decline more sharply than it would have had we not borrowed. Such a decline could negatively affect our ability to make common stock dividend payments. There can be no assurance that a leveraging strategy will be successful.

## Edgar Filing: ARES CAPITAL CORP - Form N-2

The following table illustrates the effect on return to a holder of our common stock of the leverage created by our use of borrowing at the interest rate of 3.03% and assumes (i) our total value of net assets as of December 31, 2008; (ii) \$908.8 million debt outstanding as of December 31, 2008 and (iii) hypothetical annual returns on our portfolio of minus 15 to plus 15 percent.

Assumed Return on Portfolio (Net of Expenses)(1)	-15%	-10%	-5%	0%	5%	10%	15%
Corresponding Return to Common Stockholders(2)	-31%	-22%	-12%	-3%	7%	17%	26%

(1) The assumed portfolio return is required by regulation of the SEC and is not a prediction of, and does not represent, our projected or actual performance. Actual returns may be greater or less than those appearing in the table.

(2) In order to compute the "Corresponding Return to Common Stockholders," the "Assumed Return on Portfolio" is multiplied by the total value of our assets at December 31, 2008 to obtain an assumed return to us. From this amount, the interest expense calculated by multiplying the interest rate of 3.03% times the \$908.8 million debt is subtracted to determine the return available to stockholders. The return available to stockholders is then divided by the total value of our net assets as of December 31, 2008 to determine the "Corresponding Return to Common Stockholders."

**In addition to regulatory restrictions that restrict our ability to raise capital, the Revolving Credit Facility and the CP Funding Facility contain various covenants which, if not complied with, could accelerate repayment under these Facilities, thereby materially and adversely affecting our liquidity, financial condition and results of operations.**

The agreements governing the Facilities require us to comply with certain financial and operational covenants. These covenants include:

restrictions on the level of indebtedness that we are permitted to incur in relation to the value of our assets;

restrictions on our ability to incur liens; and

maintenance of a minimum level of stockholders' equity.

As of December 31, 2008, we were in compliance with these covenants. However, our continued compliance with these covenants depends on many factors, some of which are beyond our control. For example, during the quarter ended December 31, 2008, net unrealized depreciation in our portfolio increased and, depending on the condition of the public debt and equity markets and pricing levels subsequent to this period, net unrealized depreciation in our portfolio may continue to increase in the future. Any such further increase could result in our inability to comply with our obligation to restrict the level of indebtedness that we are able to incur in relation to the value of our assets or to maintain a minimum level of stockholders' equity.

Accordingly, although we believe we will continue to be in compliance, there are no assurances that we will continue to comply with the covenants in our Facilities. Failure to comply with these covenants would result in a default under the Facilities which, if we were unable to obtain a waiver from the lenders under the Facilities, could accelerate repayment under the Facilities and thereby have a material adverse impact on our business, financial condition and results of operations.

**We operate in a highly competitive market for investment opportunities.**

A number of entities compete with us to make the types of investments that we make in middle market companies. We compete with other BDCs, public and private funds, commercial and investment banks, commercial financing companies, insurance companies, high yield investors, hedge

funds, and, to the extent they provide an alternative form of financing, private equity funds. Many of our competitors are substantially larger and have considerably greater financial, technical and marketing resources than we do. Some competitors may have a lower cost of funds and access to funding sources that are not available to us. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than us. Furthermore, many of our competitors are not subject to the regulatory restrictions that the Investment Company Act imposes on us as a BDC and that the Code imposes on us as a RIC. We cannot assure you that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations. Also, as a result of this competition, we may not be able to pursue attractive investment opportunities from time to time.

We do not seek to compete primarily based on the interest rates we offer and we believe that some of our competitors may make loans with interest rates that are comparable to or lower than the rates we offer. Rather, we compete with our competitors based on our existing investment platform, our seasoned management team, our experience and focus on middle market companies, our disciplined investment philosophy, our extensive industry focus and our flexible transaction structuring. For a more detailed discussion of these competitive advantages, see "Business Competitive Advantages."

We may lose investment opportunities if we do not match our competitors' pricing, terms and structure. If we match our competitors' pricing, terms and structure, we may experience decreased net interest income and increased risk of credit loss. As a result of operating in such a competitive environment, we may make investments that are on better terms to our portfolio companies than what we may have originally anticipated, which may impact our return on these investments.

**We will be subject to corporate-level income tax if we fail to qualify as a RIC.**

The Company has elected to be treated as a RIC under Subchapter M of the Code and operates in a manner so as to qualify for the tax treatment applicable to RICs. As a RIC, we generally will not pay corporate-level U.S. federal income taxes on any ordinary income or capital gains that we distribute to our stockholders as dividends. To qualify as a RIC under the Code, we must meet certain income source, asset diversification and annual distribution requirements.

The annual distribution requirement for a RIC is satisfied if we distribute to our stockholders on a timely basis an amount equal to at least 90% of our ordinary income and net short-term capital gain in excess of net long-term capital loss, if any, reduced by deductible expenses, for each year. Because we use debt financing, we are subject to certain asset coverage ratio requirements under the Investment Company Act and financial covenants under our indebtedness that could, under certain circumstances, restrict us from making distributions necessary to qualify as a RIC. If we are unable to obtain cash from other sources, we may fail to qualify as a RIC and, thus, may be subject to corporate-level income tax. Because we must make distributions to our stockholders as described above, such amounts, to the extent a stockholder is not participating in our dividend reinvestment plan, will not be available to fund investment originations.

To qualify as a RIC, we must also meet certain asset diversification requirements at the end of each calendar quarter. Failure to meet these tests may result in our having to (i) dispose of certain investments quickly or (ii) raise additional capital to prevent the loss of RIC status. Because most of our investments are in private companies and are generally illiquid, any such dispositions may be at disadvantageous prices and may result in losses. Also, the rules applicable to our qualification as a RIC under the Code are complex with many areas of uncertainty. Accordingly, no assurance can be given that we have qualified or will qualify as a RIC. If we fail to qualify as a RIC for any reason and become subject to corporate income tax, the resulting corporate taxes could substantially reduce our

net assets, the amount of income available for distribution and the amount of our distributions. Such a failure would have a material adverse effect on us and our stockholders. See "Material U.S. Federal Income Tax Considerations Taxation as a RIC."

**We may have difficulty paying our required distributions if we recognize income before or without receiving cash representing such income.**

For U.S. federal income tax purposes, we include in income certain amounts that we have not yet received in cash, such as original issue discount, which may arise if we receive warrants in connection with the making of a loan or possibly in other circumstances, or payment-in-kind interest, which represents contractual interest added to the loan balance and due at the end of the loan term. Such original issue discount or increases in loan balances are included in income before we receive any corresponding cash payments. We also may be required to include in income certain other amounts that we will not receive in cash, including, for example, non cash income from payment in kind securities and deferred payment securities.

Since in certain cases we may recognize income before or without receiving cash representing such income, we may have difficulty meeting the tax requirement to distribute an amount equal to at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, reduced by deductible expenses, to maintain our status as a RIC. Accordingly, we may have to sell some of our investments at times we would not consider advantageous, raise additional debt or equity capital or reduce new investment originations to meet these distribution requirements. If we are not able to obtain cash from other sources, we may fail to qualify as a RIC and thus be subject to corporate-level income tax. See "Material U.S. Federal Income Tax Considerations Taxation as a RIC."

If a portfolio company defaults on a loan that is structured to provide accrued interest, it is possible that accrued interest previously used in the calculation of the incentive fee will become uncollectible. 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 receive as a result of a default by an entity on the obligation that resulted in the accrual of such income.

**We may in the future determine to fund a portion of our investments with preferred stock, which would magnify the potential for gain or loss and the risks of investing in us in the same way as our borrowings.**

Because preferred stock is another form of leverage and the dividends on any preferred stock we issue must be cumulative, preferred stock has the same risks to our common stockholders as borrowings. Payment of such dividends and repayment of the liquidation preference of such preferred stock must take preference over any dividends or other payments to our common stockholders, and preferred stockholders are not subject to any of our expenses or losses and are not entitled to participate in any income or appreciation in excess of their stated preference.

**We are exposed to risks associated with changes in interest rates.**

General interest rate fluctuations may have a substantial negative impact on our investments and investment opportunities and, accordingly, may have a material adverse effect on our investment objective and our rate of return on invested capital. Because we borrow money and may issue debt securities or preferred stock to make investments, our net investment income is dependent upon the difference between the rate at which we borrow funds or pay interest or dividends on such debt securities or preferred stock and the rate at which we invest these funds. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income. Trading prices for debt that pays a fixed rate of return tend to fall as

interest rates rise. Trading prices tend to fluctuate more for fixed-rate securities that have longer maturities. We have entered into certain hedging transactions, such as interest rate swap agreements, to mitigate our exposure to adverse fluctuations in interest rates, and we may continue to do so in the future. However, we cannot assure you that such transactions will be successful in mitigating our exposure to credit risk. Hedging transactions may also limit our ability to participate in the benefits of lower interest rates with respect to our portfolio investments. Although we have no policy governing the maturities of our investments, under current market conditions we expect that we will invest in a portfolio of debt generally having maturities of up to 10 years. This means that we are subject to greater risk (other things being equal) than a fund invested solely in shorter-term securities. A decline in the prices of the debt we own could adversely affect the trading price of our shares. Also, an increase in interest rates available to investors could make investment in our common stock less attractive if we are not able to increase our dividend rate, which could reduce the value of our common stock.

**Many of our portfolio investments are not publicly traded and, as a result, there is uncertainty as to the value of our portfolio investments.**

A large percentage of our portfolio investments are not publicly traded. The fair value of investments that are not publicly traded may not be readily determinable. We value these investments quarterly at fair value as determined in good faith by our board of directors based on the input of our management and audit committee and independent valuation firms that have been engaged at the direction of the board to assist in the valuation of each portfolio investment without a readily available market quotation at least once during a trailing 12 month period. The valuation process is conducted at the end of each fiscal quarter, with approximately 50% (based on value) of our valuations of portfolio companies without readily available market quotations subject to review by an independent valuation firm. However, we may use additional independent valuation firms to value our investments more frequently as determined in good faith by our board of directors to the extent necessary to reflect significant events affecting the value of our investments. The types of factors that may be considered in valuing our investments include the enterprise value of the portfolio company, the nature and realizable value of any collateral, the portfolio company's ability to make payments and its earnings, the markets in which the portfolio company does business, comparison to publicly traded companies, discounted cash flow and other relevant factors. Because such valuations, and particularly valuations of private investments and private companies, are inherently uncertain, may fluctuate over short periods of time and may be based on estimates, our determinations of fair value may differ materially from the values that would have been used if a ready market for these investments existed and may differ materially from the values that we may ultimately realize. Our net asset value per share could be adversely affected if our determinations regarding the fair value of these investments are materially higher than the values that we realize upon disposition of such investments.

**The lack of liquidity in our investments may adversely affect our business.**

As we generally make investments in private companies, substantially all of these investments are subject to legal and other restrictions on resale or are otherwise less liquid than publicly traded securities. The illiquidity of our investments may make it difficult for us to sell such investments if the need arises. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we have recorded our investments. In addition, we may face other restrictions on our ability to liquidate an investment in a portfolio company to the extent that we or an affiliated manager of Ares has material non-public information regarding such portfolio company.

**We may experience fluctuations in our quarterly results.**

We could experience fluctuations in our quarterly operating results due to a number of factors, including the interest rates payable on the debt investments we make, the default rates on such investments, the level of our expenses, variations in and the timing of the recognition of realized and unrealized gains or losses and the degree to which we encounter competition in our markets and general economic conditions. As a result of these factors, results for any period should not be relied upon as being indicative of performance in future periods.

**There are significant potential conflicts of interest that could impact our investment returns.**

Certain of our executive officers and directors, and members of the investment committee of our investment adviser serve or may serve as officers, directors or principals of other entities and affiliates of our investment adviser and investment funds managed by our affiliates. Accordingly, they may have obligations to investors in those entities, the fulfillment of which might not be in the best interests of us or our stockholders or that may require them to devote time to services for other entities, which could interfere with the time available to provide services to us. For example, Messrs. Ressler, Rosenthal, Kissick and Sachs each are and, will continue to be, Founding Members of Ares with significant responsibilities for other Ares funds. Messrs. Ressler and Rosenthal are required to devote a substantial majority of their business time, and Mr. Kissick is required to devote a majority of his business time, to the affairs of ACOF. However, Ares believes that the efforts of Messrs. Ressler, Rosenthal and Kissick relative to Ares Capital and ACOF are synergistic with and beneficial to the affairs of each of Ares Capital and ACOF.

Although other Ares funds generally have different primary investment objectives than Ares Capital, they may from time to time invest in asset classes similar to those targeted by Ares Capital. Ares Capital Management endeavors to allocate investment opportunities in a fair and equitable manner, and in any event consistent with any fiduciary duties owed to Ares Capital. Nevertheless, it is possible that we may not be given the opportunity to participate in certain investments made by investment funds managed by investment managers affiliated with Ares Capital Management.

We pay management and incentive fees to Ares Capital Management, and reimburse Ares Capital Management for certain expenses it incurs. In addition, investors in our common stock will invest on a gross basis and receive distributions on a net basis after expenses, resulting in, among other things, a lower rate of return than one might achieve through direct investments.

Ares Capital Management's management fee is based on a percentage of our total assets (other than cash or cash equivalents but including assets purchased with borrowed funds) and Ares Capital Management may have conflicts of interest in connection with decisions that could affect the Company's total assets, such as decisions as to whether to incur indebtedness.

The incentive fees payable to our investment adviser are subject to certain hurdles. To the extent we or Ares Capital Management are able to exert influence over our portfolio companies, these hurdles may provide Ares Capital Management (subject to its fiduciary duty to us) with an incentive to induce our portfolio companies to accelerate or defer interest or other obligations owed to us from one calendar quarter to another under circumstances where accrual would not otherwise occur, such as acceleration or deferral of the declaration of a dividend or the timing of a voluntary redemption.

Acceleration of obligations may result in stockholders recognizing taxable gains earlier than anticipated, while deferral of obligations creates incremental risk of an obligation becoming uncollectible in whole or in part if the issuer of the security suffers subsequent deterioration in its financial condition. Any such inducement by the investment adviser solely for the purpose of adjusting the incentive fees would be a breach of the investment adviser's fiduciary duty to us.

## Edgar Filing: ARES CAPITAL CORP - Form N-2

The part of the incentive fee payable by us that relates to our pre-incentive fee net investment income is computed and paid on income that may include interest that is accrued but not yet received in cash. If a portfolio company defaults on a loan that is structured to provide accrued interest, it is possible that accrued interest previously used in the calculation of the incentive fee will become uncollectible.

Our investment advisory and management agreement automatically renews for successive annual periods if approved by our board of directors or by the affirmative vote of the holders of a majority of our outstanding voting securities, including, in either case, approval by a majority of our directors who are not interested persons. However, both we and Ares Capital Management have the right to terminate the agreement without penalty upon 60 days' written notice to the other party. Moreover, conflicts of interest may arise if our investment adviser seeks to change the terms of our investment advisory and management agreement, including, for example, the terms for compensation. While any material change to the investment advisory and management agreement must be submitted to stockholders for approval under the Investment Company Act, we may from time to time decide it is appropriate to seek stockholder approval to change the terms of the agreement.

Pursuant to a separate amended and restated administration agreement, referred to herein as our "administration agreement", Ares Administration, an affiliate of Ares Capital Management, furnishes us with administrative services and we pay Ares Administration our allocable portion of overhead and other expenses incurred by Ares Administration in performing its obligations under the administration agreement, including our allocable portion of the cost of our officers and their respective staffs.

Our wholly owned subsidiary, Ivy Hill Management, is party to a services agreement, referred to herein as the "services agreement," with Ares Capital Management, pursuant to which Ares Capital Management provides Ivy Hill Management with the facilities, investment advisory services and administrative services necessary for the operations of Ivy Hill Management. Ivy Hill Management reimburses Ares Capital Management for the costs associated with such services, including Ares Capital Management's allocable portion of overhead and the cost of its officers and respective staff on performing its obligations under the services agreement.

We lease office facilities directly (the "ARCC Office Space") from a third party. We have entered into a sublease with Ares Management LLC ("Ares Management") whereby Ares Management subleases approximately 25% of the ARCC Office Space for a fixed rent equal to 25% of the basic annual rent payable by us under our lease, plus certain additional costs and expenses. As a result of these arrangements, there may be times when the management team of Ares Management has interests that differ from those of our stockholders, giving rise to a conflict.

Our stockholders may have conflicting investment, tax and other objectives with respect to their investments in us. The conflicting interests of individual stockholders may relate to or arise from, among other things, the nature of our investments, the structure or the acquisition of our investments, and the timing of disposition of our investments. As a consequence, conflicts of interest may arise in connection with decisions made by our investment adviser, including with respect to the nature or structuring of our investments, that may be more beneficial for one stockholder than for another stockholder, especially with respect to stockholders' individual tax situations. In selecting and structuring investments appropriate for us, our investment adviser will consider the investment and tax objectives of the Company and our stockholders as a whole, not the investment, tax or other objectives of any stockholder individually.

**Our investment adviser's liability is limited under the investment advisory and management agreement, and we are required to indemnify our investment adviser against certain liabilities, which may lead our investment adviser to act in a riskier manner on our behalf than it would when acting for its own account.**

Our investment adviser has not assumed any responsibility to us other than to render the services described in the investment advisory and management agreement, and it will not be responsible for any action of our board of directors in declining to follow our investment adviser's advice or recommendations. Pursuant to the investment advisory and management agreement, our investment adviser and its managing members, officers and employees will not be liable to us for their acts under the investment advisory and management agreement, absent willful misfeasance, bad faith, gross negligence or reckless disregard in the performance of their duties. We have agreed to indemnify, defend and protect our investment adviser and its managing members, officers and employees with respect to all damages, liabilities, costs and expenses resulting from acts of our investment adviser not arising out of willful misfeasance, bad faith, gross negligence or reckless disregard in the performance of their duties under the investment advisory and management agreement. These protections may lead our investment adviser to act in a riskier manner when acting on our behalf than it would when acting for its own account. See "Risk Factors Risks Relating to our Investments Our investment adviser's incentive fee may induce Ares Capital Management to make certain investments, including speculative investments."

**We may be obligated to pay our investment adviser incentive compensation even if we incur a loss.**

Our investment adviser is entitled to incentive compensation for each fiscal quarter in an amount equal to a percentage of the excess of our pre-incentive fee net investment income for that quarter (before deducting incentive compensation, net operating losses and certain other items) above a threshold return for that quarter. Our pre-incentive fee net investment income for incentive compensation purposes excludes realized and unrealized capital losses or depreciation that we may incur in the fiscal quarter, even if such capital losses or depreciation result in a net loss on our statement of operations for that quarter. Thus, we may be required to pay our manager incentive compensation for a fiscal quarter even if there is a decline in the value of our portfolio or we incur a net loss for that quarter.

Under the investment advisory and management agreement, we will defer cash payment of any incentive fee otherwise earned by our 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) our aggregate distributions to our stockholders and (b) our change in net assets (defined as total assets less indebtedness and before taking into account any incentive fees payable during the period) is less than 8.0% of our net assets at the beginning of such period. These calculations will be adjusted for any share issuances or repurchases. Any deferred incentive fees will be carried over for payment in subsequent calculation periods to the extent such payment can then be made under the investment advisory and management agreement.

**Changes in laws or regulations governing our operations, or changes in the interpretation thereof, and any failure by us to comply with laws or regulations governing our operations may adversely affect our business.**

We and our portfolio companies are subject to regulation by laws at the local, state and federal levels. These laws and regulations, as well as their interpretation, may be changed from time to time. Accordingly, any change in these laws or regulations, or their interpretation, or any failure by us to comply with these laws or regulations may adversely affect our business.

**The Company may not replicate Ares' historical success and our ability to enter into transactions with Ares and our other affiliates is restricted.**

Our primary focus in making investments differs from those of other private funds that are or have been managed by Ares' investment professionals. Further, investors in Ares Capital are not acquiring an interest in other Ares funds. Accordingly, we cannot assure you that Ares Capital will replicate Ares' historical success, and we caution you that our investment returns could be substantially lower than the returns achieved by those private funds.

Further, we are prohibited under the Investment Company Act from knowingly participating in certain transactions with our affiliates, our investment adviser and its affiliates without the prior approval of our independent directors and, in some cases, the SEC. Any person that owns, directly or indirectly, 5% or more of our outstanding voting securities is our affiliate for purposes of the Investment Company Act and we are generally prohibited from buying or selling any security from or to such affiliate, absent the prior approval of our independent directors. The Investment Company Act also prohibits "joint" transactions with an affiliate, or our investment adviser or its affiliates, which could include investments in the same portfolio company (whether at the same or different times), without prior approval of our independent directors. In addition, we are prohibited from buying or selling any security from or to, or entering into joint transactions with, our investment adviser and its affiliates, or any person who owns more than 25% of our voting securities or is otherwise deemed to control, be controlled by, or be under common control with us, absent the prior approval of the SEC through an exemptive order (other than in certain limited situations pursuant to current regulatory guidance).

We have applied for an exemptive order from the SEC that would permit us to co-invest with funds managed by Ares. Any such order will be subject to certain terms and conditions and there can be no assurance that the application for exemptive relief will be granted by the SEC. Accordingly, we cannot assure you that the Company will be permitted to co-invest with funds managed by Ares, other than in the limited circumstances currently permitted by regulatory guidance.

#### **RISKS RELATING TO OUR INVESTMENTS**

**Price declines and illiquidity in the corporate debt markets have adversely affected, and may continue to adversely affect, the fair value of our portfolio investments, reducing our net asset value through increased net unrealized depreciation.**

As a BDC, we are required to carry our investments at market value or, if no market value is ascertainable, at fair value as determined in good faith by or under the direction of our board of directors. As part of the valuation process, we may take into account the following types of factors, if relevant, in determining the fair value of our investments: the enterprise value of a portfolio company (an estimate of the total fair value of the portfolio company's debt and equity), 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, a comparison of the portfolio company's securities to publicly traded securities, changes in the interest rate environment and the credit markets generally that may affect the price at which similar investments may be made in the future 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 valuation. Decreases in the market values or fair values of our investments are recorded as unrealized depreciation. The continuing unprecedented declines in prices and liquidity in the corporate debt markets have resulted in significant net unrealized depreciation in our portfolio. The effect of all of these factors on our portfolio has reduced our net asset value by increasing net unrealized depreciation in our portfolio. Depending on market conditions, we could incur substantial

realized losses and may continue to suffer additional unrealized losses in future periods, which could have a material adverse impact on our business, financial condition and results of operations.

**Economic recessions or downturns could impair our portfolio companies and harm our operating results.**

As of the date of this prospectus, the economy is in the midst of a recession and in the difficult part of a credit cycle with industry defaults increasing. Many of our portfolio companies may be materially and adversely affected by the current cycle and, in turn, may be unable to satisfy their financial obligations (including their loans to us) over the coming months.

Many of our portfolio companies may be susceptible to economic slowdowns or recessions and may be unable to repay our loans during these periods. Therefore, our non-performing assets are likely to increase and the value of our portfolio is likely to decrease during these periods if we are required to write down the values of our investments. Adverse economic conditions also may decrease the value of collateral securing some of our loans and the value of our equity investments. Economic slowdowns or recessions could lead to financial losses in our portfolio and a decrease in revenues, net income and assets. Unfavorable economic conditions also could increase our funding costs, limit our access to the capital markets or result in a decision by lenders not to extend credit to us. These events could prevent us from increasing investments and harm our operating results.

A portfolio company's failure to satisfy financial or operating covenants imposed by us or other lenders could lead to defaults and, potentially, acceleration of the time when the loans are due and foreclosure on its secured assets, which could trigger cross defaults under other agreements and jeopardize our portfolio company's ability to meet its obligations under the debt that we hold and the value of any equity securities we own. We may incur expenses to the extent necessary to seek recovery upon default or to negotiate new terms with a defaulting portfolio company.

**Investments in privately held middle market companies involve significant risks.**

We primarily invest in privately held U.S. middle market companies. Investments in privately held middle market companies involve a number of significant risks, including the following:

these companies may have limited financial resources and may be unable to meet their obligations, which may be accompanied by a deterioration in the value of any collateral and a reduction in the likelihood of us realizing any guarantees we may have obtained in connection with our investment;

they typically have shorter operating histories, narrower product lines and smaller market shares than larger businesses, which tend to render them more vulnerable to competitors' actions and market conditions, as well as general economic downturns;

they typically depend on the management talents and efforts of a small group of persons; therefore, the death, disability, resignation or termination of one or more of these persons could have a material adverse impact on our portfolio company and, in turn, on us;

there is generally little public information about these companies. These companies and their financial information are not subject to the Sarbanes Oxley Act of 2002 and other rules that govern public companies, and we may be unable to uncover all material information about these companies, which may prevent us from making a fully informed investment decision and cause us to lose money on our investments;

they generally have less predictable operating results, and may require substantial additional capital to support their operations, finance expansion or maintain their competitive position. In addition, our executive officers, directors and our investment

## Edgar Filing: ARES CAPITAL CORP - Form N-2

adviser may, in the ordinary course of business, be named as defendants in litigation arising from our investments in the portfolio companies; and

they may have difficulty accessing the capital markets to meet future capital needs.

### **Our debt investments may be risky, and we could lose all or part of our investment.**

The debt that we invest in is typically not initially rated by any rating agency, but we believe that if such investments were rated, they would be below investment grade (rated lower than "Baa3" by Moody's or lower than "BBB-" by Standard & Poor's). Indebtedness of below investment grade quality is regarded as having predominantly speculative characteristics with respect to the issuer's capacity to pay interest and repay principal. Our mezzanine investments may result in an above average amount of risk and volatility or loss of principal. We also invest in assets other than mezzanine investments including first and second lien loans, high-yield securities, U.S. government securities, credit derivatives and other structured securities and certain direct equity investments. These investments will entail additional risks that could adversely affect our investment returns. In addition, to the extent interest payments associated with such debt are deferred, such debt will be subject to greater fluctuations in value based on changes in interest rates. Also, such debt could subject us to phantom income, and since we generally do not receive any cash prior to maturity of the debt, the investment is of greater risk.

### **Investments in equity securities involve a substantial degree of risk.**

We may purchase common and other equity securities. Although common stocks have historically generated higher average total returns than fixed income securities over the long term, common stocks also have experienced significantly more volatility in those returns and in recent years have significantly under performed relative to fixed income securities. The equity securities we acquire may fail to appreciate and may decline in value or become worthless and our ability to recover our investment will depend on our portfolio company's success. Investments in equity securities involve a number of significant risks, including:

any equity investment we make in a portfolio company could be subject to further dilution as a result of the issuance of additional equity interests and to serious risks as a junior security that will be subordinate to all indebtedness or senior securities in the event that the issuer is unable to meet its obligations or becomes subject to a bankruptcy process;

to the extent that the portfolio company requires additional capital and is unable to obtain it, we may not recover our investment in equity securities; and

in some cases, equity securities in which we invest will not pay current dividends, and our ability to realize a return on our investment, as well as to recover our investment, will be dependent on the success of our portfolio companies. Even if the portfolio companies are successful, our ability to realize the value of our investment may be dependent on the occurrence of a liquidity event, such as a public offering or the sale of the portfolio company. It is likely to take a significant amount of time before a liquidity event occurs or we can sell our equity investments. In addition, the equity securities we receive or invest in may be subject to restrictions on resale during periods in which it could be advantageous to sell.

There are special risks associated with investing in preferred securities, including:

preferred securities may include provisions that permit the issuer, at its discretion, to defer distributions for a stated period without any adverse consequences to the issuer. If we own a preferred security that is deferring its distributions, we may be required to report income for tax purposes although it has not yet received such income;

## Edgar Filing: ARES CAPITAL CORP - Form N-2

preferred securities are subordinated to debt in terms of priority to corporate income and liquidation payments, and therefore will be subject to greater credit risk than debt;

preferred securities may be substantially less liquid than many other securities, such as common stocks or U.S. government securities; and

generally, preferred security holders have no voting rights with respect to the issuing company, subject to limited exceptions.

Additionally, when we invest in first and second lien senior loans or mezzanine debt, we may acquire warrants or other equity securities as well. Our goal is ultimately to dispose of such equity interests and realize gains upon our disposition of such interests. However, the equity interests we receive may not appreciate in value and, in fact, may decline in value. Accordingly, we may not be able to realize gains from our equity interests, and any gains that we do realize on the disposition of any equity interests may not be sufficient to offset any other losses we experience.

We may invest, to the extent permitted by law, in the equity securities of investment funds that are operating pursuant to certain exceptions to the Investment Company Act and in advisers to similar investment funds, and, to the extent we so invest, will bear our ratable share of any such company's expenses, including management and performance fees. We will also remain obligated to pay management and incentive fees to Ares Capital Management with respect to the assets invested in the securities and instruments of such companies. With respect to each of these investments, each of our common stockholders will bear his or her share of the management and incentive fee of Ares Capital Management as well as indirectly bearing the management and performance fees and other expenses of any such investment funds or advisers.

### **There may be circumstances where our debt investments could be subordinated to claims of other creditors or we could be subject to lender liability claims.**

If one of our portfolio companies were to go bankrupt, even though we may have structured our interest as senior debt, depending on the facts and circumstances, a bankruptcy court might recharacterize our debt holding as an equity investment and subordinate all or a portion of our claim to that of other creditors. In addition, lenders can be subject to lender liability claims for actions taken by them where they become too involved in the borrower's business or exercise control over the borrower. For example, we could become subject to a lender's liability claim, if, among other things, we actually render significant managerial assistance.

### **Our portfolio companies may incur debt or issue equity securities that rank equally with, or senior to, our investments in such companies.**

Our portfolio companies may have, or may be permitted to incur, other debt, or issue other equity securities, that rank equally with, or senior to, our investments. By their terms, such instruments may provide that the holders are entitled to receive payment of dividends, interest or principal on or before the dates on which we are entitled to receive payments in respect of our investments. These debt instruments usually prohibit the portfolio companies from paying interest on or repaying our investments in the event and during the continuance of a default under such debt. Also, in the event of insolvency, liquidation, dissolution, reorganization or bankruptcy of a portfolio company, holders of securities ranking senior to our investment in that portfolio company typically are entitled to receive payment in full before we receive any distribution in respect of our investment. After repaying such holders, the portfolio company may not have any remaining assets to use for repaying its obligation to us. In the case of securities ranking equally with our investments, we would have to share on an equal basis any distributions with other security holders in the event of an insolvency, liquidation, dissolution, reorganization or bankruptcy of the relevant portfolio company.

## Edgar Filing: ARES CAPITAL CORP - Form N-2

The rights we may have with respect to the collateral securing any junior priority loans we make to our portfolio companies may also be limited pursuant to the terms of one or more intercreditor agreements that we enter into with the holders of senior debt. Under such an intercreditor agreement, at any time that senior obligations are outstanding, we may forfeit certain rights with respect to the collateral to the holders of the senior obligations. These rights may include the right to commence enforcement proceedings against the collateral, the right to control the conduct of such enforcement proceedings, the right to approve amendments to collateral documents, the right to release liens on the collateral and the right to waive past defaults under collateral documents. We may not have the ability to control or direct such actions, even if as a result our rights as junior lenders are adversely affected.

### **When we are a debt or minority equity investor in a portfolio company, we may not be in a position to control the entity, and management of the company may make decisions that could decrease the value of our portfolio holdings.**

We make both debt and minority equity investments; therefore, we are subject to the risk that a portfolio company may make business decisions with which we disagree, and the stockholders and management of such company may take risks or otherwise act in ways that do not serve our interests. As a result, a portfolio company may make decisions that could decrease the value of our investment.

### **Our portfolio companies may be highly leveraged.**

Some of our portfolio companies may be highly leveraged, which may have adverse consequences to these companies and to us as an investor. These companies may be subject to restrictive financial and operating covenants and the leverage may impair these companies' ability to finance their future operations and capital needs. As a result, these companies' flexibility to respond to changing business and economic conditions and to take advantage of business opportunities may be limited. Further, a leveraged company's income and net assets will tend to increase or decrease at a greater rate than if borrowed money were not used.

### **Our investment adviser's incentive fee may induce Ares Capital Management to make certain investments, including speculative investments.**

The incentive fee payable by us to Ares Capital Management may create an incentive for Ares Capital Management to make investments on our behalf that are risky or more speculative than would be the case in the absence of such compensation arrangement. The way in which the incentive fee payable to our investment adviser is determined, which is calculated as a percentage of the return on invested capital, may encourage our investment adviser to use leverage to increase the return on our investments. Under certain circumstances, the use of leverage may increase the likelihood of default, which would disfavor the holders of our common stock, including investors in offerings of common stock, securities convertible into our common stock or warrants representing rights to purchase our common stock or securities convertible into our common stock pursuant to this prospectus. In addition, the investment adviser will receive the incentive fee based, in part, upon net capital gains realized on our investments. Unlike the portion of the incentive fee based on income, there is no hurdle rate applicable to the portion of the incentive fee based on net capital gains. As a result, the investment adviser may have a tendency to invest more in investments that are likely to result in capital gains as compared to income producing securities. Such a practice could result in our investing in more speculative securities than would otherwise be the case, which could result in higher investment losses, particularly during economic downturns. The part of the incentive fee payable by us that relates to our pre-incentive fee net investment income will be computed and paid on income that may include interest that is accrued but not yet received in cash. If a portfolio company defaults on a loan that is structured to provide accrued interest, it is possible that accrued interest previously used in the calculation of the

incentive fee will become uncollectible. The investment adviser is not under any obligation to reimburse us for any part of the incentive fee it received that was based on such accrued interest that we never actually receive.

Because of the structure of the incentive fee, it is possible that we may have to pay an incentive fee in a quarter where we incur a loss. For example, if we receive pre-incentive fee net investment income in excess of the hurdle rate for a quarter, we will pay the applicable incentive fee even if we have incurred a loss in that quarter due to realized capital losses. In addition, if market interest rates rise, we may be able to invest our funds in debt instruments that provide for a higher return, which would increase our pre-incentive fee net investment income and make it easier for our investment adviser to surpass the fixed hurdle rate and receive an incentive fee based on such net investment income.

**Our investments in foreign debt may involve significant risks in addition to the risks inherent in U.S. investments. We may expose ourselves to risks if we engage in hedging transactions.**

Our investment strategy contemplates potential investments in debt of foreign companies. Investing in foreign companies may expose us to additional risks not typically associated with investing in U.S. companies. These risks include changes in exchange control regulations, political and social instability, expropriation, imposition of foreign taxes, less liquid markets, less available information than is generally the case in the United States, higher transaction costs, less government supervision of exchanges, brokers and issuers, less developed bankruptcy laws, difficulty in enforcing contractual obligations, lack of uniform accounting and auditing standards and greater price volatility.

Although most of our investments will be U.S. dollar denominated, our investments that are denominated in a foreign currency will be subject to the risk that the value of a particular currency will change in relation to one or more other currencies. Among the factors that may affect currency values are trade balances, the level of short-term interest rates, differences in relative values of similar assets in different currencies, long-term opportunities for investment and capital appreciation, and political developments. We may employ hedging techniques to minimize these risks, but we cannot assure you that such strategies will be effective.

We have and may in the future enter into hedging transactions, which may expose us to risks associated with such transactions. We may utilize instruments such as forward contracts, currency options and interest rate swaps, caps, collars and floors to seek to hedge against fluctuations in the relative values of our portfolio positions from changes in currency exchange rates and market interest rates. Use of these hedging instruments may include counter party credit risk. Hedging against a decline in the values of our portfolio positions does not eliminate the possibility of fluctuations in the values of such positions or prevent losses if the values of such positions decline. However, such hedging can establish other positions designed to gain from those same developments, thereby offsetting the decline in the value of such portfolio positions. Such hedging transactions may also limit the opportunity for gain if the values of the underlying portfolio positions should increase. Moreover, it may not be possible to hedge against an exchange rate or interest rate fluctuation that is so generally anticipated that we are not able to enter into a hedging transaction at an acceptable price.

The success of our hedging transactions will depend on our ability to correctly predict movements, currencies and interest rates. Therefore, while we may enter into such transactions to seek to reduce currency exchange rate and interest rate risks, unanticipated changes in currency exchange rates or interest rates may result in poorer overall investment performance than if we had not engaged in any such hedging transactions. In addition, the degree of correlation between price movements of the instruments used in a hedging strategy and price movements in the portfolio positions being hedged may vary. Moreover, for a variety of reasons, we may not seek to establish a perfect correlation between such hedging instruments and the portfolio holdings being hedged. Any such imperfect

correlation may prevent us from achieving the intended hedge and expose us to risk of loss. In addition, it may not be possible to hedge fully or perfectly against currency fluctuations affecting the value of securities denominated in non-U.S. currencies because the value of those securities is likely to fluctuate as a result of factors not related to currency fluctuations. See also "Risk Factors Risk Relating to our Business We are exposed to risks associated with changes in interest rates."

**We may initially invest a portion of the net proceeds of offerings pursuant to this prospectus primarily in high-quality short-term investments, which will generate lower rates of return than those expected from the interest generated on first and second lien loans and mezzanine debt.**

We may initially invest a portion of the net proceeds of offerings primarily in cash, cash equivalents, U.S. government securities and other high-quality short-term investments. These securities may earn yields substantially lower than the income that we anticipate receiving once we are fully invested in accordance with our investment objective. As a result, we may not be able to achieve our investment objective and/or pay any dividends during this period or, if we are able to do so, such dividends may be substantially lower than the dividends that we expect to pay when our portfolio is fully invested. If we do not realize yields in excess of our expenses, we may incur operating losses and the market price of our shares may decline.

#### **RISKS RELATING TO OFFERINGS PURSUANT TO THIS PROSPECTUS**

**Our shares of common stock currently trade at a discount from net asset value and may continue to do so in the future, which limits our ability to raise additional equity capital.**

Shares of closed-end investment companies frequently trade at a market price that is less than the net asset value that is attributable to those shares. This characteristic of closed-end investment companies is separate and distinct from the risk that our net asset value per share may decline. It is not possible to predict whether any shares of common stock offered hereby will trade at, above, or below net asset value. As of the date of this prospectus, the stocks of BDCs as an industry, including shares of our common stock, have been trading below net asset value and at near historic lows as a result of concerns over liquidity, leverage restrictions and distribution requirements. When our common stock is trading below its net asset value per share, we will generally not be able to issue additional shares of our common stock at its market price without first obtaining approval for such issuance from our stockholders and our independent directors.

**There is a risk that investors in our equity securities may not receive dividends or that our dividends may not grow over time and that investors in our debt securities may not receive all of the interest income to which they are entitled.**

We intend to make distributions on a quarterly basis to our stockholders out of assets legally available for distribution. We cannot assure you that we will achieve investment results that will allow us to make a specified level of cash distributions or year-to-year increases in cash distributions. If we declare a dividend and if more stockholders opt to receive cash distributions rather than participate in our dividend reinvestment plan, we may be forced to sell some of our investments in order to make cash dividend payments.

In addition, due to the asset coverage test applicable to us as a BDC, we may be limited in our ability to make distributions. Further, if we invest a greater amount of assets in equity securities that do not pay current dividends, it could reduce the amount available for distribution. See "Price Range of Common Stock and Distributions."

The above referenced distribution requirement may also inhibit our ability to make required interest payments to holders of our debt securities, which may cause a default under the terms of our

debt securities. Such a default could materially increase our cost of raising capital, as well as cause us to incur penalties under the terms of our debt securities.

**Provisions of the Maryland General Corporation Law and of our charter and bylaws could deter takeover attempts and have an adverse impact on the price of our common stock.**

The Maryland General Corporation Law, our charter and our bylaws contain provisions that may discourage, delay or make more difficult a change in control of Ares Capital or the removal of our directors. We are subject to the Maryland Business Combination Act, subject to any applicable requirements of the Investment Company Act. Our board of directors has adopted a resolution exempting from the Business Combination Act any business combination between us and any other person, subject to prior approval of such business combination by our board, including approval by a majority of our disinterested directors. If the resolution exempting business combinations is repealed or our board does not approve a business combination, the Business Combination Act may discourage third parties from trying to acquire control of us and increase the difficulty of consummating such an offer. Our bylaws exempt from the Maryland Control Share Acquisition Act acquisitions of our stock by any person. If we amend our bylaws to repeal the exemption from the Control Share Acquisition Act, the Control Share Acquisition Act also may make it more difficult for a third party to obtain control of us and increase the difficulty of consummating such an offer.

We have also adopted measures that may make it difficult for a third party to obtain control of us, including provisions of our charter classifying our board of directors in three classes serving staggered three-year terms, and provisions of our charter authorizing our board of directors to classify or reclassify shares of our stock in one or more classes or series, to cause the issuance of additional shares of our stock, and to amend our charter, without stockholder approval, to increase or decrease the number of shares of stock that we have authority to issue. These provisions, as well as other provisions of our charter and bylaws, may delay, defer or prevent a transaction or a change in control that might otherwise be in the best interests of our stockholders.

**Investing in our securities may involve an above average degree of risk.**

The investments we make in accordance with our investment objective may result in a higher amount of risk than alternative investment options and volatility or loss of principal. Our investments in portfolio companies may be highly speculative and aggressive, and therefore, an investment in our securities may not be suitable for someone with lower risk tolerance.

**The market price of our common stock may fluctuate significantly.**

The capital and credit markets have been experiencing extreme volatility and disruption for more than 18 months. In recent months, the volatility and disruption have reached unprecedented levels and we have experienced greater than usual stock price volatility. The price of the common stock that will prevail in the market after an offering pursuant to this prospectus may be higher or lower than the price you pay. The market price and liquidity of the market for shares of our common stock may be significantly affected by numerous factors, some of which are beyond our control and may not be directly related to our operating performance. These factors include:

significant volatility in the market price and trading volume of securities of RICs, business development companies or other companies in our sector, which are not necessarily related to the operating performance of these companies;

price and volume fluctuations in the overall stock market from time to time;

changes in regulatory policies or tax guidelines, particularly with respect to RICs or business development companies;

## Edgar Filing: ARES CAPITAL CORP - Form N-2

loss of RIC status;

changes in our earnings or variations in our operating results;

changes in the value of our portfolio of investments;

any shortfall in revenue or net income or any increase in losses from levels expected by investors or securities analysts;

departure of Ares Capital Management's key personnel;

operating performance of companies comparable to us;

short-selling pressure with respect to shares of our common stock or business development companies generally;

general economic trends and other external factors; and

loss of a major funding source.

In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been brought against that company. If our stock price fluctuates significantly, we may be the target of securities litigation in the future. Securities litigation could result in substantial costs and divert management's attention and resources from our business.

**Stockholders may incur dilution if we sell shares of our common stock in one or more offerings at prices below the then current net asset value per share of our common stock or securities to subscribe for or convertible into shares of our common stock.**

As of the date of this prospectus, we have asked our stockholders to approve two proposals at our 2009 Annual Stockholders Meeting designed to allow us to access the capital markets in ways that we would otherwise be unable to as a result of restrictions that, absent stockholder approval, apply to BDCs under the Investment Company Act. Specifically, we have asked our stockholders to approve proposals that authorize us to sell or otherwise issue (1) shares of our common stock below its then current net asset value per share in one or more offerings subject to certain limitations (including, without limitation, that the number of shares issuable does not exceed 25% of our then outstanding common stock) and (2) warrants or securities to subscribe for or convertible into shares of our common stock subject to certain limitations (including, without limitation, that the number of shares issuable does not exceed 25% of our then outstanding common stock and that the exercise or conversion price thereof is not, at the date of issuance, less than the greater of the market value per share and the net asset value per share of our common stock). Any decision to sell shares of our common stock below the then current net asset value per share of our common stock or securities to subscribe for or convertible into shares of our common stock would be subject to the determination by our board of directors that such issuance is in our and our stockholders' best interests.

If our stockholders authorize us to do so, and if we were to sell shares of our common stock below net asset value per share, such sales would result in an immediate dilution to our net asset value per share. This dilution would occur as a result of the sale of shares at a price below the then current net asset value per share of our common stock and a proportionately greater decrease in the stockholders' interest in our earnings and assets and their voting interest in us than the increase in our assets resulting from such issuance. Because the number of shares of common stock that could be so issued and the timing of any issuance is not currently known, the actual dilutive effect cannot be predicted.

In addition, if we issue warrants or securities to subscribe for or convertible into shares of our common stock subject to certain limitations, the exercise or conversion price per share could be less than net asset value per share at the time of exercise or conversion (including through the operation of

anti-dilution protections). Because the Company would incur expenses in connection with any issuance of such securities, such issuance could result in a dilution of net asset value per share at the time of exercise or conversion. This dilution would include reduction in net asset value per share as a result of the proportionately greater decrease in the stockholders' interest in our earnings and assets and their voting interest than the increase in our assets resulting from such issuance.

Further, if current stockholders of the Company do not purchase any shares to maintain their percentage interest, regardless of whether such offering is above or below the then current net asset value per share, their voting power will be diluted. For additional information and hypothetical examples of these risks, see "Sales of Common Stock Below Net Asset Value" and the prospectus supplement pursuant to which such sale is made.

**Your interest in us may be diluted if you do not fully exercise your subscription rights in any rights offering. In addition, if the subscription price is less than our net asset value per share, then you will experience an immediate dilution of the aggregate net asset value of your shares.**

In the event we issue subscription rights, stockholders who do not fully exercise their subscription rights should expect that they will, at the completion of a rights offering pursuant to this prospectus, own a smaller proportional interest in us than would otherwise be the case if they fully exercised their rights. We cannot state precisely the amount of any such dilution in share ownership because we do not know at this time what proportion of the shares will be purchased as a result of such rights offering.

In addition, if the subscription price is less than our net asset value per share, then our stockholders would experience an immediate dilution of the aggregate net asset value of their shares as a result of the offering. The amount of any decrease in net asset value is not predictable because it is not known at this time what the subscription price and net asset value per share will be on the expiration date of a rights offering or what proportion of the shares will be purchased as a result of such rights offering. Such dilution could be substantial. See "Risk Factors Risks Relating to Offerings Pursuant to this Prospectus Stockholders may incur dilution if we sell shares of our common stock in one or more offerings at prices below the then current net asset value per share of our common stock or securities to subscribe for or convertible into shares of our common stock" and "Sales of Common Stock Below Net Asset Value."

**Investors in offerings of our common stock will incur immediate dilution upon the closing of such offering.**

We generally expect the public offering price of any offering of shares of our common stock to be higher than the book value per share of our outstanding common stock (unless we offer shares pursuant to a rights offering or after obtaining prior approval for such issuance from our stockholders and our independent directors). Accordingly, investors purchasing shares of common stock in offerings pursuant to this prospectus may pay a price per share that exceeds the tangible book value per share after such offering.

**Stockholders will experience dilution in their ownership percentage if they do not participate in our dividend reinvestment plan.**

All dividends declared in cash payable to stockholders that are participants in our dividend reinvestment plan are automatically reinvested in shares of our common stock. As a result, stockholders that do not participate in the dividend reinvestment plan will experience dilution over time.

**There is a risk that you may receive shares of our common stock as dividends.**

We have the ability to declare a large portion of a dividend for the purpose of fulfilling our RIC distribution requirements in shares of our common stock instead of in cash. As long as a portion of such dividend is paid in cash (which portion can be as low as 10% for our taxable years ending on or before December 31, 2009) and certain requirements are met, the entire distribution will be treated as a dividend for U.S. federal income tax purposes. As a result, a stockholder would be taxed on 100% of the dividend in the same manner as a cash dividend, even though most of the dividend was paid in shares of our common stock. Stockholders who elect cash may experience greater dilution than other stockholders if we elect to distribute our common stock as a dividend.

**Sales of substantial amounts of our common stock in the public market may have an adverse effect on the market price of our common stock.**

Sales of substantial amounts of our common stock, or the availability of such common stock for sale, could adversely affect the prevailing market prices for our common stock. If this occurs and continues, it could impair our ability to raise additional capital through the sale of securities should we desire to do so.

**The trading market or market value of our publicly issued debt securities may fluctuate.**

Upon issuance, our publicly issued debt securities will not have an established trading market. We cannot assure you that a trading market for our publicly issued debt securities will ever develop or be maintained if developed. In addition to our creditworthiness, many factors may materially adversely affect the trading market for, and market value of, our publicly issued debt securities. These factors include:

the time remaining to the maturity of these debt securities;

the outstanding principal amount of debt securities with terms identical to these debt securities;

the supply of debt securities trading in the secondary market, if any;

the redemption or repayment features, if any, of these debt securities;

the level, direction and volatility of market interest rates generally; and

market rates of interest higher or lower than rates borne by the debt securities.

You should also be aware that there may be a limited number of buyers when you decide to sell your debt securities. This too may materially adversely affect the market value of the debt securities or the trading market for the debt securities.

**Terms relating to redemption may materially adversely affect your return on any debt securities that we may issue.**

If your debt securities are redeemable at our option, we may choose to redeem your debt securities at times when prevailing interest rates are lower than the interest rate paid on your debt securities. In addition, if your debt securities are subject to mandatory redemption, we may be required to redeem your debt securities also at times when prevailing interest rates are lower than the interest rate paid on your debt securities. In this circumstance, you may not be able to reinvest the redemption proceeds in a comparable security at an effective interest rate as high as your debt securities being redeemed.

**Our credit ratings may not reflect all risks of an investment in our debt securities.**

Our credit ratings are an assessment by third parties of our ability to pay our obligations. Consequently, real or anticipated changes in our credit ratings will generally affect the market value of our debt securities. Our credit ratings, however, may not reflect the potential impact of risks related to market conditions generally or other factors discussed above on the market value of or trading market for the publicly issued debt securities.



**FORWARD-LOOKING STATEMENTS**

Some of the statements in this prospectus constitute forward-looking statements, which relate to future events or the future performance or financial condition of the Company. The forward-looking statements contained in this prospectus involve risks and uncertainties, including statements as to:

our future operating results;

our business prospects and the prospects of our portfolio companies;

the return or impact of investments that we expect to make;

the impact of a protracted decline in the liquidity of credit markets on our business;

the impact of fluctuations in interest rates on our business;

the valuation of our investments in portfolio companies, particularly those having no liquid trading market;

our ability to recover unrealized losses;

our ability to access alternative debt markets and additional capital;

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, form and amount of any dividend distributions;

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, including the factors set forth in "Risk Factors" and elsewhere in this prospectus.

We have based the forward-looking statements included in this prospectus on information available to us on the date of this prospectus, and we assume no obligation to update any such forward-looking statements. Although we undertake no obligation to revise or update any

## Edgar Filing: ARES CAPITAL CORP - Form N-2

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 have filed or 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.

You should understand that under Sections 27A(b)(2)(B) of the Securities Act of 1933 (the "Securities Act") and Section 21E(b)(2)(B) of the Exchange Act, the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 do not apply to statements made in connection with any offering of securities pursuant to this prospectus.

**USE OF PROCEEDS**

Unless otherwise specified in a prospectus supplement, we intend to use the net proceeds from the sale of our securities for general corporate purposes, which includes investing in portfolio companies in accordance with our investment objective and strategies and market conditions. We also expect to use the net proceeds of the offering to (i) repay outstanding indebtedness under the Revolving Credit Facility (\$[ ] million outstanding as of [ ], 2009), (ii) repay outstanding indebtedness under the CP Funding Facility (\$[ ] million outstanding as of [ ], 2009) and/or (iii) repurchase CLO Notes under the Debt Securitization (\$[ ] million of CLO Notes outstanding as of [ ], 2009). The interest charged on the indebtedness incurred under the Revolving Credit Facility is based on LIBOR (one, two, three or six month) plus 1.00%, generally. As of [ ], 2009, the one, two, three and six month LIBOR were [ ]%, [ ]%, [ ]% and [ ]%, respectively. The Revolving Credit Facility expires on December 28, 2010. The interest charged on the indebtedness incurred under the CP Funding Facility is based on the commercial paper rate plus 1.00% and is payable quarterly. As of [ ], 2009, the commercial paper rate was [ ]%. The CP Funding Facility is scheduled to expire on July 21, 2009 (unless extended prior to such date with the consent of the lenders). As of [ ], 2009, the blended pricing of the CLO Notes, excluding fees, was approximately [ ] month LIBOR plus [ ] basis points. The CLO Notes mature on December 20, 2019. The supplement to this prospectus relating to an offering may more fully identify the use of the proceeds from such offering. We anticipate that substantially all of the net proceeds of an offering of securities pursuant to this prospectus and its related prospectus supplement will be used for the above purposes within three months of any such offering, depending on the availability of appropriate investment opportunities consistent with our investment objective and strategies and market conditions.

Our primary focus is to generate current income and capital appreciation through investments in first and second lien senior loans and mezzanine debt, and, to a lesser extent, equity securities of eligible portfolio companies. In addition to such investments, we may invest up to 30% of our portfolio in opportunistic investments of non-eligible portfolio companies. As part of this 30%, we may invest in debt of middle market companies located outside of the United States. Pending such investments, we will invest a portion of the net proceeds primarily in cash, cash equivalents, U.S. government securities and other high-quality short-term investments. These securities may earn yields substantially lower than the income that we anticipate receiving once we are fully invested in accordance with our investment objective. As a result, we may not be able to achieve our investment objective and/or pay any dividends during this period or, if we are able to do so, such dividends may be substantially lower than the dividends that we expect to pay when our portfolio is fully invested. If we do not realize yields in excess of our expenses, we may incur operating losses and the market price of our shares may decline. See "Regulation Temporary Investments" for additional information about temporary investments we may make while waiting to make longer-term investments in pursuit of our investment objective.

## PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

Our common stock is traded on The NASDAQ Global Select Market under the symbol "ARCC." We completed our initial public offering in October 2004 at a price of \$15.00 per share. Prior to October 2004, there was no public market for our common stock. Our common stock has historically traded at prices both above and below its net asset value. It is not possible to predict whether the common stock offered hereby will trade at, above, or below net asset value. See "Risk Factors Risks Relating to Offerings Pursuant to this Prospectus Our shares of common stock currently trade at a discount from net asset value and may continue to do so in the future, which limits our ability to raise additional equity capital."

The following table sets forth the net asset value per share of our common stock, the range of high and low closing sales prices of our common stock as reported on The NASDAQ Global Select Market, the closing sales price as a percentage of net asset value and the dividends declared by us for each fiscal quarter since our initial public offering. On [ ], 2009, the last reported closing sales price of our common stock on The NASDAQ Global Select Market was \$[ ] per share, which represented a discount of approximately [ ]% to the net asset value per share reported by us as of December 31, 2008.

	Net Asset Value(1)	Price Range		Premium of High Sales Price to Net Asset Value(2)	Premium of Low Sales Price to Net Asset Value(2)	Cash Dividend Per Share(3)
		High	Low	Value(2)	Value(2)	
<b>Year ended December 31, 2006</b>						
First Quarter	\$ 15.03	\$17.97	\$16.23	119.6%	108.0%	\$ 0.36
Second Quarter	\$ 15.10	\$17.50	\$16.36	115.9%	108.3%	\$ 0.38
Third Quarter	\$ 15.06	\$17.51	\$15.67	116.3%	104.1%	\$ 0.40
Fourth Quarter	\$ 15.17	\$19.31	\$17.39	127.3%	114.6%	\$ 0.50(4)
<b>Year ended December 31, 2007</b>						
First Quarter	\$ 15.34	\$20.46	\$17.82	133.4%	116.2%	\$ 0.41
Second Quarter	\$ 15.84	\$18.84	\$16.85	118.9%	106.4%	\$ 0.41
Third Quarter	\$ 15.74	\$17.53	\$14.92	111.4%	94.8%	\$ 0.42
Fourth Quarter	\$ 15.47	\$17.47	\$14.40	112.9%	93.1%	\$ 0.42
<b>Year ended December 31, 2008</b>						
First Quarter	\$ 15.17	\$13.81	\$11.65	91.0%	76.8%	\$ 0.42
Second Quarter	\$ 13.67	\$12.98	\$10.08	95.0%	73.7%	\$ 0.42
Third Quarter	\$ 12.83	\$12.60	\$ 9.30	98.2%	72.5%	\$ 0.42
Fourth Quarter	\$ 11.27	\$10.15	\$ 3.77	90.1%	33.5%	\$ 0.42
<b>Year ending December 31, 2009</b>						
First Quarter (through 2009)	\$ *	\$ [ ]	\$ [ ]	*%	*%	\$ 0.42

- (1) Net asset value per share is determined as of the last day in the relevant quarter and therefore may not reflect the net asset value per share on the date of the high and low closing sales prices. The net asset values shown are based on outstanding shares at the end of the relevant quarter.
- (2) Calculated as the respective high or low closing sales price divided by net asset value.
- (3) Represents the dividend declared in the relevant quarter.
- (4) Includes an additional cash dividend of \$0.10 per share.
- \* Net asset value has not yet been calculated for this period.



## Edgar Filing: ARES CAPITAL CORP - Form N-2

We currently intend to distribute quarterly dividends to our stockholders. Our quarterly dividends, if any, will be determined by our board of directors.

The following table summarizes our dividends declared to date:

<b>Date Declared</b>	<b>Record Date</b>	<b>Payment Date</b>	<b>Amount</b>
December 16, 2004	December 27, 2004	January 26, 2005	\$ 0.30
Total declared for 2004			\$ 0.30
February 23, 2005	March 7, 2005	April 15, 2005	\$ 0.30
June 20, 2005	June 30, 2005	July 15, 2005	\$ 0.32
September 6, 2005	September 16, 2005	September 30, 2005	\$ 0.34
December 12, 2005	December 22, 2005	January 16, 2006	\$ 0.34
Total declared for 2005			\$ 1.30
February 28, 2006	March 24, 2006	April 14, 2006	\$ 0.36
May 8, 2006	June 15, 2006	June 30, 2006	\$ 0.38
August 9, 2006	September 15, 2006	September 29, 2006	\$ 0.40
November 8, 2006	December 15, 2006	December 29, 2006	\$ 0.40
November 8, 2006	December 15, 2006	December 29, 2006	\$ 0.10
Total declared for 2006			\$ 1.64
March 8, 2007	March 19, 2007	March 30, 2007	\$ 0.41
May 10, 2007	June 15, 2007	June 29, 2007	\$ 0.41
August 9, 2007	September 14, 2007	September 28, 2007	\$ 0.42
November 8, 2007	December 14, 2007	December 31, 2007	\$ 0.42
Total declared for 2007			\$ 1.66
February 28, 2008	March 17, 2008	March 31, 2008	\$ 0.42
May 8, 2008	June 16, 2008	June 30, 2008	\$ 0.42
August 7, 2008	September 15, 2008	September 30, 2008	\$ 0.42
November 6, 2008	December 15, 2008	January 2, 2009	\$ 0.42
Total declared for 2008			\$ 1.68
March 2, 2009	March 16, 2009	March 31, 2009	\$ 0.42
Total declared for 2009			\$ 0.42

To maintain our RIC status, we must timely distribute an amount equal to at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, reduced by deductible expenses, out of the assets legally available for distribution for each year. To avoid certain excise taxes imposed on RICs, we are generally required to distribute during each calendar year an amount at least equal to the sum of (i) 98% of our ordinary income for the calendar year, plus (ii) 98% of our capital gains in excess of capital losses for the one-year period ending on October 31 of the calendar year plus (iii) any ordinary income and net capital gains for preceding years that were not distributed during such years. If this requirement is not met, we will be required to pay a nondeductible excise tax equal to 4% of the amount by which 98% of the current year's taxable income exceeds the distribution for the year. The taxable income on which an excise tax is paid is generally carried forward and distributed to stockholders in the next tax year. Depending on the level of taxable income earned in a tax year, we may choose to carry forward taxable income in excess of current year distributions into the next tax year and pay a 4%

## Edgar Filing: ARES CAPITAL CORP - Form N-2

excise tax on such income, as required. For the years ended December 31, 2008 and 2007, we recorded a net excise tax provision of \$0.1 million for both years. We cannot assure you that we will achieve results that will permit the payment of any cash distributions.

We maintain an "opt out" dividend reinvestment plan for our common stockholders. As a result, if we declare a cash dividend, then stockholders' cash dividends will be automatically reinvested in additional shares of our common stock, unless they specifically "opt out" of the dividend reinvestment plan so as to receive cash dividends. See "Dividend Reinvestment Plan."

**RATIOS OF EARNINGS TO FIXED CHARGES**

For the years ended December 31, 2008, 2007, 2006 and 2005, and the period June 23, 2004 (inception) through December 31, 2004, the ratios of earnings to fixed charges of the Company, computed as set forth below, were as follows:

	<b>For the Year Ended December 31, 2008</b>	<b>For the Year Ended December 31, 2007</b>	<b>For the Year Ended December 31, 2006</b>	<b>For the Year Ended December 31, 2005</b>	<b>For the Period June 23, 2004 (inception) Through December 31, 2004</b>
<b>Earnings to Fixed Charges(1)</b>	(0.1)	3.4	5.0	28.5	24.2

For purposes of computing the ratios of earnings to fixed charges, earnings represent net increase in stockholders' equity resulting from operations plus (or minus) income tax expense including excise tax expense plus fixed charges. Fixed charges include interest and credit facility fees expense and amortization of debt issuance costs.

(1)

Earnings include the net change in unrealized appreciation or depreciation. Net change in unrealized appreciation or depreciation can vary substantially from year to year. Excluding the net change in unrealized appreciation or depreciation, the earnings to fixed charges ratio would be 4.7 for the year ended December 31, 2008, 3.7 for the year ended December 31, 2007, 5.8 for the year ended December 31, 2006, 25.6 for the year ended December 31, 2005 and 22.5 for the period June 23, 2004 (inception) through December 31, 2004.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
AND RESULTS OF OPERATIONS**

*The information contained in this section should be read in conjunction with the Selected Financial and Other Data and our financial statements and notes thereto appearing elsewhere in this prospectus or the accompanying prospectus supplement.*

**OVERVIEW**

We are a specialty finance company that is a closed-end, non-diversified management investment company incorporated in Maryland. We have elected to be regulated as a BDC under the Investment Company Act. We were founded on April 16, 2004 and were initially funded on June 23, 2004 and on October 8, 2004 completed our initial public offering (the "IPO").

Our investment objective is 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 includes an equity component like warrants. To a lesser extent we make equity investments.

We are externally managed by Ares Capital Management, an affiliate of Ares Management, an independent international investment management firm, pursuant to the investment advisory and management agreement. Ares Administration, an affiliate of Ares Management, 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 and indebtedness of private U.S. companies, cash, cash equivalents, U.S. government securities and high-quality debt investments that mature in one year or less.

The Company has elected to be treated as a RIC under Subchapter M of the Code and operates in a manner so as to qualify for the tax treatment applicable to RICs. To qualify as a RIC, we must, among other things, meet certain source-of-income and asset diversification requirements and timely distribute to our stockholders at least 90% of our investment company taxable income, as defined by the Code, for each year. Pursuant to this election, we generally will not have to pay corporate level taxes on any income that we distribute to our stockholders.

**CRITICAL ACCOUNTING POLICIES**

***Basis of Presentation***

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States, and include the accounts of the Company and its wholly owned subsidiaries. The consolidated financial statements reflect all adjustments and reclassifications which, in the opinion of management, are necessary for the fair presentation of the results of the operations and financial condition as of and for the periods presented. All significant intercompany balances and transactions have been eliminated.

***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. Investments for which market quotations are readily available are typically valued at such market quotations. In order to validate market quotations, we look at a number of factors to determine if the quotations are representative of fair value, including the source and nature of the quotations. Debt and equity securities that are not publicly traded or whose market prices are not readily available (i.e., substantially all of our investments) are valued at fair value as determined in good faith by our board of directors, based on the input of our management and audit committee and independent valuation firms that have been engaged at the direction of the board to assist in the valuation of each portfolio investment without a readily available market quotation at least once during a trailing 12 month period. The valuation process is conducted at the end of each fiscal quarter, with approximately 50% (based on value) of our valuations of portfolio companies without readily available market quotations subject to review by an independent valuation firm. However, we may use additional independent valuation firms to value our investments more frequently as determined in good faith by our board of directors to the extent necessary to reflect significant events affecting the value of our investments

As part of the valuation process, we may take into account the following types of factors, if relevant, in determining the fair value of our investments: the enterprise value of a portfolio company (an estimate of the total fair value of the portfolio company's debt and equity), 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, a comparison of the portfolio company's securities to publicly traded securities, changes in the interest rate environment and the credit markets generally that may affect the price at which similar investments may be made in the future 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 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 of directors, based on the input of our management and audit committee and independent valuation firms 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 fluctuate from period to period. Additionally, 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 may differ materially from the values that we may ultimately realize. Further, such investments are generally subject to legal and other restrictions on resale or otherwise are less liquid than publicly traded securities. If we were required to liquidate a portfolio investment in a forced or liquidation sale, we may realize significantly less than the value at which we have recorded it.

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. See "Risk Factors Risks Relating to our Investments Price declines and illiquidity in the corporate debt markets have adversely affected, and may continue to adversely affect, the fair value of our portfolio investments, reducing our net asset value through increased net unrealized depreciation."

## Edgar Filing: ARES CAPITAL CORP - Form N-2

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 in conjunction with our portfolio management team.

Preliminary valuation conclusions are then documented and discussed by our management.

The audit committee of our board of directors reviews these preliminary valuations, as well as the input of independent valuation firms with respect to the valuations of approximately 50% (based on value) of our portfolio companies without readily available market quotations.

The board of directors discusses valuations and determines the fair value of each investment in our portfolio without a readily available market quotation in good faith based on the input of our management and audit committee and independent valuation firms.

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157, Fair Value Measurements ("SFAS 157"), which expands the application of fair value accounting for investments (see Note 9 to the consolidated financial statements).

### ***Interest Income Recognition***

Interest income, adjusted for amortization of premium and accretion of discount, is recorded on an accrual basis. 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 amortization of premiums.

Loans are generally placed on non-accrual status when principal or interest payments are past due 30 days or more or when there is reasonable doubt that principal or interest will be collected. Accrued interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment regarding collectability. Non-accrual loans are restored to accrual status when past due principal and interest is paid and, in management's judgment, are likely to remain current. The Company may make exceptions to this if the loan has sufficient collateral value and is in the process of collection.

### ***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.

### ***Capital Structuring Service Fees and Other Income***

The Company's investment adviser seeks to provide assistance to our 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 of 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 multiple equity investors, restructuring existing loans, raising equity and debt capital, and providing general financial advice, which concludes upon closing of the investment. 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 does not provide significant services in connection with the investment, a portion of loan fees paid to the Company in such situations will be deferred and amortized over the estimated life 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.

Other income includes fees for asset management, consulting, loan guarantees, commitments, and other services rendered by the Company to portfolio companies. Such fees are recognized as income when earned or the services are rendered.

#### ***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 period.
- (2) Purchases and sales of investment securities, income and expenses at the rates of exchange prevailing on the respective dates of such transactions, income or expenses.

Results of operations based on changes in foreign exchange rates are separately disclosed in the statement of operations. 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, currency fluctuation and revaluations and future adverse political, social and economic developments, which could cause investments in foreign markets to be less liquid and prices more volatile than those of comparable U.S. companies or U.S. government securities.

#### ***Accounting for Derivative Instruments***

The Company does not utilize hedge accounting and marks its derivatives to market through operations.

#### ***Offering Expenses***

The Company's offering costs are charged against the proceeds from equity offerings when received.

#### ***Debt Issuance Costs***

Debt issuance costs are being amortized over the life of the related credit facility using the straight line method, which closely approximates the effective yield method.

#### ***U.S. Federal Income Taxes***

The Company has elected to be treated as a RIC under Subchapter M of the Code and operates in a manner so as to qualify for the tax treatment applicable to RICs. In order to qualify as a RIC, among other things, the Company is required to timely distribute to its stockholders at least 90% of investment company taxable income, as defined by the Code, for each year. The Company has made

and intends to continue to make the requisite distributions to its stockholders, which will generally relieve the Company from U.S. federal income taxes.

Depending on the level of taxable income earned in a tax year, we may choose to carry forward taxable income in excess of current year dividend distributions into the next tax year and pay a 4% excise tax on such income, as required. To the extent that the Company determines that its estimated current year annual taxable income will be in excess of estimated current year dividend distributions, the Company accrues excise tax, if any, on estimated excess taxable income as taxable income is earned.

Certain of our wholly owned subsidiaries are subject to U.S. federal and state income taxes.

### ***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 current and expected future earnings estimated by management. Net realized capital gains, if any, are generally distributed at least annually, although we may decide to retain such capital gains for investment.

We have adopted a dividend reinvestment plan that provides for reinvestment of any distributions we declare in cash 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 dividend. While we generally use primarily newly issued shares to implement the plan (especially if our shares are trading at a premium to net asset value), we may purchase shares in the open market in connection with our obligations under the plan. In particular, if our shares are trading at a significant enough discount to net asset value and we are otherwise permitted under applicable law to purchase such shares, we intend to purchase shares in the open market in connection with our obligations under our dividend reinvestment plan.

### ***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.

### ***New Accounting Pronouncements***

On October 10, 2008, FASB Staff Position No. 157-3 *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*, or "FSP 157-3", was issued. FSP 157-3 provides an illustrative example of how to determine the fair value of a financial asset in an inactive market. FSP 157-3 does not change the fair value measurement principles set forth in SFAS 157 (see Note 9 to the consolidated financial statements for a description of SFAS 157). Since adopting SFAS 157 in January 2008, our process for determining the fair value of our investments has been, and continues to be, consistent with the guidance provided in the example in FSP 157-3. As a result, the adoption of FSP 157-3 did not affect our process for determining the fair value of our investments and did not have a material effect on our financial position or results of operations.

## PORTFOLIO AND INVESTMENT ACTIVITY

	Year Ended December 31, (in millions, except number of new investment commitments, terms and percentages)		
	2008	2007	2006
<b>New investments(1):</b>			
New portfolio companies	\$600.5	\$1,091.6	\$812.5
Existing portfolio companies	305.0	256.0	297.5
<b>Total new investments</b>	<b>905.5</b>	<b>1,347.6</b>	<b>1,110.0</b>
<b>Less:</b>			
Investments exited	430.3	654.1	404.9
<b>Net investments</b>	<b>\$475.2</b>	<b>\$693.5</b>	<b>\$705.1</b>
<b>New investments funded:</b>			
New portfolio companies	\$455.5	\$876.8	\$736.1
Existing portfolio companies	279.7	253.0	292.1
<b>Total</b>	<b>\$735.2</b>	<b>\$1,129.8</b>	<b>\$1,028.2</b>
<b>Principal amount of investments purchased:</b>			
Senior term debt	\$529.2	\$886.7	\$726.4
Senior subordinated debt	336.3	187.1	249.4
Equity and other	60.4	177.6	111.7
<b>Total</b>	<b>\$925.9</b>	<b>\$1,251.4</b>	<b>\$1,087.5</b>
<b>Principal amount of investments sold or repaid:</b>			
Senior term debt	\$448.8	\$608.3	\$255.5
Senior subordinated debt	29.0	89.8	99.2
Equity and other	7.4	20.6	75.3
<b>Total</b>	<b>\$485.2</b>	<b>\$718.7</b>	<b>\$430.0</b>
Number of new investments(2)	39	47	54
Average new investment amount	\$23.2	\$28.7	\$19.0
Weighted average term for new investments (in months)	66	69	69
Weighted average yield of debt and income producing securities at fair value funded during the period(3)	12.57%	11.51%	11.76%
Weighted average yield of debt and income producing securities at amortized cost funded during the period(3)	12.58%	11.53%	11.76%
Weighted average yield of debt and income producing securities at fair value sold or repaid during the period(3)	9.49%	11.67%	11.39%
Weighted average yield of debt and income producing securities at amortized cost sold or repaid during the period(3)	9.79%	11.72%	11.95%

(1) New investment commitments include new agreements to fund revolving credit facilities or delayed draw loans.

(2) Number of new investments represents each commitment to a particular portfolio company.

(3) When we refer to the "weighted average yield at fair value" in this report, we compute it with respect to particular securities by taking the (a) annual stated interest rate or yield earned plus the net annual amortization of original issue discount and market discount earned on accruing debt included in such securities, and dividing it by (b) total debt and income producing securities at fair value included in such securities. When we refer to the "weighted average yield at amortized cost" in this report, we compute it with respect to particular securities by taking the (a) annual stated



## Edgar Filing: ARES CAPITAL CORP - Form N-2

interest rate or yield earned plus the net annual amortization of original issue discount and market discount earned on accruing debt included in such securities, and dividing it by (b) total debt and income producing securities at amortized cost included in such securities.

The investment adviser employs an investment rating system to categorize our investments. In addition to various risk management and monitoring tools, the investment adviser grades the credit status of all investments on a scale of 1 to 4 no less frequently than quarterly. This system is intended to reflect the performance of the portfolio company's business, the collateral coverage of the investment and other relevant factors. Under this system, investments with a grade of 4 involve the least amount of risk in our portfolio. This portfolio company is performing above expectations and the trends and risk factors are generally favorable, including a potential exit. Investments graded 3 involve a level of risk that is similar to the risk at the time of origination. This portfolio company is performing as expected and the risk factors are neutral to favorable. All new investments are initially assessed a grade of 3. Investments graded 2 involve a portfolio company performing below expectations and indicates that the investment's risk has increased materially since origination. This portfolio company may be out of compliance with debt covenants, however, payments are generally not more than 120 days past due. For investments graded 2, our investment adviser increases procedures to monitor the portfolio company and will write down the fair value of the investment if it is deemed to be impaired. An investment grade of 1 indicates that the portfolio company is performing materially below expectations and that the investment risk has substantially increased since origination. Most or all of the debt covenants are out of compliance and payments are substantially delinquent. Investments graded 1 are not anticipated to be repaid in full and our investment adviser will reduce the fair market value of the investment to the amount our investment adviser anticipates will be recovered. Our investment adviser employs half-point increments to reflect underlying trends in portfolio company operating or financial performance, as well as the general outlook. As of December 31, 2008, the weighted average investment grade of the investments in our portfolio was 2.9 and six loans were past-due or on non-accrual status. The weighted average investment grade of the investments in our portfolio as of December 31, 2007 was 3.0. The distribution of the grades of our portfolio companies as of December 31, 2008 and 2007 is as follows (dollar amounts in thousands):

	As of December 31, 2008		As of December 31, 2007	
	Fair Value	Number of Companies	Fair Value	Number of Companies
Grade 1	\$ 48,192	8	\$ 13,927	1
Grade 2	180,527	9	115,585	6
Grade 3	1,632,136	68	1,581,811	66
Grade 4	112,122	6	62,879	3
	\$1,972,977	91	\$1,774,202	76

The weighted average yields of the following portions of our portfolio as of December 31, 2008 and 2007 were as follows:

	As of December 31,			
	2008		2007	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost
Debt and income producing securities	12.79%	11.73%	11.68%	11.64%
Total portfolio	11.24%	9.78%	10.22%	10.14%
Senior term debt	12.01%	10.85%	11.19%	11.05%
Senior subordinated debt	14.78%	13.69%	13.23%	12.97%
Income producing equity securities	8.42%	9.30%	10.36%	9.90%
First lien senior term debt	10.80%	9.99%	10.53%	10.47%
Second lien senior term debt	13.75%	12.04%	12.38%	12.10%

**RESULTS OF OPERATIONS***For the years ended December 31, 2008, 2007 and 2006*

Operating results for the years ended December 31, 2008, 2007 and 2006 are as follows (in thousands):

	<b>For the Year Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Total Investment Income	\$ 240,461	\$ 188,873	\$ 120,021
Total Expenses	113,221	94,750	58,458
Net Investment Income Before Income Taxes	127,240	94,123	61,563
Income Tax Expense (Benefit), Including Excise Tax	248	(826)	4,931
Net Investment Income	126,992	94,949	56,632
Net Realized Gains	6,371	6,544	27,616
Net Unrealized Losses	(272,818)	(10,661)	(14,553)
Net (Decrease) Increase in Stockholders' Equity Resulting From Operations	\$(139,455)	\$ 90,832	\$ 69,695

**Investment Income**

For the year ended December 31, 2008, total investment income increased \$51.6 million, or 27% over the year ended December 31, 2007. Interest income from investments increased \$46.0 million, or 28%, to \$208.5 million for the year ended December 31, 2008 from \$162.4 million for the comparable period in 2007. The increase in interest income from investments was primarily due to the increase in the size of the portfolio as well as increases in the weighted average yield on the portfolio. The average investments, at fair value, for the year increased to \$2.0 billion for the year ended December 31, 2008 from \$1.5 billion for the comparable period in 2007. Capital structuring service fees increased \$3.2 million, or 18%, to \$21.2 million for the year ended December 31, 2008 from \$18.0 million for the comparable period in 2007. The increase in capital structuring service fees was primarily due to the increase in fee percentages as a result of more favorable terms available in the current market.

For the year ended December 31, 2007, total investment income increased \$68.9 million, or 57%, from the year ended December 31, 2006. Interest income from investments increased \$64.1 million, or 65%, to \$162.4 million for the year ended December 31, 2007 from \$98.3 million for the comparable period in 2006. The increase in interest income from investments was primarily due to the increase in the overall size of the portfolio. The average investments, at fair value, for the year increased to \$1.5 billion for the year ended December 31, 2007 from \$871.0 million for the comparable period in 2006. Capital structuring service fees increased \$2.0 million, or 12%, to \$18.0 million for the year ended December 31, 2007 from \$16.0 million for the comparable period in 2006. The increase in capital structuring service fees was primarily due to the increased amount of new investments made. The amount of new investments made increased to \$1.3 billion during the year ended December 31, 2007 from \$1.1 billion for the comparable period in 2006.

**Operating Expenses**

For the year ended December 31, 2008, total expenses increased \$18.5 million, or 19%, from the year ended December 31, 2007. Base management fees increased \$6.9 million, or 29%, to \$30.5 million for the year ended December 31, 2008 from \$23.5 million for the comparable period in 2007, primarily due to the increase in the size of the portfolio. Incentive fees related to pre-incentive fee net investment income increased \$8.2 million, or 35%, to \$31.7 million for the year ended

December 31, 2008 from \$23.5 million for the comparable period in 2007, primarily due to the increase in the size of the portfolio and the related increase in net investment income. The increase in total expenses was partially offset by the decline in interest expense and credit facility fees. Interest expense and credit facility fees decreased \$0.4 million, or 1%, to \$36.5 million for the year ended December 31, 2008 from \$36.9 million for the comparable period in 2007, despite significant increases in the outstanding borrowings for the period. The average outstanding borrowings during the year ended December 31, 2008 was \$819.0 million compared to average outstanding borrowings of \$567.9 million for the comparable period in 2007. The increase in outstanding borrowings was more than offset by the decline in the average cost of borrowing which went from 6.08% for the year ended December 31, 2007 to 4.06% for the year ended December 31, 2008.

For the year ended December 31, 2007, total expenses increased \$36.3 million, or 62%, from the year ended December 31, 2006. Base management fees increased \$9.9 million, or 72%, to \$23.5 million for the year ended December 31, 2007 from \$13.6 million for the comparable period in 2006, primarily due to the increase in the size of the portfolio. Incentive fees related to pre-incentive fee net investment income increased \$7.5 million, or 46%, to \$23.5 million for the year ended December 31, 2007 from \$16.1 million for the comparable period in 2006, primarily due to the increase in the size of the portfolio and the related increase in net investment income. Interest expense and credit facility fees increased \$18.3 million, or 99%, to \$36.9 million for the year ended December 31, 2007 from \$18.6 million for the comparable period in 2006, primarily due to the significant increase in the outstanding borrowings. The average outstanding borrowings during the year ended December 31, 2007 was \$567.9 million compared to average outstanding borrowings of \$262.4 million for the comparable period in 2006. The increase in total expenses was partially offset by the decline in incentive fees related to realized gains. There were no incentive fees related to realized gains during the year ended December 31, 2007 compared to \$3.4 million for the year ended December 31, 2006, due to gross unrealized depreciation offsetting net realized gains for the period. Net realized gains were \$6.6 million during the year ended December 31, 2007 whereas gross unrealized depreciation recognized was \$61.2 million.

#### **Income Tax Expense, Including Excise Tax**

The Company has elected to be treated as a RIC under Subchapter M of the Code and operates in a manner so as to qualify for the tax treatment applicable to RICs. Among other things, the Company has, in order to maintain its RIC status, made and intends to continue to make the requisite distributions to its stockholders which will generally relieve the Company from U.S. federal income taxes.

Depending on the level of taxable income earned in a tax year, we may choose to carry forward taxable income in excess of current year dividend distributions into the next tax year and pay a 4% excise tax on such income, as required. To the extent that the Company determines that its estimated current year annual taxable income will be in excess of estimated current year dividend distributions, the Company accrues excise tax, if any, on estimated excess taxable income as taxable income is earned. For the years ended December 31, 2008, 2007 and 2006 provisions of approximately \$0.1 million, \$0.1 million and \$0.6 million respectively, were recorded for federal excise tax.

Certain of our wholly owned subsidiaries are subject to U.S. federal and state income taxes. For the year ended December 31, 2008, we recorded a tax provision of approximately \$0.1 for these subsidiaries. For the year ended December 31, 2007, we recorded a tax benefit of approximately \$0.9 million for these subsidiaries. For the year ended December 31, 2006, we recorded a tax provision of \$4.4 million, for these subsidiaries.

## Edgar Filing: ARES CAPITAL CORP - Form N-2

### Net Realized Gains/Losses

During the year ended December 31, 2008, the Company had \$495.6 million of sales and repayments resulting in \$6.6 million of net realized gains. These sales and repayments included the \$75.5 million of loans sold to the Ivy Hill Funds. Net realized gains were comprised of \$6.8 million of gross realized gains and \$0.2 of gross realized losses. The most significant realized gains and losses during the year ended December 31, 2008 were as follows (in millions):

Portfolio Company	Realized Gain (Loss)
Hudson Group, Inc.	\$ 2.8
Waste Pro USA, Inc.	2.0
Daily Candy, Inc.	1.3
Other	0.5
<b>Total</b>	<b>\$ 6.6</b>

During the year ended December 31, 2007, the Company had \$725.2 million of sales and repayments resulting in \$6.6 million of net realized gains. These sales and repayments included the \$133.0 million of loans sold to Ivy Hill I. Net realized gains were comprised of \$16.2 million of gross realized gains and \$9.7 million of gross realized losses. The most significant realized gains and losses during the year ended December 31, 2007 were as follows (in millions):

Portfolio Company	Realized Gain (Loss)
The GSI Group, Inc.	\$ 6.2
Varel Holdings, Inc.	4.0
Equinox SMU Partners LLC	3.5
Berkline/Benchcraft Holdings LLC	(8.8)
Other	1.7
<b>Total</b>	<b>\$ 6.6</b>

During the year ended December 31, 2006, the Company had \$457.7 million of sales and repayments resulting in \$27.6 million of net realized gains. Net realized gains were comprised of \$27.7 million of gross realized gains and \$0.1 million of gross realized losses. The most significant realized gains and losses during the year ended December 31, 2006 were as follows (in millions):

Portfolio Company	Realized Gain (Loss)
CICQ, LP	\$ 18.6
United Site Services, Inc.	4.5
GCA Services Group, Inc.	1.0
Other	3.5
<b>Total</b>	<b>\$ 27.6</b>

### Net Unrealized Gains/Losses

For the year ended December 31, 2008, the Company had net unrealized losses of \$272.8 million, which was comprised of \$54.9 million in unrealized appreciation, \$323.9 million in unrealized depreciation and \$3.8 million relating to the reversal of prior period net unrealized

Edgar Filing: ARES CAPITAL CORP - Form N-2

appreciation. The most significant changes in net unrealized appreciation and depreciation during the year ended December 31, 2008 were as follows (in millions):

Portfolio Company	Unrealized Appreciation (Depreciation)
R3 Education, Inc.	\$ 5.0
Instituto de Banco Y Comercio, Inc.	4.5
Industrial Container Services LLC	4.1
Diversified Collection Services, Inc.	3.4
Campus Management Corp.	3.0
Prommis Solutions, LLC	(3.1)
309179 Nova Scotia, Inc.	(3.1)
National Print Group, Inc.	(3.1)
Athletic Club Holdings, Inc.	(3.2)
Booz Allen Hamilton, Inc.	(3.2)
Wastequip, Inc.	(3.3)
Direct Buy Holdings, Inc.	(3.6)
OnCURE Medical Corp.	(3.6)
VSS-Tranzact Holdings, LLC	(4.0)
Summit Business Media, LLC	(4.0)
Best Brands Corporation	(4.3)
GG Merger Sub I, Inc.	(4.7)
Apogee Retail, LLC	(4.8)
Ivy Hill Middle Market Credit Fund, Ltd.	(5.6)
Making Memories Wholesale, Inc.	(6.7)
Vistar Corporation	(6.9)
HB&G Building Products	(7.4)
Growing Family, Inc.	(7.5)
Primis Marketing Group, Inc.	(7.6)
Capella Healthcare, Inc.	(9.5)
Wear Me Apparel, LLC	(12.1)
Things Remembered, Inc.	(12.3)
Apple & Eve, LLC	(12.4)
MPBP Holdings, Inc.	(15.3)
DSI Renal, Inc.	(18.1)
Reflexite Corporation	(19.2)
Courtside Acquisition Corp.	(30.9)
Firstlight Financial Corporation	(37.0)
Other	(32.5)
<b>Total</b>	<b>\$ (269.0)</b>

For the year ended December 31, 2007, the Company had net unrealized losses of \$10.7 million, which was comprised of \$52.5 million in unrealized appreciation, \$60.4 million in unrealized depreciation and \$2.8 million relating to the reversal of prior period net unrealized

## Edgar Filing: ARES CAPITAL CORP - Form N-2

appreciation. The most significant changes in unrealized appreciation and depreciation during the year ended December 31, 2007 were as follows (in millions):

Portfolio Company	Unrealized Appreciation (Depreciation)
Reflexite Corporation	\$ 27.2
The GSI Group, Inc.	5.6
Waste Pro, Inc.	4.0
Daily Candy, Inc.	3.6
Industrial Container Services, Inc.	3.2
Varel Holdings, Inc.	3.0
Wastequip, Inc.	(3.2)
Making Memories Wholesale, Inc.	(5.0)
Primis Marketing Group, Inc.	(5.6)
Universal Trailer Corporation	(7.2)
Wear Me Apparel, LLC	(8.0)
Firstlight Financial Corporation	(10.0)
MPBP Holdings, Inc.	(10.5)
Other	(5.0)
<b>Total</b>	<b>\$ (7.9)</b>

For the year ended December 31, 2006, the Company had net unrealized losses of \$14.6 million, which was comprised of \$9.2 million in unrealized appreciation, \$8.9 million in unrealized depreciation and \$14.9 million relating to the reversal of prior period net unrealized appreciation. The most significant changes in unrealized appreciation and depreciation during the year ended December 31, 2006 were as follows (in millions):

Portfolio Company	Unrealized Appreciation (Depreciation)
CICQ, LP	\$ 4.0
Universal Trailer Corporation	3.4
Varel Holdings, Inc.	1.0
Making Memories Wholesale, Inc.	(2.4)
Berkshire/Benchcraft Holdings LLC	(6.5)
Other	0.8
<b>Total</b>	<b>\$ 0.3</b>

### FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Since the Company's inception, the Company's liquidity and capital resources have been generated primarily from the net proceeds of public offerings of common stock, the Debt Securitization (as defined herein), advances from the CP Funding Facility and Revolving Credit Facility as well as cash flows from operations.

As of December 31, 2008, the Company had \$89.4 million in cash and cash equivalents and \$908.8 million in total indebtedness outstanding. Subject to leverage restrictions, the Company had approximately \$265.2 million available for additional borrowings under the Facilities as of December 31, 2008.

## Edgar Filing: ARES CAPITAL CORP - Form N-2

Due to increasing volatility in global markets, the availability of capital and access to capital markets has been limited. Until constraints on raising new capital ease, we intend to pursue other avenues of liquidity such as adjusting the pace of our investments, becoming more selective in evaluating investment opportunities to ensure appropriate risk-adjusted returns, pursuing asset sales, and/or recycling lower yielding investments. As the global liquidity situation evolves, we will continue to monitor and adjust our funding approach accordingly. However, given the unprecedented nature of the volatility in the global markets, there can be no assurances that these activities will be successful. Moreover, if current levels of market disruption and volatility continue or worsen, we could face materially higher financing costs. Consequently, our operating strategy could be materially and adversely affected. The illiquidity of our investments may make it difficult for us to sell such investments if required. As a result, we may realize significantly less than the value at which we have recorded our investments. A failure to renew or replace the CP Funding Facility with other indebtedness, and any required sale of all or a portion of the collateral securing the CP Funding Facility, could have a material adverse impact on our business, financial condition and results of operations.

### Equity Offerings

On April 28, 2008, we completed a transferable rights offering, issuing 24,228,030 shares at a subscription price of \$11.0016 per share, less dealer manager fees of \$0.22 per share. Net proceeds after deducting the dealer manager fees and estimated offering expenses were approximately \$259.8 million. Ares Investments LLC ("Ares Investments"), an affiliate of the investment adviser, purchased 1,643,215 shares in the rights offering, bringing its total shares owned to 2,859,882 shares of common stock, representing approximately 2.9% of our total shares outstanding as of December 31, 2008.

The following table summarizes the total shares issued and proceeds we received net of underwriter, dealer manager and offering costs for the years ended December 31, 2008, 2007 and 2006 (in millions, except per share data):

	Shares issued	Offering price per share	Proceeds net of underwriting and offering costs
<b>2008</b>			
April 2008 public offering	24.2	\$ 11.00	\$ 259.8
<b>Total for the year ended December 31, 2008</b>	<b>24.2</b>		<b>\$ 259.8</b>
<b>2007</b>			
August 2007 public offering	2.6	\$ 16.30	\$ 42.3
April 2007 public offering	15.5	\$ 17.97	267.2
February 2007 public offering	1.4	\$ 19.95	27.2
Underwriters over-allotment option related to December 2006 public offering	0.4	\$ 18.50	7.5
<b>Total for the year ended December 31, 2007</b>	<b>19.9</b>		<b>\$ 344.2</b>
<b>2006</b>			
December 2006 public offering	2.7	\$ 18.50	\$ 49.8
July 2006 public offering	10.8	\$ 15.67	162.0
<b>Total for the year ended December 31, 2006</b>	<b>13.5</b>		<b>\$ 211.8</b>

Part of the proceeds from our public offerings in 2008, 2007 and 2006 were used to repay outstanding indebtedness. The remaining unused portions of the proceeds from our public offerings were used to fund investments in portfolio companies in accordance with our investment objective and strategies and market conditions.

## Edgar Filing: ARES CAPITAL CORP - Form N-2

As of December 31, 2008, total market capitalization for the Company was \$0.6 billion compared to \$1.1 billion as of December 31, 2007.

### Debt Capital Activities

Our debt obligations consisted of the following as of December 31, 2008 and 2007 (in millions):

	As of December 31, 2008	As of December 31, 2007
Revolving Credit Facility	\$ 480.5	\$ 282.5
CP Funding Facility	114.3	85.0
Debt Securitization	314.0	314.0
	\$ 908.8	\$ 681.5

The weighted average interest rate and weighted average maturity of all our outstanding borrowings as of December 31, 2008 were 3.03% and 4.9 years, respectively.

The weighted average interest rate and weighted average maturity of all our outstanding borrowings as of December 31, 2007 were 5.66% and 6.9 years, respectively.

The ratio of total debt outstanding to stockholders' equity as of December 31, 2008 was 0.83:1.00 compared to 0.60:1.00 as of December 31, 2007.

A summary of our contractual payment obligations as of December 31, 2008 are as follows (in millions):

	Total	Payments Due by Period			After 5 years
		Less than 1 year	1-3 years	4-5 years	
Revolving Credit Facility	\$480.5	\$	\$ 480.5	\$	\$
CP Funding Facility	114.3	114.3			
Debt Securitization	314.0				314.0
<b>Total Debt</b>	<b>\$908.8</b>	<b>\$ 114.3</b>	<b>\$ 480.5</b>	<b>\$</b>	<b>\$314.0</b>

In accordance with the Investment Company Act, with certain limited exceptions, we are only allowed to borrow amounts such that our asset coverage, as defined in the Investment Company Act, is at least 200% after such borrowing. As of December 31, 2008, our asset coverage for borrowed amounts was 220%.

### CP Funding Facility

In October 2004, we formed Ares Capital CP Funding LLC ("Ares Capital CP"), a wholly owned subsidiary of the Company, through which we established a revolving facility, referred to as the "CP Funding Facility," that, as amended, allows Ares Capital CP to issue up to \$350.0 million of variable funding certificates. As of December 31, 2008, there was \$114.3 million outstanding under the CP Funding Facility and the Company continues to be in compliance with all of the limitations and requirements of the CP Funding Facility.

On July 22, 2008, we entered into an amendment to the CP Funding Facility to, among other things, extend its maturity, decrease the availability and advance rates applicable to certain types of eligible loans and make certain provisions of the facility more restrictive. The Company paid a renewal fee of 0.786% of the total amount available for borrowing, or \$2.75 million. On December 5, 2008, we entered into an amendment to the CP Funding Facility to, among other things, modify the net worth

## Edgar Filing: ARES CAPITAL CORP - Form N-2

test applicable to the Company, decrease the advance rates applicable to certain types of eligible loans and add an asset coverage requirement with respect to the Company consistent with regulatory requirements.

The CP Funding Facility is scheduled to expire on July 21, 2009. The CP Funding Facility is secured by all of the assets held by Ares Capital CP, which as of December 31, 2008 consisted of 45 investments. See Note 8 to our consolidated financial statements for more detail on the CP Funding Facility.

### ***Revolving Credit Facility***

In December 2005, we entered into a senior secured revolving credit facility, referred to as the Revolving Credit Facility, under which, as amended, the lenders have agreed to extend credit to the Company in an aggregate principal amount not exceeding \$525.0 million at any one time outstanding. The Revolving Credit Facility expires on December 28, 2010 and with certain exceptions is secured by substantially all of the assets in our portfolio (other than investments held by Ares Capital CP under the CP Funding Facility and those held as a part of the Debt Securitization, discussed below), which as of December 31, 2008 consisted of 170 investments.

The Revolving Credit Facility also includes an "accordion" feature that allows us to increase the size of the Revolving Credit Facility to a maximum of \$765.0 million under certain circumstances. On January 21, 2009, we partially exercised the accordion feature of the Revolving Credit Facility, increasing the total amount available for borrowing from \$510.0 million to \$525.0 million. As of December 31, 2008, there was \$480.5 million outstanding under the Revolving Credit Facility and the Company continues to be in compliance with all of the limitations and requirements of the Revolving Credit Facility. See Note 8 to our consolidated financial statements for more detail on the Revolving Credit Facility.

### ***Debt Securitization***

In July 2006, through our wholly owned subsidiary, ARCC CLO 2006 LLC ("ARCC CLO"), we completed a \$400.0 million debt securitization (the "Debt Securitization") and issued approximately \$314.0 million principal amount of asset-backed notes (including \$50.0 million of revolving notes, all of which were drawn down as of December 31, 2008) (the "CLO Notes") to third parties that were secured by a pool of middle market loans that have been purchased or originated by the Company. The CLO Notes are included in the December 31, 2008 consolidated balance sheet. We retained approximately \$86.0 million of aggregate principal amount of certain BBB and non-rated securities in the Debt Securitization (the "Retained Notes"). As of December 31, 2008, there were 67 investments securing the CLO Notes.

The CLO Notes mature on December 20, 2019. As of December 31, 2008, there was \$314.0 million outstanding under the Debt Securitization (excluding the Retained Notes). See Note 8 to our consolidated financial statements for more detail on the Debt Securitization. In February 2009, we purchased, in open market transactions, a total of \$27.0 million of our outstanding debt securities under the Debt Securitization for \$6.6 million.

In addition, as of December 31, 2008, we had a long-term issuer rating of Baa3 from Moody's Investor Service and a long-term counterparty credit rating from Standard & Poor's Ratings Service of BBB.

### **PORTFOLIO VALUATION**

Investment transactions are recorded on the trade date. Realized gains or losses are computed using the specific identification method. Investments for which market quotations are readily available

are typically valued at such market quotations. In order to validate market quotations, we look at a number of factors to determine if the quotations are representative of fair value, including the source and nature of the quotations. Debt and equity securities that are not publicly traded or whose market prices are not readily available (i.e., substantially all of our investments) are valued at fair value as determined in good faith by our board of directors, based on the input of our management and audit committee and independent valuation firms that have been engaged at the direction of the board to assist in the valuation of each portfolio investment without a readily available market quotation at least once during a trailing 12 month period. The valuation process is conducted at the end of each fiscal quarter, with approximately 50% (based on value) of our valuations of portfolio companies without readily available market quotations subject to review by an independent valuation firm. However, we may use additional independent valuation firms to value our investments more frequently as determined in good faith by our board of directors to the extent necessary to reflect significant events affecting the value of our investments.

As part of the valuation process, we may take into account the following types of factors, if relevant, in determining the fair value of our investments: the enterprise value of a portfolio company (an estimate of the total fair value of the portfolio company's debt and equity), 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, a comparison of the portfolio company's securities to publicly traded securities, changes in the interest rate environment and the credit markets generally that may affect the price at which similar investments may be made in the future 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 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 of directors, based on the input of our management and audit committee and independent valuation firms 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 fluctuate from period to period. Additionally, 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 may differ materially from the values that we may ultimately realize. Further, such investments are generally subject to legal and other restrictions on resale or otherwise are less liquid than publicly traded securities. If we were required to liquidate a portfolio investment in a forced or liquidation sale, we may realize significantly less than the value at which we have recorded it.

In addition, changes in the market environment, such as inflation, 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. See "Risk Factors Risks Relating to our Investments Price declines and illiquidity in the corporate debt markets have adversely affected, and may continue to adversely affect, the fair value of our portfolio investments, reducing our net asset value through increased net unrealized depreciation."

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 in conjunction with our portfolio management team.

Preliminary valuation conclusions are then documented and discussed by our management.

## Edgar Filing: ARES CAPITAL CORP - Form N-2

The audit committee of our board of directors reviews these preliminary valuations, as well as the input of independent valuation firms with respect to the valuations of approximately 50% (based on value) of our portfolio companies without readily available market quotations.

The board of directors discusses valuations and determines the fair value of each investment in our portfolio without a readily available market quotation in good faith based on the input of our management and audit committee and independent valuation firms.

Effective January 1, 2008, the Company adopted SFAS 157, which expands the application of fair value accounting for investments (see Note 9 to the consolidated financial statements).

### OFF BALANCE SHEET ARRANGEMENTS

As of December 31, 2008, the Company had the following commitments to fund various revolving senior secured and subordinated loans (in millions):

	As of December 31, 2008	As of December 31, 2007
Total revolving commitments	\$ 419.0	\$ 323.6
Less: funded commitments	(139.6)	(79.2)
<b>Total unfunded commitments</b>	<b>279.4</b>	<b>244.4</b>
Less: commitments substantially at discretion of the Company	(32.4)	
Less: unavailable commitments due to borrowing base or other covenant restriction	(64.5)	(15.4)
<b>Total net adjusted unfunded revolving commitments</b>	<b>\$ 182.5</b>	<b>\$ 229.0</b>

Of the total commitments as of December 31, 2008, \$342.9 million extend beyond the maturity date for our Revolving Credit Facility. Included within the total commitments as of December 31, 2008 are commitments to issue up to \$15.8 million in standby letters of credit through a financial intermediary on behalf of certain portfolio companies. Under these arrangements, the Company would be required to make payments to third parties if the portfolio companies were to default on their related payment obligations. As of December 31, 2008, the Company had \$12.5 million in standby letters of credit issued and outstanding on behalf of the portfolio companies, of which no amounts were recorded as a liability. Of these letters of credit, \$0.2 million expire on January 31, 2009, \$3.7 million expire on February 28, 2009, \$8.1 million expire on September 30, 2009 and \$0.5 million expire on August 31, 2010.

As of December 31, 2008 and 2007, the Company was subject to subscription agreements to fund equity investments in private equity investment partnerships, substantially all at the discretion of the Company as follows (in millions):

	December 31, 2008	December 31, 2007
Total private equity commitments	\$ 428.3	\$ 111.8
Total unfunded private equity commitments	\$ 423.6	\$ 110.5

**QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are subject to financial market risks, including changes in interest rates of our investment portfolio.

**Interest Rate Risk**

Interest rate sensitivity refers to the change in earnings that may result from changes in the level of interest rates. Because we fund a portion of our investments with borrowings, our net investment income is affected by the spread between the rate at which we invest and the rate at which we borrow. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income.

As of December 31, 2008, approximately 57% of the investments at fair value in our portfolio were at fixed rates while approximately 32% were at variable rates and 11% were non-interest earning. The Debt Securitization, the CP Funding Facility and the Revolving Credit Facility all feature variable rates.

We regularly measure our exposure to interest rate risk. We assess interest rate risk and manage our interest rate exposure on an ongoing basis by comparing our interest rate sensitive assets to our interest rate sensitive liabilities. Based on that review, we determine whether or not any hedging transactions are necessary to mitigate exposure to changes in interest rates.

In October 2008, we entered into a two-year interest rate swap agreement for a total notional amount of \$75 million. Under the interest rate swap agreement, we will pay a fixed interest rate of 2.985% and receive a floating rate based on the prevailing three-month LIBOR. We believe that this agreement will enable us to mitigate interest rate risk and remain match funded.

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.

Based on our December 31, 2008 balance sheet, the following table shows the impact on net income of base rate changes in interest rates assuming no changes in our investment and borrowing structure and reflecting the effect of our interest rate swap agreement described above and in Note 10 of the consolidated financial statements (in millions):

<b>Basis Point Change</b>	<b>Interest Income</b>	<b>Interest Expense</b>	<b>Net Income</b>
Up 300 basis points	\$ 21.4	\$ 25.0	\$ (3.6)
Up 200 basis points	\$ 14.2	\$ 16.7	\$ (2.5)
Up 100 basis points	\$ 7.1	\$ 8.3	\$ (1.2)
Down 100 basis points	\$ (6.2)	\$ (8.3)	\$ 2.1
Down 200 basis points	\$ (11.2)	\$ (15.1)	\$ 3.9
Down 300 basis points	\$ (14.7)	\$ (17.0)	\$ 2.3

Based on our December 31, 2007 balance sheet, the following table shows the impact on net income of base rate changes in interest rates assuming no changes in our investment and borrowing structure (in millions):

<b>Basis Point Change</b>	<b>Interest Income</b>	<b>Interest Expense</b>	<b>Net Income</b>
Up 300 basis points	\$ 24.4	\$ 20.4	\$ 4.0
Up 200 basis points	\$ 16.3	\$ 13.6	\$ 2.7
Up 100 basis points	\$ 8.1	\$ 6.8	\$ 1.3
Down 100 basis points	\$ (8.1)	\$ (6.8)	\$ (1.3)
Down 200 basis points	\$ (16.3)	\$ (13.6)	\$ (2.7)
Down 300 basis points	\$ (24.4)	\$ (20.4)	\$ (4.0)