Opportunities in Global Direct Lending

A Historical and Prospective View of the U.S. and European Markets

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ARES

Contents

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Please see the Endnotes and Legal Notice and Disclaimers beginning on page 23.

Executive Summary

- ***Direct lending has emerged as an attractive asset class among institutional investors, generating solid risk-adjusted returns that are primarily floating rate with high current income and lower volatility compared to other similar fixed income alternatives.*** Based upon a November 2017 institutional investor survey by Preqin, ~76% of investors have increased their appetite for private debt in the 12 months prior to the survey. Investors find middle market direct loans attractive due to their floating rate nature, high current yields and lack of correlation to traded assets. In fact, middle market senior loans have generated superior returns compared to liquid leveraged loans (spread premiums of 245–325 basis points) and generated comparable returns to high yield bonds, but with security and less volatility. In addition, U.S. middle market loans have generated a higher Sharpe Ratio vs. the S&P/LSTA U.S. Leveraged Loan 100 Index, High Yield Bond Index and the S&P 500 over a three-, five- and seven-year period. Direct lending has also demonstrated attractive relative value in Europe. The table below illustrates current yields by market across the U.S. and Europe.

U.S. and European
Targeted Middle Market Returns

	U.S.	Europe
	Effective Yield*	
Senior 1st Lien	6.50%–7.25%	7.00%–8.00%
Unitranche	8.00%–9.25%	8.00%–9.00%
2nd Lien	10.00%–11.50%	9.00%–11.00%
Subordinated	11.00%–13.00%	12.00%–14.00%

* Assumes fee income of 2–3% in the U.S. and 3–3.5% in Europe, 3-month LIBOR of 2.3% in the U.S. and GBP LIBOR of 0.5% in Europe. Amortizes fees over three years. Target returns are estimated market pricing in the U.S. and Europe.

- ***We believe directly originated middle market loans are typically structured with greater lender protections compared to broadly syndicated transactions.*** Middle market loans generally include stronger covenant packages, more frequent and transparent financial reporting, and often have higher amortization payments. We believe these protections have contributed to capital preservation and lower default rates.
- ***The market opportunity for direct lending has evolved over the last several decades as commercial banks reduced their willingness to originate and hold significant amounts of leveraged loans to middle market companies.*** The shift in bank behavior was driven by significant consolidation, increased regulation and lack of infrastructure. As a result, banks have ceded market share to a growing number of non-bank, direct lending platforms who have filled the void in the marketplace. We believe this trend represents a secular shift and is unlikely to change.
- ***The European direct lending market is less mature when compared to the U.S., as alternative lenders began to emerge in reaction to the Global Financial Crisis (the "GFC").*** Bank consolidation and nationalization during the last credit cycle resulted in an overall reduction in supply of leveraged credit to the middle market in Europe. This trend has accelerated in the last five years and today, we estimate that banks account for ~50% of the total European market.[i] We believe that regulatory pressures will continue to impact bank's appetite to participate in the market, while institutional lenders will continue to fill the gap, following the U.S. trend (where banks account for ~9% of the total market today).[ii]
- ***Supporting the growth of the direct lending market has been the increase in non-bank lenders funded by institutional investors such as insurance companies, pension funds, endowments and sovereign wealth funds.*** Many of these investors have overcome legacy challenges associated with debt-oriented, non-benchmarked products. In the U.S., retail investors have also increasingly invested capital in a growing number of Business Development Companies ("BDCs").
- ***We estimate the size of outstanding middle market direct loans in the U.S. to be ~$910 billion and ~€120 billion in Europe.***[iii] Since the reported data for the size of the direct lending markets in the U.S. and Europe are limited, we believe the reported transaction volume likely understates the size of the market opportunity based on our analysis.
- ***We believe despite the long duration of the current credit cycle, continued strong corporate earnings, low defaults, significant private equity dry powder and recent tax reform in the U.S. are drivers of a continuation of the current business cycle in the near term.*** In our view, the structural changes that have led to the emergence of direct lending as an established asset class remain firmly in place, with continuing macroeconomic trends supporting the current investment environment.
- ***We believe it is critical to invest with managers that have scale, origination advantages and significant credit expertise.*** Manager selection is a very important factor in meeting investor expectations with this asset class.

The Growth & Appeal of Direct Lending as an Asset Class

Direct lending is a term meant to describe a transaction where a lending source directly provides a loan to the borrower without the use of an intermediary. This type of "direct lending" is accomplished by going directly to private equity sponsors or owner/operators of middle market companies, commercial projects or commercial real estate to originate loans. For purposes of this whitepaper, we will focus on non-bank corporate lending, but our market analysis does include loans provided by banks.

Over the last twenty plus years, direct lending has emerged as both an attractive asset class for institutional investors and as a flexible capital substitute for traditional bank-provided loans, particularly for those seeking capital for various forms of corporate transactions (e.g., leveraged buyouts, recapitalizations, acquisitions and corporate expansion). From an investor's perspective, directly originated loans can provide relatively high absolute returns (6–12% without leverage) based upon a floating base rate (LIBOR) with low market volatility and credit losses.[iv] Direct loans are particularly attractive in today's interest rate environment where the Federal Reserve has indicated that several more interest rate increases are expected in 2018 and 2019.

Direct lending produces several sources of returns that can lead to consistent income generation.[v] Senior secured loans generally consist of floating rate coupons that can be attractive in a rising rate environment. In addition to the cash interest coupons, these loans typically include upfront origination fees, call protection and LIBOR floors, which can enhance total return. As a result of their privately negotiated nature, middle market lenders seek to reduce risk through maintenance covenants, enhanced due diligence and secured lending terms. Mezzanine loans can include equity warrants, which provide the potential for further upside. In addition, middle market transactions often have less total leverage than larger syndicated loan transactions, thus offering creditors a higher cushion against potential losses.

Compared to private equity or venture capital, direct lending strategies can help mitigate the effect of the J-curve, as these funds typically only charge management fees on invested capital and in most cases will immediately receive current income generated by the underlying loans. When benchmarked against the liquid asset classes such as high yield bonds, liquid leveraged loans and U.S. public equities, direct loans have higher Sharpe ratios.[vi] As a result of these attractive qualities and market dynamics, a large number of asset managers have initiated direct lending platforms in recent years and have raised capital from institutional and retail investors in various forms (e.g., commingled funds, separately managed accounts, and public and private closed end funds such as BDCs).

The key providers or buyers of direct loans (and there are key distinctions between the direct lenders and buyers of direct loans) are public and private alternative asset managers, BDCs and mid-market focused Collateralized Loan Obligation ("CLO") fund managers in the U.S. as well as hedge funds, insurance companies, finance companies, etc., in both the U.S and Europe (*Figure 1*). These managers vary greatly in terms of size, scale and experience in the marketplace.

Figure 1. Number of Direct Middle Market Loan Providers in US and Europe

	United States	Europe
Direct Lending Managers	150+	50+
CLO Managers	~25	NA
BDC Managers	50+	NA

Source: Preqin, CreditFlux, SNL Financial, Altium, Deloitte, Marlborough Partners, S&P LCD Leveraged Lending Review Q4-17. As of January 2018.

The Evolution of Direct Lending Markets in the U.S. and Europe

Over the past several decades, lending to middle market companies in the U.S. and Europe has shifted due to structural changes and evolving risk tolerances in each respective banking system.

U.S. Direct Lending

During the 1990s, bank consolidation in the U.S. began the multi-decade decline of banks' willingness to hold significant loans in the middle market. The consolidation of regional banks into larger, national banks often resulted in a preference to provide larger facilities to larger customers and therefore less capital was being allocated to smaller borrowers (*Figure 2*).

Figure 2. Bank Consolidation Over Past Decades

Numerous middle market-focused banks have disappeared over the last two decades, leaving a handful of large banks focused on large borrowers. Smaller banks have de-emphasized cash flow lending.

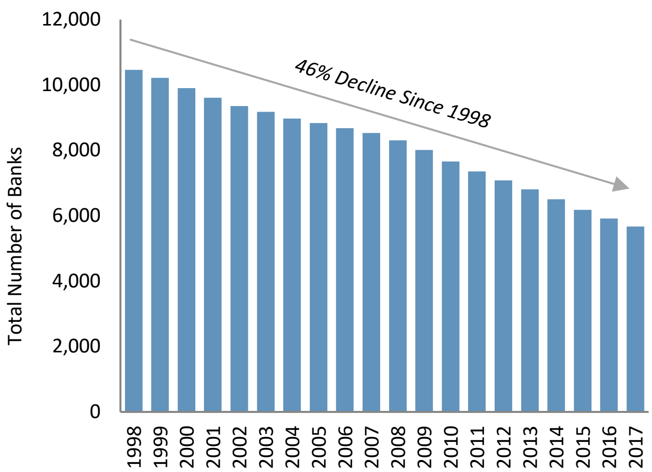
Select Bank Competitors (Historical)			Consolidators
Continental Illinois *Nations Bank* *Sovran Bank* *BankBoston*	*La Salle Bank* *Barnett Bank* *Security Pacific Bank* *Merchants Bank*	*NCNB* *Summit Bank* *Fleet* *Bank of New England*	Bank of America Merrill Lynch
Manufacturers Hanover *First Chicago*	*Bank One* *Chemical Bank*	*Washington Mutual* *Chase*	JPMorgan Chase & Co.
Foothills Capital Corp. *First Interstate Bank* *SouthTrust*	*First Union* *Northwest Bank*	*Wachovia* *Goldenwest*	Wells Fargo

Source: Ares Management. For illustrative purposes only.

Over the past several decades, lending to middle market companies in the U.S. and Europe has shifted due to structural changes and evolving risk tolerances in each respective banking system.

This initial wave of bank consolidation began the trend of declining bank capital provided to the middle market, and consolidated assets into larger banks. While bank assets have consolidated, the number of banks has declined by more than 45% between the late 1990s and today (*Figure 3*). This has resulted in numerous middle market-focused bank lenders disappearing over the last two decades, generally leaving larger banks focused on larger borrowers.

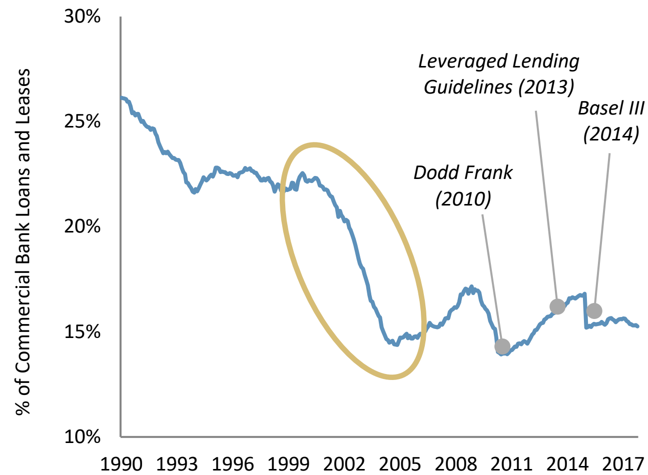
Figure 3.
Number of FDIC-Insured Institutions



Source: Federal Deposit Insurance Corp.

As shown in *Figure 4*, the percentage of commercial and industrial ("C&I") loans on bank balance sheets in 1990 was nearly double what it is today, with the largest decline in C&I loan composition occurring in the late 1990s and early 2000s as bank consolidation accelerated and banks focused on running more capital efficient businesses. We believe this consolidation trend and the corresponding reduction in C&I lending reflects the continued push for larger clients, which has resulted in a declining presence of banks serving middle market companies.

Figure 4.
Commercial and Industrial Loans and Leases



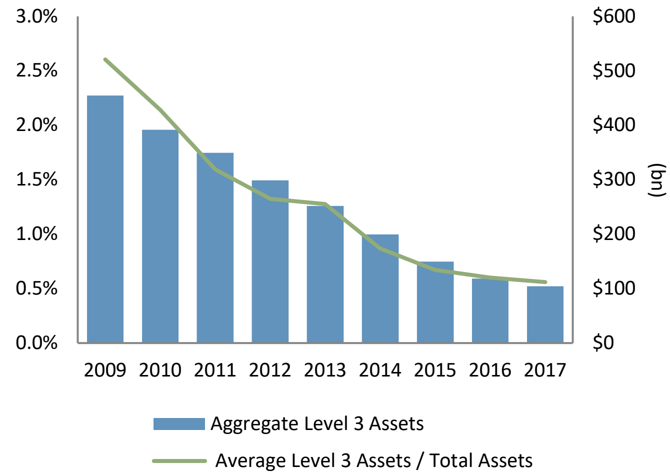
Source: Federal Reserve H8 data as of October 2017.

The GFC in 2008–2009 further accelerated the trend of bank consolidation and decreased capital provided to the middle market. During this time, stressed banks were merged, leaving a system heavily concentrated amongst a few large banks. For example, the top five banks comprise approximately half of total industry assets today as compared to less than 10% of total assets in 1990.[vii]

In the aftermath of the GFC, significant new bank regulations increased capital requirements and reporting burdens on the banks.

During the same time period, the remaining large banks shifted further up-market to larger borrowers to match the elevated size of their balance sheets and focus on clients with needs for fee-generating ancillary services. Regulations such as Dodd Frank in the United States and Basel III in both the U.S. and Europe required banks to increase their capital base and materially tighten underwriting standards. As a result, coming out of the GFC, banks have narrowed their lending products (particularly level 3, illiquid assets, as shown in *Figure 5*), shed staff, and allowed legacy businesses to run-off or be sold. This has resulted in "the biggest run down of legacy portfolios in history" according to Wells Fargo Securities research.[viii] The contraction of C&I lending and changes in bank employment further reduced the banking industry's focus on long-term financing to middle market companies.

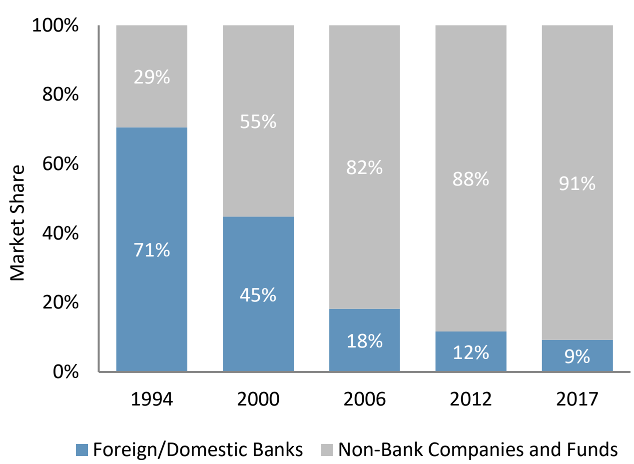
Figure 5.
Level 3 Assets at Largest 50 U.S. Banks[ix]



Source: SNL Financial.

Today, bank participation in middle market lending is a fraction of what it was during the mid-1990s. The 20 years of bank consolidation and the ramifications from post-recession regulations have resulted in banks becoming much less relevant in the sector. As *Figure 6* illustrates, this is evidenced by the fact that while banks held ~71% of leveraged loans in 1994, they hold only ~9% of such loans today.

Figure 6. Banks' Share of the Leveraged Loan Market Continues to Shrink



Source: S&P LCD Leveraged Lending Review Q4-17.

To balance the increased capital standards and declining capabilities to provide middle market loans, banks have shifted from being principal investors that commit capital, to brokers or agents for larger transactions. The banks increasingly serve as arrangers of loans and make syndication and transaction-oriented fees in distributing these loans. Certain direct lending and structured product platforms that lack direct origination capabilities may also rely on purchasing these originated loans from the large investment banks or from scaled direct lenders with meaningful origination infrastructure. In our view, the inability to directly source and structure transactions in the middle market can lead to adverse selection and minimal control during amendments. Additionally, for the increasing number of borrowers who want to know their lender, the current bank model of "originate and sell" may not serve borrower needs. Moreover, during periods of market dislocation or ongoing technical imbalance, the financing capital available from the banks is generally less reliable as banks become challenged to price and distribute new issuances efficiently.

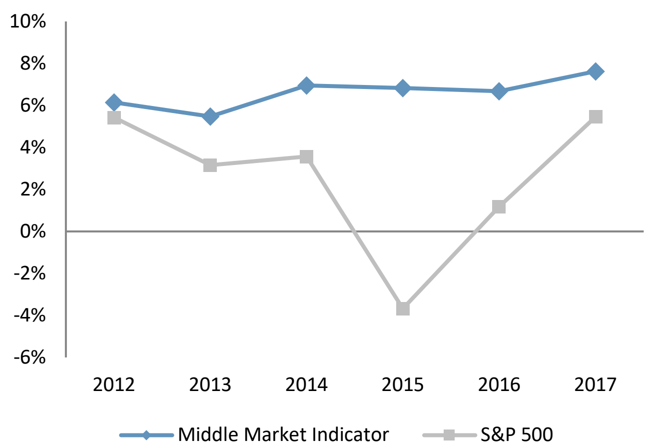
Most recently, there has been a broader push in the U.S. to relax many of the banking regulations put in place after the GFC. In concert with this sentiment of deregulation, Joseph Otting, the Comptroller of the Currency, has announced that he was comfortable with banks conducting leveraged lending as long as the banks have sufficient capital and that these loans do not impair safety and soundness.[x] Despite the recent easing in regulations, we do not believe the role of banks in middle market lending will materially change. The de-banking of the middle market began in the mid-1990s and evolved prior to the GFC. We believe the regulation that emerged post-GFC only accelerated the market opportunity for non-bank lenders. As a result, banks have shuttered much of the origination and back office infrastructure to more efficiently manage their capital. In place of these functions, banks have only maintained origination and syndicate platforms that are targeted toward larger, more liquid loans and simply do not have the sourcing infrastructure we believe is necessary to access the middle market. These dynamics are structural and unlikely, in our view, to materially alter the competitive landscape for the middle market. Further demonstrating this point, PacWest Bancorp, a west coast U.S.-centric bank, announced that it is exiting the cash flow lending business in December of 2017.[xi]

The lack of supply of middle market financing by traditional banks has not hindered demand for non-bank lenders. Middle market companies have experienced significant growth in recent years. In the U.S., the middle market is defined as the economic segment that is made up of companies with annual revenue between $10 million and $1 billion and accounts for one third of private sector GDP and employment (~47.9 million jobs).[xii] Not only is it a significant part of the U.S. economy, but it is the third-largest economy in the world.[xiii]

Middle market companies showed strong performance and resiliency through the GFC, adding 2.2 million jobs across the U.S. between 2007 and 2011.[xiv] At the time, these firms were the only segment of the economy that created positive net job creation, serving as an important indicator for the greater U.S. economy.

For the five years from 2012 through 2017, the middle market has also exhibited stronger revenue and employment growth rates than the S&P 500. As illustrated in *Figure 7*, from 2012 through 2017, the middle market generated greater revenue growth than companies in the S&P 500. In 2017, average revenue growth for middle market companies was 8.0% compared to the 5.3% average of the S&P 500.

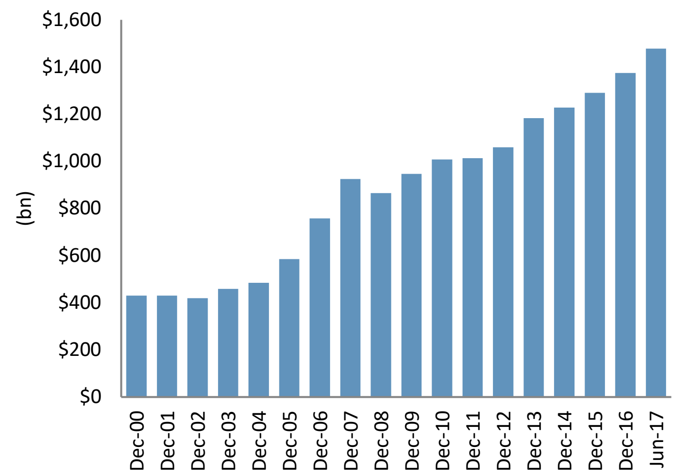
Figure 7.
Middle Market Revenue Growth vs. S&P 500



Source: National Center for the Middle Market.

Supporting this growth has been the expansion of institutional equity capital in the middle market. U.S. private equity ("PE") assets under management grew 320% from December 2000 to March 2017 according to Preqin (*Figure 8*). Middle market companies made up more than 70% of all PE-backed companies in the U.S. as of 2016.[xv] In particular, 2017 was the fifth consecutive year in which financial sponsors raised over $150 billion of buyout capital, and as of December 2017, private equity firms had $459 billion of buyout capital available for investment.

Figure 8. U.S. Private Equity Market Assets Under Management



Source: Preqin.

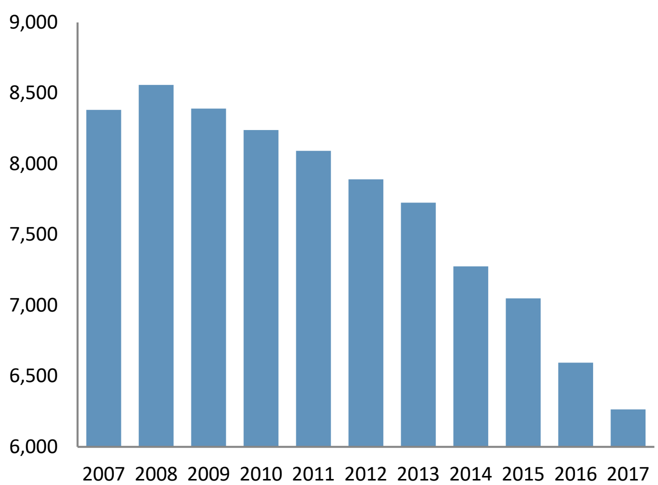
Middle market companies showed strong performance through the financing crisis, adding 2.2 million jobs across the U.S.[xiv]

In addition, the middle market has generated greater revenue growth than companies in the S&P 500.

European Direct Lending

The development of the European direct lending market traces its roots back to the GFC, which began in 2008. Prior to this time, senior loans to middle market companies were almost exclusively the domain of commercial banks with fund-based lenders focused solely on providing additional higher risk mezzanine loans ranking behind senior bank loans in the capital structure. As a result of the crisis, the European banking sector experienced fundamental and longstanding changes, including bankruptcy, consolidation and nationalization in local markets, as well as foreign banks retreating to their home markets. As shown in *Figure 9*, the net result of these trends was a decrease in the number of active bank participants in middle market European credit, with the impact felt most severely in the United Kingdom.

Figure 9. Number of Credit Institutions in the EU



Source: European Banking Federation.

Post GFC, increasingly stringent banking regulations (including Basel II which transitioned into Basel III after the GFC) resulted in a decreased appetite for holding middle market credit by increasing loan capital charges and reserve requirements. Thus, there was a combined effect, which led to an overall reduction in the supply of leveraged credit to the European middle market.

The vast majority of alternative non-bank lenders in Europe began to emerge only in reaction to the GFC with particular growth in the past five years.[xvi] Direct lenders have been able to benefit from their ability to (i) lend at higher loan-to-value rates versus commercial banks (usually compensated for by a higher interest rate), (ii) hold these loans in much more significant scale vis-à-vis the banks thus providing borrowers with a complete solution, (iii) offer more flexible terms, (iv) commit more quickly than commercial banks, and (v) commit to undrawn facilities, which are unattractive and costly for banks.

The dynamics regarding banks and alternative lenders are still relevant and observable in the European markets today. Banks are still experiencing significant regulation and scrutiny, and are finding it ever more difficult to finance middle market companies. Bank balance sheet allocations to credit continue to shrink and, to the extent available, commercial and investment banks are underwriting financings with significant pricing flex, resulting in uncertainty for financial sponsors and borrowers. In addition, similar to the U.S., many banks are looking to de-emphasize their middle market offerings in favor of larger corporate clients and capital markets transactions. These dynamics coupled with the lack of alternative financing options such as CLOs and BDCs for European middle market companies (which are available in the U.S. market), leave European direct lenders well-positioned to fill the gap in the market left by commercial banks.

Figure 10 compares the evolution of the asset class in the U.S. and Europe.

Figure 10. U.S. vs. European Direct Lending

	Pre-Crisis *Before 2007*	Credit Crisis and Fallout *2008–2012*	Era of Bank Regulation and DL Acceptance *2013+*
U.S.	• **Consolidation wave** — large banks acquire smaller banks • Capacity leaves market • **Diminishing lending capabilities** of mid market banking platforms • **Rise of non-bank lenders** and institutional investors	• Regulators increase **capital and risk standards** • **Banks refocus** towards lower risk lending • Growing borrower **acceptance of non-bank lenders**	• **Growing demand from borrowers** underserved by current banking system • Global **demand from retail and institutional** investors • Absolute returns in **pursuit of yield**
Europe	• European middle market leveraged buyout financing was **dominated by commercial banks** • The role of alternative lenders in Europe was **new** • Institutional capital was concentrated in **mezzanine funds and large-market CLOs**	• Many **banks failed**, went **bankrupt**, became **state-owned** or **merged** • International banks retrenched to their **home markets** • The number of **available bank lenders declined** • Banks that were able to lend dramatically **reduced the amount** they invested	• Banks' **balance sheet allocations shrinking**, resulting in smaller tickets • **Regulation** has forced some players out of the market entirely • **Alternative lenders** have taken a significant share of the direct lending middle market • **Rapidly growing** direct lending volumes • **Growing number of participants**

The U.S. opportunity has developed broadly over the last twenty years and is fully institutionalized
The U.K. and continental Europe are undergoing a sweeping transformation today

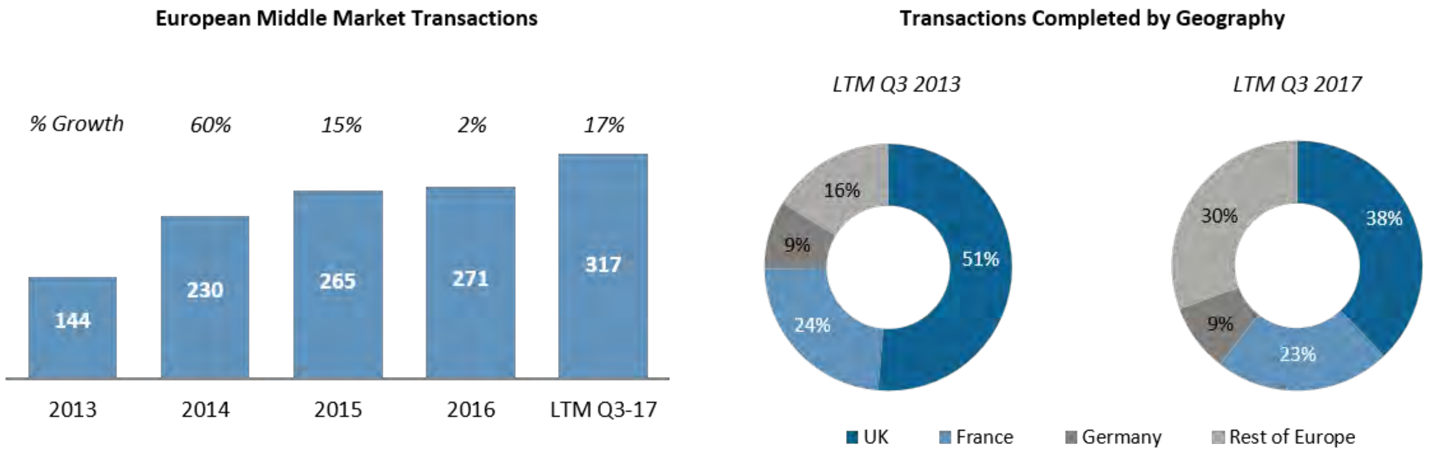
Stricter bank regulations, higher capital requirements, increased compliance costs and other ramifications of the GFC shifted the risk culture of many European banks. As many banks retrench and downsize, non-bank direct lending has continued to grow as a new source of financing for European mid-market companies.

To illustrate the growth rate of European direct lending, according to Deloitte, there were 317 direct lending middle market transactions funded by non-bank lenders in the twelve months ended September 30, 2017. This compares with 144 transactions in 2013, representing an ~120% increase over approximately four years. This growth is also illustrated in *Figure 11*.

In summary, we believe these shifts in capital availability to middle market borrowers remain powerful and have caused structural changes in the way businesses access credit in both the U.S. and Europe.

In addition, the Continental European markets are increasingly more accepting of direct lenders, following the U.K. example. As can be seen in Deloitte's data (see *Figure 11*), Continental European alternative lender transactions accounted for ~65% of the total European market volume in the twelve months to September 30, 2017, compared to roughly 50% in 2013.

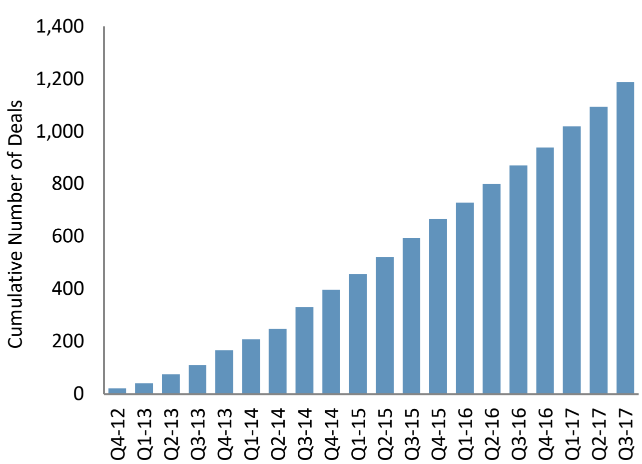
Figure 11. European Middle Market Direct Lending Transactions and Geographic Split



Source: Transaction count is as per the specific Deloitte deal count requirements (i.e. primary mid-market UK and European deals, tracked across 58 alternative lenders, deals with up to €350 million of debt).

As a result, the number of alternative transactions in Europe has increased significantly (*Figure 12*).

Figure 12. Cumulative Alternative Lending Transactions in Europe since Q4 2012



Source: Deloitte Alternative Lender Deal Tracker as of Q3-17.

Sizing the Direct Lending Market Opportunity

U.S. Market Size

In the syndicated bank loan market, loan syndications by banks are reported for trading and league table credit. However, since middle market participants do not have incentives to report transactions due to the private and club-nature of middle market lending, it is more challenging to evaluate the true size of the middle market. Using outside data and our own analysis, we estimate 2017 annual volume in the U.S. middle market was ~$365 billion,[xvii] which allows us to extrapolate that the total amount of outstanding middle market loans may be ~$910 billion.

Using transactions sizes or issuer revenue size of less than or equal to $500 million, Thomson Reuters reported 2017 total volume of middle market loans of ~$170 billion. For the same period, S&P Global Market Intelligence reported ~$80 billion in loan volume for transaction sizes less than or equal to $500 million. After eliminating ~$30 billion of duplicate transactions in both databases and assuming 10% of such transactions refinanced within the same year (~$20 billion), we estimate the 2017 annual reported volume was ~$200 billion.

However, many transactions go unreported and are not included in these two databases available to the public. During the year ended December 31, 2017, Ares reviewed ~1,400 direct lending transactions. Excluding the ~10% of transactions that we estimate were refinanced within the same year, we estimate 1,280 distinct 2017 loan transactions. Assuming average leverage of 5.0x (debt to EBITDA) and using the weighted EBITDA of $40 million from transactions we reviewed, we estimate that we reviewed ~$260 billion in transactions. That said, we also estimate that ~10% of the transactions we evaluated were not executed either by us or other market participants, and ~25% of the transactions we evaluated overlapped with the reported market. Therefore, we estimate there is a total of $165 billion in additional volume that we evaluated over this time frame that was not included in the reported transaction data. We believe this implies that the total volume for 2017 was ~$365 billion in U.S. middle market loans.

While the average life of loans may vary by company and overall market conditions, we estimate the average life of middle market loans to be ~2.5 years. Multiplying the 2017 annual volume of ~$365 billion by an assumed 2.5-year life implies a middle market size of ~$910 billion of loans outstanding. Separately, Thomson Reuters stated that there are $500 billion in total syndicated middle market loans that will mature between 2018 and 2021, which we believe further validates our view of the size of the visible part of the middle market.[xviii]

Our calculations and data for the U.S. middle market are shown in *Figure 13*.

Figure 13. Estimated Size of the U.S. Middle Market for Direct Loans

$ in Billions, unless otherwise stated; as of 12/31/17

Reported Loan Volume:	
Thomson Reuters Reported Middle Market Direct Loans	$170
S&P Global Reported Middle Market Direct Loans	$79
Less: Duplicate Transactions	($30)
Reported Loan Volume	**$219**
Less: $ Refinanced Within 12 Months	($22)
Reported Loan Volume (Less Refinancings of Same Companies)	**$197**
Ares Transactions Reviewed:	
Number of Transactions	1,422
Transactions Refinanced Within 12 Months (10%)	(142)
Number of Transactions Excluding Refis in 2017	**1,280**
Average EBITDA ($ Millions)	$40
Average Leverage	5.0x
Total Ares Transactions Reviewed	$256
Transactions Not Closed by Ares or Market (10%)	($26)
Overlap with Reported Transactions (25%)	($64)
Ares Transactions Reviewed That Were Not Reported	**$166**
Total Estimated Loan Volume	**$364**
Average Life (Years)	2.5
Estimated Size of Loan Market	**$909**

Source: Thomson Reuters, S&P Global Market Intelligence, Ares Management.

European Market Size

Due to the lack of a comprehensive third-party source, Ares conducts a bottom-up European market-sizing exercise using completed transaction data from Deloitte, DC Advisory Partners and Marlborough Partners for middle market (defined as debt facilities between €50–€250 million) non-bank lenders, in addition to Ares' own market observations on transaction counts and values. From these sources, we estimated the total 2016 originations for European non-bank direct lenders to be ~€22 billion (UK: ~€14 billion and rest of Europe ~€8 billion). This represents an increase vis-à-vis 2015 (~€20 billion) and 2014 (~€18 billion). Based on these statistics and an assumed 3-year average life, we estimate European non-bank direct loans outstanding to be ~€60 billion. Assuming banks' market share in middle market lending is 50%, we estimate the total size of outstanding middle market loans for Europe to be ~€120 billion.

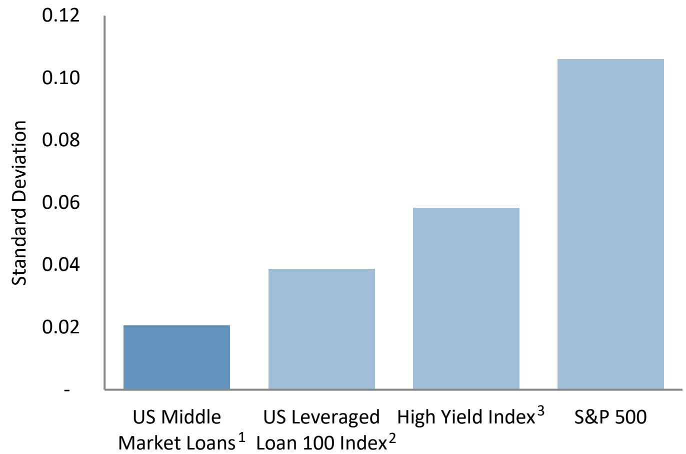
We believe since the time of the above exercise, the market has continued to grow, driven by:

- increased market acceptance of direct lenders, both in the UK and continental Europe;
- direct lenders have now become applicable for larger sized companies; and
- corporate transactions becoming an increasingly larger portion of the direct lending market.

Attractive Investment Performance Has Led to Growing Institutional Focus

Not only is there a large addressable market in both the U.S. and Europe. As shown in *Figure 14*, middle market loans have generated attractive long-term risk adjusted returns compared to liquid leveraged loans and comparable returns to high yield bonds, but with less volatility.

Figure 14. Lower Volatility – Standard Deviation over 7 Year Period*



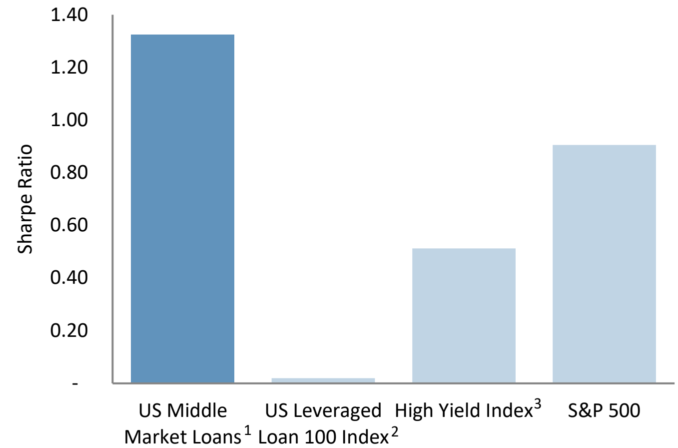
* Reflects the standard deviation over the past seven years as of December 31, 2017.

(1) The Middle Market Index consists of middle market facilities drawn from the larger S&P/LSTA (Loan Syndications and Trading Association) Leveraged Loan Index. It is designed to measure the performance of the U.S. leveraged loan market. S&P/LSTA defines the middle market as deals with an EBITDA of less than $50 million.

(2) The U.S. Leveraged Loan 100 Index consists of 100 loan facilities drawn from the larger S&P/LSTA (Loan Syndications and Trading Association) Leveraged Loan Index. It is designed to measure the performance of the U.S. leveraged loan market.

(3) The ICE BofA Merrill Lynch US High Yield Index (H0A0) tracks the performance of US dollar denominated below investment grade corporate debt publicly issued in the US domestic market.

Figure 15. Attractive Long Term Risk Adjusted Returns — Sharpe Ratios over 7 Year Period*



* Reflects the Sharpe Ratio over the past seven years as of December 31, 2017.

(1) The Middle Market Index consists of middle market facilities drawn from the larger S&P/LSTA (Loan Syndications and Trading Association) Leveraged Loan Index. It is designed to measure the performance of the U.S. leveraged loan market. S&P/LSTA defines the middle market as deals with an EBITDA of less than $50 million.

(2) The U.S. Leveraged Loan 100 Index consists of 100 loan facilities drawn from the larger S&P/LSTA (Loan Syndications and Trading Association) Leveraged Loan Index. It is designed to measure the performance of the U.S. leveraged loan market.

(3) The ICE BofA Merrill Lynch US High Yield Index (H0A0) tracks the performance of US dollar denominated below investment grade corporate debt publicly issued in the US domestic market.

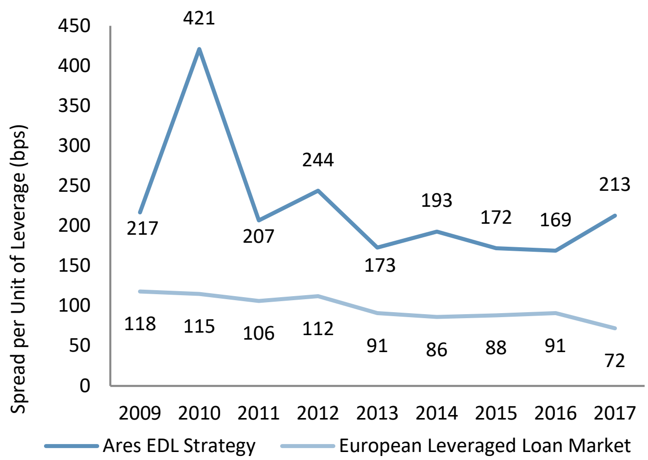
Specifically, when compared to high yield debt, middle market loans have experienced 40% less volatility for the past three, five and seven years (*Figure 14*).[xix]

U.S. Middle Market Loans generated a higher Sharpe Ratio vs. the US Leveraged Loan 100 Index, High Yield Index and the S&P 500 over a 3-, 5- and 7-year period (*Figure 15*).

In Europe, the attractive relative value can be exemplified by a key measure of risk-adjusted return, "spread per unit of leverage" or the loan margin divided by the number of turns of leverage risk, for a European Directing Lending portfolio[xx] versus the European Leveraged Loan market, exhibiting a more attractive return offering per unit of risk.

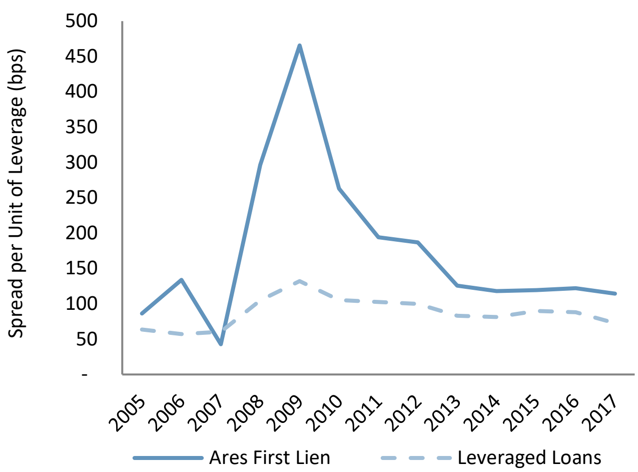
In both the U.S. and Europe, middle market loans have generated attractive returns with lower volatility compared to other investments.

Figure 16. Spread per Unit of Leverage for the Ares European Direct Lending Strategy versus the European Leveraged Loan Market[xxi]



Past performance is not indicative of future results.

Figure 17. Spread per Unit of Leverage for the Ares U.S. Direct Lending Strategy versus the U.S. Leveraged Loan Market [xxii]



Past performance is not indicative of future results.

Historically, the European liquid loan market has generated ~100 bps spread per unit of leverage and more recently as of Q3 2017, the European liquid loan markets generated ~70 bps spread per unit of leverage. In contrast, the investments in Ares' European direct lending strategy generally offer an ~100 bps premium to this rate (*Figure 16*). Much of this premium is driven by the supply demand dynamics and inefficiencies inherent in the Direct Lending market, which require direct origination capabilities to benefit from these dynamics.

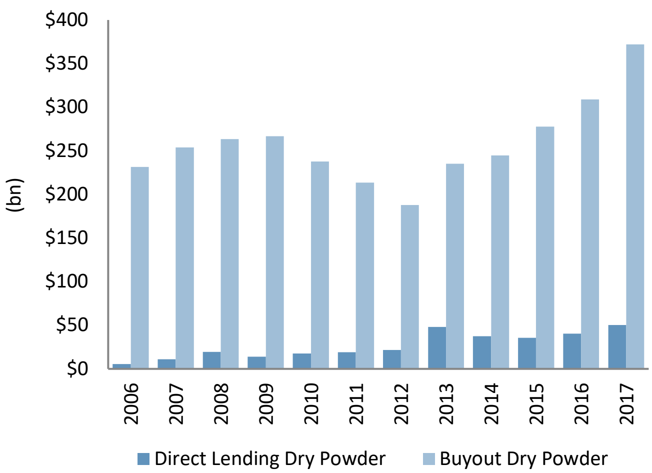
Not only are there lower spreads per unit of leverage in the liquid markets, but lender protections are also easing compared to what can be achieved in the direct lending market. Direct lenders will typically control capital structures with financial/maintenance covenants, whereas "covenant lite" transactions are becoming an increasing feature in the European liquid markets. Directly originated loans also typically benefit from more frequent and detailed financial reporting and the potential for higher excess cash flow sweep requirements. We believe these lender protections have been a key driver behind the low loss rates the European direct lending market has experienced.

In both the U.S. and Europe, the combination of yield premiums and lower volatility have resulted in middle market loans generating superior risk-adjusted returns when compared to broadly syndicated loans, and other asset classes such as high yield bonds.

Supply & Demand Dynamics

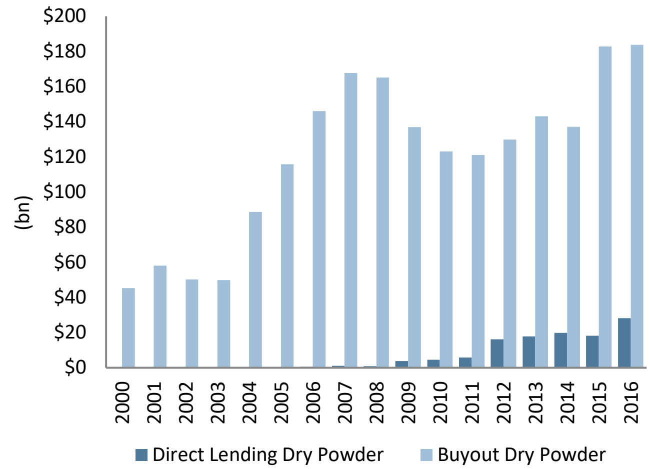
The continued strong performance of direct lending has generated increased institutional investor acceptance. Historically, middle market lending struggled to find a place in institutional investors' asset allocations among direct lending fund managers public liquid debt mandates that were managed against a benchmark and illiquid allocations to private equity (with PE equity-like return expectations). Yield compression in liquid products as well as the growing acceptance of direct lending has caused institutional investors to carve out allocations for direct lending fund managers. As institutional investors have overcome these historical impediments, increasing amounts of capital have been raised to meet this emerging non-bank lending opportunity (*Figure 18* and *Figure 19*).

Figure 18. North America Direct Lending and Buyout Dry Powder



Source: Preqin.

Figure 19. Europe Direct Lending and Buyout Dry Powder



Source: Preqin.

While the supply of institutional capital has increased in the middle market, we believe there is a long runway of opportunity for lending to this segment of the economy. As of December 2017, North American private equity dry powder totaled ~$530 billion[xxiii] and assuming a 60/40 debt/equity capital structure, this implies over $750 billion of future debt financing opportunities in sponsored buyouts. With significant dry powder and continued strong middle market company performance, the middle market appears positioned to grow and is well supported by increasing demand for credit. In Europe, middle-market private equity dry powder increased from ~€90 billion in 2012 to ~€150 billion in 2017, nearing ten-year highs, thereby providing tailwinds for direct lending deployment.[xxiv] The growth of institutional capital in this sector is expected to continue as this maturing market evolves. According to a recent study conducted by Preqin, 39% of investors surveyed now have an active mandate for direct lending funds as of January 2018.[xxv] We expect this number to grow as institutional investors continue to be under allocated in direct lending, with 42% of the investors surveyed stating they plan to commit more capital to private credit funds in the next 12 months vs. the past 12 months.[xxvi] While the level of competition for institutional capital is increasing, there is a positive sentiment in the marketplace as investors increase their allocations toward direct lending.

Spectrum of Products & Their Characteristics

Most middle market loans are evaluated and structured based on the ongoing cash flow and enterprise value of the company; as opposed to asset-based lending, which focuses on the liquidation value of assets on a company's balance sheet. As a result, strong middle market managers should have deep credit capabilities to successfully underwrite a wide array of business models if they are to generate the best long-term risk-adjusted returns.

Below is an overview of debt products commonly used in the direct lending market:

First Lien: First lien loans place a first priority, perfected lien against substantially all assets, often including the capital stock of the business. Since most of the value collateralizing the loan is the enterprise value of the company, the long-term enterprise valuation is a critical component in evaluating the risk of a loan. These loans are typically priced with a floating rate coupon, generally as a spread to 3-month LIBOR.

Second Lien: A second lien loan is second in priority to the collateral of a company's assets and capital. While the loan is secured, it is junior to the first lien senior secured loans. Often these second lien loans are floating rate and priced as a spread to 3-month LIBOR, but can also be structured as a fixed rate loan.

Unitranche: The unitranche structure combines a senior and junior credit position into one blended loan with one set of legal documents and one rate that is a blend of the senior and junior risk with a single lien that is often a senior, first lien position. Borrowers appreciate the simplification of the unitranche structure as a "one stop" source of financing with limited to no syndication risk. Lenders who can structure the unitranche loan and have the capital to speak for the entirety of the facility can often garner more advantageous terms and/or pricing than if the lender participated in each loan separately. The interest rate paid by the borrower generally falls between the rate for senior debt and second lien/subordinated debt.

The unitranche loan can also be structured to create "first out" and "last out" tranches through an agreement typically known as an Agreement Among Lenders ("AAL"). The size of the first and last out tranches changes by deal and is dependent on the attractiveness of the blended pricing that can be achieved and the lenders interested in any given deal at the proposed pricing and terms.

Subordinated/Mezzanine: Mezzanine financing is debt that is subordinated to all liens as it is unsecured, but has a priority claim to equity upon liquidation or restructuring of the business. Mezzanine loans are often fixed rate loans and can carry pay interest on both a cash and non-cash basis. The non-cash interest payment, called "Payment in Kind" or "PIK" accretes the interest payment to growing the principal balance of the loan, which is repaid upon maturity or full repayment of the loan.

All of the debt products outlined above typically have significant equity contributions from financial sponsors and/or management owners sitting behind the debt capital.

Figures 20 and *21* outline pricing, fees and returns for debt strategies commonly used. Note that additional return upside can be achieved through call protection, amendment fees and other return drivers.

Figure 20.
U.S. Middle Market Returns by Products

Returns		
	Pricing	Effective Yield*
Senior 1st Lien	L + 3.75–4.25%	6.50%–7.25%
Unitranche	L + 5.25–6.00%+	8.00%–9.25%
2nd Lien	L + 7.25–8.25%+	10.00%–11.50%
Subordinated	10.50%–12.00%+	11.00%–13.00%

* Assumes fee income of 2–3%, 3-month LIBOR of 2.3% and amortizes fees. Target returns are estimated market pricing in the U.S.

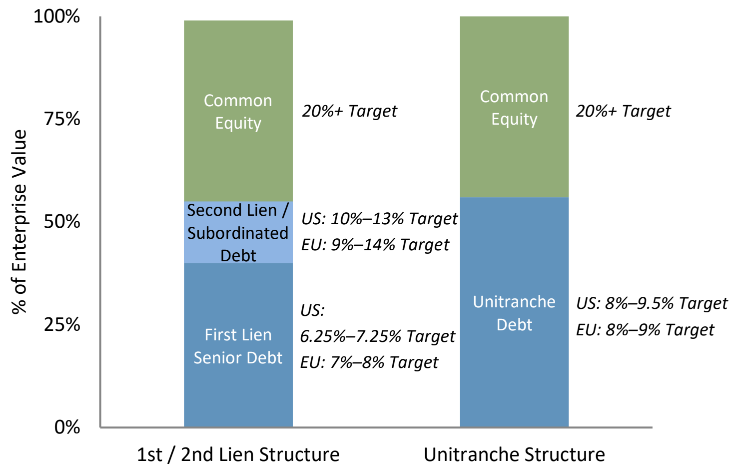
Figure 21.
European Middle Market Returns by Products

Returns		
	Pricing	Effective Yield*
Senior 1st Lien	L + 6.00–6.50%	7.00%–8.00%
Unitranche	L + 6.75–7.50%	8.00%–9.00%
2nd Lien	L + 7.50–8.50%	9.00%–11.00%
Subordinated	L + 10.00%–12.00%	12.00%–14.00%

* Assumes fee income of 3–3.5%, 3-month LIBOR of 0.5% and amortizes fees over three years. Target returns are estimated market pricing in Europe.

Figure 22 provides an illustration of the various direct lending products and where they fit in the capital structure in U.S. and European buyouts.

Figure 22. Illustrative Capital Structures of Primary Middle Market Buyouts



Source: Thomson Reuters LPC Middle Market Quarterly Data as of Q4-17.

Additional Drivers of Return

It is important to note that direct lenders who have the scale and expertise to act as the lead or control investor are able to obtain transaction fees and generate additional drivers of return beyond interest income. Underwriting, closing, amendment and other fees can range between 2–3% of a transaction. Over time, particularly in our experience with a 2–2.5-year average life of middle market loans, this can lead to a significant component of return in a portfolio.

Attractive Relative Value

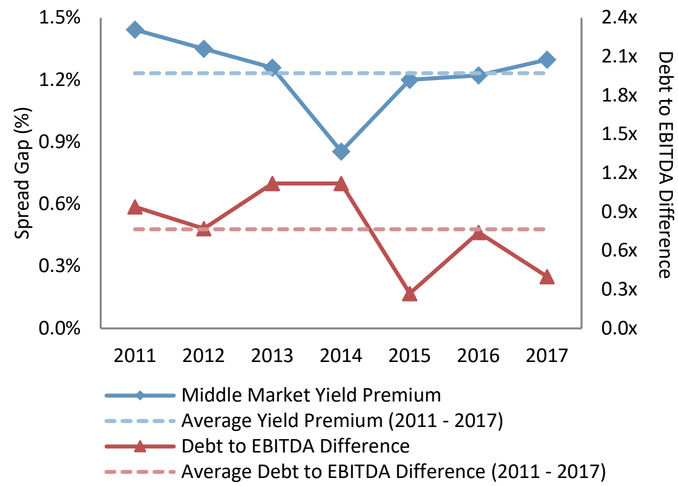
Compared to broadly syndicated loans, we believe that directly originated middle market loans offer an attractive risk-reward profile with substantial illiquidity premiums, reduced volatility and greater influence over terms and overall structures.

Since 2002, Thomson Reuters data on reported transaction new issue middle market spreads have exceeded broadly syndicated loan spreads by an average of 99 bps. In 2016 and year-to-date Q1-Q3 2017, average middle market loan pricing was 122 bps and 133 bps, respectively, higher than broadly syndicated pricing (*Figure 23*).[xxvii] In our experience, the premium can meaningfully exceed the market data, particularly for directly originated transactions.

From what we've seen in the marketplace, the pricing premium achieved for middle market direct lending versus the broadly syndicated market in Europe is similar to the U.S.

We have also seen that leveraged middle market loans are typically structured with less leverage at the borrower level than broadly syndicated leveraged loans. Since 2011, new issue middle market leverage has been an average of 0.8x of EBITDA lower than broadly syndicated loan total leverage.[xxviii]

Figure 23. U.S. Middle Market vs. Large Loans Leverage Levels and Spread Premium



Source: Thomson Reuters LPC Middle Market Quarterly Data.

Importantly, directly originated middle market transactions are typically structured with increased lender protections compared to broadly syndicated transactions, including stronger covenant packages, more frequent financial reporting, higher excess cash flow sweep requirements, and can have higher amortization payments. Since 2013, 75% of broadly syndicated transactions have been structured as covenant-lite while only 20% of middle market transactions have been covenant-lite.[xxix] In Europe, covenant-lite is typically not a feature of middle market lending.

Between 2007–2016, the average annual middle market default rate in the U.S. has been 1.9% while the broadly syndicated annual default rate has been 2.8%.[xxx] While a significant portion of the variance was created during the GFC (e.g., broadly syndicated default rate of 12.0% versus 4.6% middle market default rate experienced in 2009), the five-year average default rate for the middle market over the five years from 2011–2016 outperformed the broadly syndicated market (broadly syndicated average default rate of 1.9% compared to 1.5% for the middle market).[xxxi]

Assuming the average high yield default rate, as a proxy for the subordinated, unsecured loans, the annual default rate is nearly double that of senior secured loans.[xxxii]

In contrast, using the lower 36% recovery rate for the higher default rate of 4.2% of subordinated loans implies a loss rate of ~2.7% (*Figure 24*).

Figure 24.
Middle Market vs. Large Syndicated Loans

	Annual Default Rate	Annual Recovery Rate
Broadly Syndicated Loans	2.8%[xxxiii]	68%[xxxiv]
Large Middle Market Sr. Loans	1.9%[xxxv]	
Subordinated Unsecured	4.2%[xxxvi]	36%[xxxvii]

In our experience, similar to the U.S., the European middle market default rates have historically outperformed the broadly syndicated annual default rates of 1.69%.[xxxviii]

Overview of Origination Channels

Shown below is an overview of the three main origination channels for middle market loans: sponsored, capital markets and direct to company.

The most prolific of the three sources of origination is the sponsored channel, which provides many advantages. Lenders can benefit by investing alongside control-oriented financial sponsors that take an active role in managing their portfolio companies, have particular insight into industry trends and will typically support their investments with additional equity capital for growth or acquisitions and, if needed, for liquidity. While establishing relationships with private equity firms may take a significant time and require investments in people and infrastructure, these relationships often lead to additional opportunities.

Non-sponsored or direct to company transactions require continuous communication and relationships with management teams, regional accounting firms, law firms and business brokers. These transactions also tend to require a more significant involvement from the lender during both the due diligence phase and portfolio monitoring. From a portfolio monitoring standpoint, the lender is usually the sole institutional capital in the deal and the duties of advising, strategic planning, and overseeing execution can fall on the lenders. Although non-sponsored transactions are smaller and more labor-intensive, they can generate attractive, and in some cases, higher risk-adjusted returns.

The capital markets channel typically involves participation in a third-party distributed investment. Often capital markets-oriented transactions are more efficiently priced; however, the main drawback is that these transactions are intermediated, and therefore the terms have already been negotiated.

While there are certainly advantages and disadvantages to all three origination methods, a multi-pronged approach enhances the probability that a lender will have the opportunity to review the highest quality business financing opportunities.

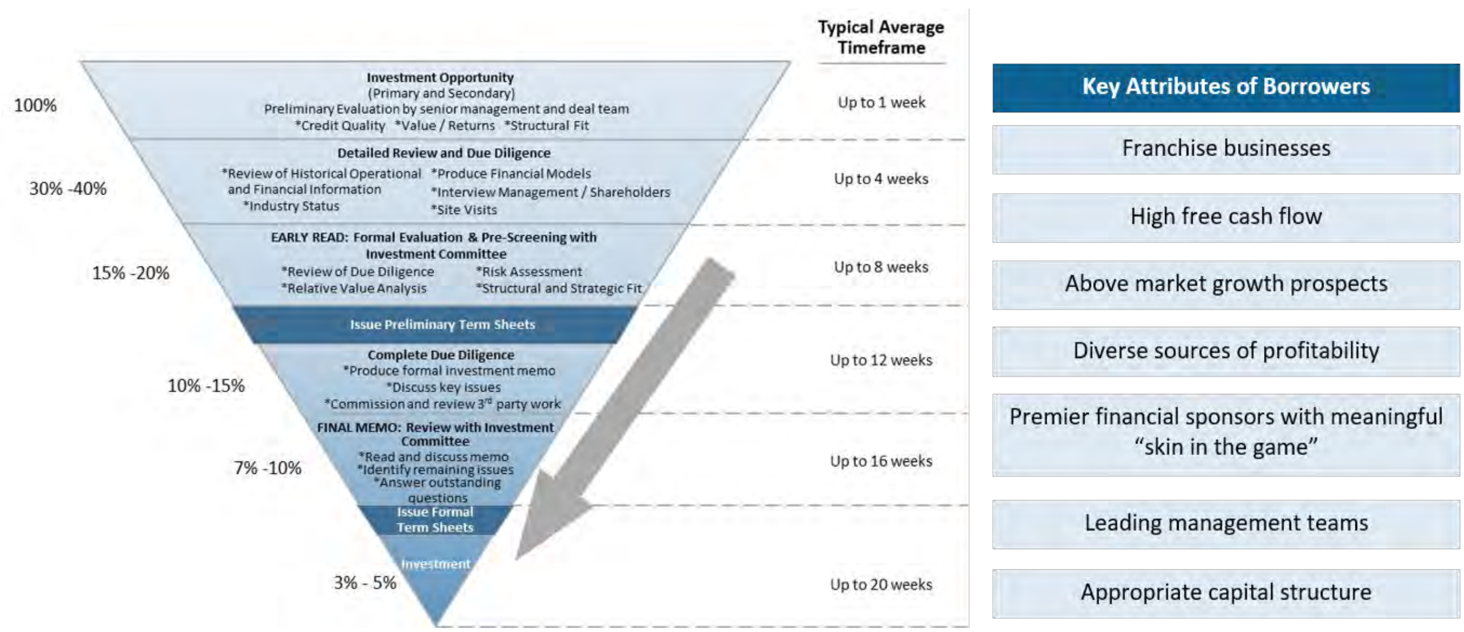
Underwriting and Managing Direct Loans

We believe a manager's sourcing, underwriting capabilities and deal structure experience are key considerations in the manager selection process. Managers that possess the tools and expertise to perform the necessary credit and market analysis will be well positioned to succeed within the space.

Because of the broad capabilities and private equity-like underwriting process required for directly originated loans, the investment process can take several months. The diligence process includes proprietary due diligence conducted internally as well as research from third party consultants and broad market checks to evaluate the industry and company-specific credit risks. These underwriting factors will help determine the suitability of an investment, as well as pricing, leverage and credit terms, including specific covenant levels.

Figure 25 provides an illustration of a typical investment process. Note that timing can vary amongst different transactions.

Figure 25. Timeline of the Typical Investment Process[xxxix]



Source: Ares Management. For illustrative purposes only.

Characteristics of Sophisticated Direct Lenders

As previously noted, not all managers are created equal. Given the recent inflow of new entrants into the sector, it is imperative that investors select managers wisely. We believe that in order to be a successful direct originator in the middle market, it is important to have a scaled platform with a broad geographical footprint, multi-channel origination strategy, diverse product capabilities, flexible sources of capital and deep credit experience. In our view, these attributes will lead to the origination of a broader set of investment opportunities, greater asset selectivity and improved long-term credit decisions.

We believe there are seven characteristics a sophisticated direct lender should exhibit.

1. ***Scale & Depth:*** Size matters. Larger players have the ability to evaluate a wide fairway of deals and to look at the full capital structure of a business to determine where to optimally invest. The benefits of a broad geographical footprint and increased deal flow are further enhanced by a lender's ability to offer a full-service and diversified product offering, providing institutional investors with solutions across asset classes as market conditions shift. Importantly, scale also provides the ability to commit and hold large positions. In fact, a survey of middle market lenders completed by Thomson Reuters validated this perspective by demonstrating that hold size was deemed one of the most valuable competitive advantages for controlling terms in the market.[xl] This often provides efficiencies in execution to the borrower and provides the lender with greater ability to control terms. Controlling the structure provides meaningful downside protection for a lender as it generally leads to better outcomes in stressed or distressed situations.

   The ability to be a total solutions provider and the flexibility to hold a wide range of investment sizes is a tremendous advantage to a lender and provides significant benefits to the borrower. A scaled lender is also attractive for borrowers looking to grow via add-on products, providing a lender with additional opportunities to invest.

   In Europe, the ability to execute cross-border and multi-currency transactions is an important advantage for direct lending funds.

2. ***Consistent Access to Capital:*** In order to commit and hold large balance sheet positions and offer institutional investors comprehensive investment solutions, a lender must have the ability to consistently access capital. While banks have decreased their middle market lending activity, they are still investing in the asset class through their partnerships with direct lenders.

3. ***Direct Origination as Lead Agent/Structuring Capabilities:*** Since middle market loans are generally illiquid and secured by the cash flows of the underlying middle market company, there are strong credit and investment benefits to directly sourcing and structuring the loans. A manager that focuses on being the lead investor in their transactions will benefit from primary due diligence, the structuring of the covenants and loan documentation and additional control over investment outcomes. In addition, successful managers are supported by highly sophisticated infrastructure and operations management capabilities to facilitate information warehousing, consistent communication and coordination.

4. ***Longstanding Relationships/Incumbency:*** Incumbent relationships inherently result in better knowledge of borrowers, better credit performance and a source of un-competed deals. Establishing and building these relationships takes years and new entrants are more likely to have a less diverse and lower quality pool of potential financial partners. Incumbency also creates organic growth opportunities within existing portfolios. For example, developing strong existing relationships often give the lender "first looks" and "last looks" at potential transactions.

5. ***Demonstrated Credit Expertise/Strength of Underwriting:*** The ability to accurately identify and analyze which companies, industries and geographies to transact with are particularly important for direct lending. In order to accurately understand a company's future performance, a manager must have the ability to perform a forensic analysis on a potential target's financials, accounting practices, earnings quality, customers, end markets, etc.

   Industry selection is critically important. Those who avoid increasing their exposure in industries with greater default rates have historically outperformed. For example, firms that avoided the automotive, home building, printing and publishing industries during the GFC outperformed those who invested in the higher yielding, riskier companies that operated in those areas.

In European direct lending, country expertise is paramount. Each European country has its own unique bankruptcy laws that, all else equal, can significantly alter the risk of loans from one country to another, in the event of non-consensual court-led restructuring.

6. ***Proactive Portfolio Management:*** Employing a robust portfolio monitoring strategy through regular dialogue and reporting with management teams and controlling stakeholders facilitates transparent communication with borrowers. It also provides early warnings for potential issues or opportunities within the portfolio for value creation or protection in times of increased defaults. We believe that having an integrated investment and portfolio management team with joint responsibility and accountability over the entire life of an investment maximizes investment outcomes.

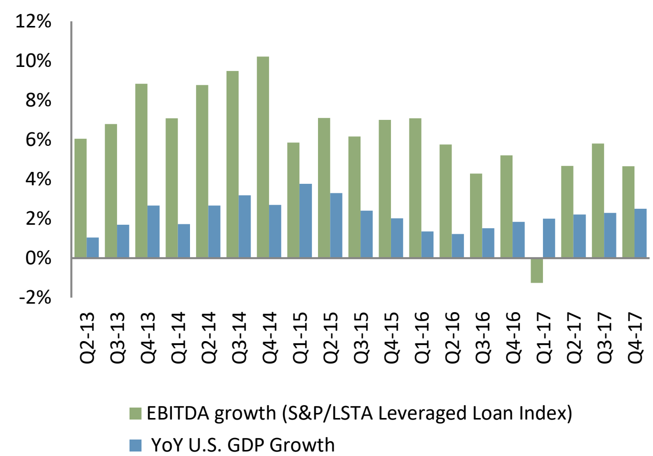
7. ***Demonstrated Results Through Business Cycles:*** We believe a demonstrated track record of successful outcomes through various credit cycles should be one of the most important characteristics when choosing a manager. A tried and tested framework that accurately anticipates turning points in the credit markets will maximize the probability that investors harvest the credit risk premiums while significantly reducing downside risk and improving risk-adjusted performance. That being said, in Europe we believe the asset class is largely untested, with most managers raising their first fund in 2012-2013. Given the relatively nascent nature of the market in Europe, few managers have a track record that has been tested through a full credit cycle.

Current Market Conditions

While we believe we are in the later phase of an extended credit cycle, the U.S. macroeconomic backdrop remains constructive amid stable or improving fundamentals. Solid corporate earnings growth, low unemployment rates and the strength in other key economic indicators demonstrate that the American economy remains constructive for direct lending. During the beginning of the last credit cycle in 2008, credit spread deterioration and declining cash flows provided early warning signals for the dislocation in the credit markets.

Outside of retail and commodity-related volatility in the energy markets, EBITDA growth for the middle market continues to outpace GDP growth rates (*Figure 26*). Additionally, while this has been the longest credit cycle since 1985, lasting 9 years compared to 5–7 years for previous cycles, the growth in overall leveraged finance debt outstanding today remains 20% below the average of levels in prior cycles since 1985.[xli]

Figure 26. EBITDA Growth & GDP Growth



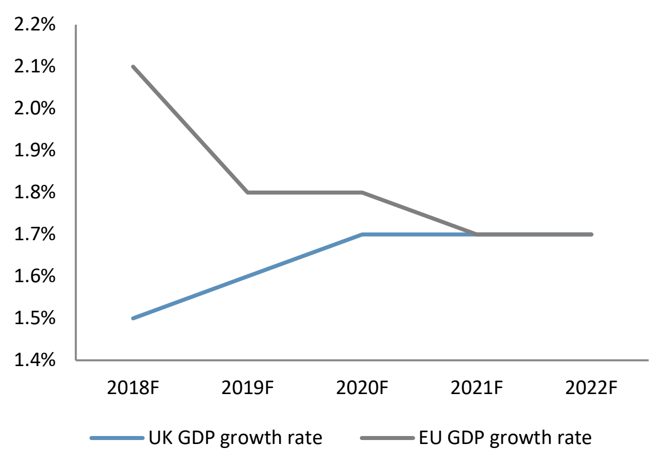
Source: S&P Global Market Intelligence.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Act") was signed into law. The Act significantly revised many aspects of U.S. federal income tax law applicable to businesses conducted in corporate and partnership form. Our preliminary view is that the majority of middle market companies will be better off under tax reform. Even without taking into account the expected boost in GDP from tax reform that may support additional top line growth, the benefits of lower corporate tax rates and immediate tax expensing of capital expenditures should outweigh the costs of interest expense limitations for most companies, except those that are the most cyclical or highly leveraged. While probably not intended, tax reform could cause defaults in distressed companies, but we believe well managed, high quality companies borrowing at reasonable rates and less than 6-7x EBITDA are likely to benefit from this legislation.

In Europe, there continues to be stable demand for financing with the UK remaining as the largest market. In 2017, strong manufacturing, services and construction activity in the UK has resulted in continued strong new business formation, modestly expanding GDP and an improving labor market.

As shown in *Figure 27*, the UK economy is set to continue to grow over the next 5 years. Demand for credit is further supported by growing M&A activity in the UK (both domestic and inbound), which is expected to reach $162 billion in 2018, suggesting a 60 percent increase from the $102 billion forecast for 2017.

Figure 27. UK and EU GDP forecast



Source: IMF Data.

European economies continue to expand with projections calling for continued stability in the upcoming years. In 2017, the European Union economy exhibited GDP growth of 2.3%, its fastest pace in a decade. Based on the IMF forecast, future GDP growth is expected at a broadly consistent rate of ~2% until 2022.

As the economy expands, we believe the supply of debt capital to European companies is also advancing in the favor of non-bank lenders as banks continue to cede market share. European banks are still suffering from low profitability, in part driven by the continued drag of non-performing assets. The average non-performing loan ratio for European banks was just above 2% in 2007, reached 8% in 2013 and now stands at 6% in 2017.[xlii]

Conclusion

In our view, the structural changes that have led to the emergence of direct lending as an established asset class are here to stay. We strongly believe direct lending should not be viewed as a short-term investment thesis or a trade, but rather a long-term investment opportunity in an established and growing asset class. In fact, once the credit cycle does turn, direct lending is likely to be a defensive investment compared to other comparable asset classes outlined in this paper since direct loans offer:

- ~50%+ equity cushions and seniority in the capital structure (making equity more vulnerable to economic cycles than direct lending);
- Increased lender protections compared to broadly syndicated transactions, including stronger covenant packages, more frequent financial reporting, higher excess cash flow sweep requirements and potentially higher amortization payments;
- Floating rates with yields that otherwise reset higher as interest rates increase, an aspect that is particularly attractive in the current environment; and
- Less volatility compared to liquid credit assets.[xliii]

That being said, there may be a high level of dispersion in the quality of managers and we believe manager selection is essential to fully seize the opportunities available in the marketplace.

About Ares Management, L.P.

Ares Management, L.P. is a publicly traded, leading global alternative asset manager with ~$106.4 billion of assets under management as of December 31, 2017 and 15+ offices in the United States, Europe, Asia and Australia. Since its inception in 1997, Ares has adhered to a disciplined investment philosophy that focuses on delivering attractive risk-adjusted investment returns throughout market cycles. Ares believes each of its three distinct but complementary investment groups in Credit, Private Equity and Real Estate is a market leader based on assets under management and investment performance. Ares was built upon the fundamental principle that each group benefits from being part of the greater whole.

Endnotes

[i] Ares Management as of January 2018.

[ii] S&P Leveraged Lending Review Q4-17.

[iii] Ares Management. See pages 11–12 for market size methodology.

[iv] Ares Management as of January 2018, target returns are estimated market pricing.

[v] Morgan Stanley, Trends in Direct Lending, November 2017.

[vi] Reflects the Sharpe Ratio over the past seven years as of December 31, 2017. See *Figure 14* on page 13 for additional information.

[vii] SNL Financial. As of December 31, 2017.

[viii] Wells Fargo Securities Research as of September 2017.

[ix] According to the SNL U.S. Bank Index as of September 2017.

[x] Source: Comments made by Joseph Otting during the SFIG ABS conference on February 27, 2018.

[xi] PacWest Bancorp press release on December 11, 2017.

[xii] National Center for the Middle Market 3Q 2017 Middle Market Indicator.

[xiii] National Center for the Middle Market 3Q 2017 Middle Market Indicator.

[xiv] National Center for the Middle Market 3Q 2017 Middle Market Indicator.

[xv] Pitchbook 2016 Annual PE Middle Market Report, published in 2017.

[xvi] Preqin, December 2017.

[xvii] Thomson Reuters LPC Middle Market Weekly Data as of November 9, 2017.

[xviii] Thomson Reuters LPC Middle Market Weekly Data as of November 9, 2017.

[xix] Based on standard deviation over the past three, five and seven years as of December 31, 2017. Comparing U.S. Middle Market Loans, U.S. Leveraged Loan 100 Index, High Yield Index and S&P 500.

(1) The Middle Market Index consists of middle market facilities drawn from the larger S&P/LSTA (Loan Syndications and Trading Association) Leveraged Loan Index. It is designed to measure the performance of the U.S. leveraged loan market. S&P/LSTA defines the middle market as deals with an EBITDA of less than $50 million.

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(3) The ICE BofA Merrill Lynch US High Yield Index (H0A0) tracks the performance of US dollar denominated below investment grade corporate debt publicly issued in the US domestic market.

[xx] Source: Ares portfolio.

[xxi] Includes the Raketech investment, which was 0.8x net leverage and 925 bps margin at closing. Excluding Raketech from Spread per Unit of Leverage (“SPL”) calculation results in last twelve months SPL of 178 bps. European liquid loan markets data based on LCD, Quarterly European Leveraged Lending Review, Q3 2017.

[xxii] Ares First Lien includes all first lien investments of the Credit Group’s U.S. direct lending team (excluding venture investments, oil & gas investments, investments warehoused or held for seasoning purposes, and investments inherited from portfolio acquisitions), including investments made through Ares Capital Corporation (NASDAQ: ARCC) and from separately managed accounts and other funds. Leveraged loans reflects new issue yield of the S&P/LSTA Leveraged Loan Index.

[xxiii] Preqin, December 2017.

[xxiv] Preqin, September 2017. Funds of up to $2.5 billion in size.

[xxv] Preqin, March 2018.

[xxvi] Preqin, March 2018.

[xxvii] Thomson Reuters LPC Middle Market Quarterly Data as of Q3-17.

[xxviii] S&P LCD as of October 2017.

[xxix] S&P LCD Interactive Volume Report as of October 12, 2017.

[xxx] Fitch U.S. Levered Loan Insights 2007-2016 Annual Default Rate.

[xxxi] S&P LCD Interactive Volume Report as of October 12, 2017.

[xxxii] Moody’s U.S. Trailing 12-Month Issuer-Weighted Spec-Grade Default Rate 2007-2016.

[xxxiii] Fitch U.S. Levered Loan Insights 2007-2016 Annual Default Rate.

[xxxiv] Moody's 2017 Annual Default Study for period 2007-2016 for Senior Secured Loans.

[xxxv] Fitch U.S. Levered Loan Insights 2007-2016 Annual Default Rate.

[xxxvi] Moody’s U.S. Trailing 12-Month Issuer-Weighted Spec-Grade Default Rate 2007-2016.

[xxxvii] Moody's 2017 Annual Default Study for period 2007-2016 for Subordinated Loans.

[xxxviii] Credit Suisse, Default rates report, 2017.

[xxxix] Not every investment meets each of the criteria.

[xl] Thomson Reuters 4Q17 Middle Market Outlook Survey (October 2017).

[xli] The Evolution of the Credit Cycle: High Yield Strategy Research from Bank of America Merrill Lynch, October 13, 2017.

[xlii] Challenges faced by the European banking sector: Speech by Vítor Constâncio, Vice-President of the ECB at the Risk & Supervision 2017 Conference organized by Associazione Bancaria Italiana, Rome, 14 June 2017.

[xliii] Reflects the Sharpe Ratio over the past seven years as of December 31, 2017.
The Middle Market Index consists of middle market facilities drawn from the larger S&P/LSTA (Loan Syndications and Trading Association) Leveraged Loan Index. It is designed to measure the performance of the U.S. leveraged loan market. S&P/LSTA defines the middle market as deals with an EBITDA of less than $50 million.
The U.S. Leveraged Loan 100 Index consists of 100 loan facilities drawn from the larger S&P/LSTA (Loan Syndications and Trading Association) Leveraged Loan Index. It is designed to measure the performance of the U.S. leveraged loan market.
The ICE BofA Merrill Lynch US High Yield Index (H0A0) tracks the performance of US dollar denominated below investment grade corporate debt publicly issued in the US domestic market.