

Chicago Atlantic(Q3 2024 Earnings)

November 7, 2024

Corporate Speakers:

- Tripp Sullivan; Chicago Atlantic; Investor Relations
- Peter Sack; Chicago Atlantic; Co-Chief Executive Officer
- David Kite; Chicago Atlantic; Chief Operating Officer
- Phillip Silverman; Chicago Atlantic; Chief Financial Officer

Participants:

- Mark Smith; Lake Street Capital; Analyst

PRESENTATION

Operator^ Good day. And welcome to the Chicago Atlantic Real Estate Finance Third Quarter 2024 Earnings Call. (Operator Instructions)

Please note, this event is being recorded.

I would now like to turn the conference over to Tripp Sullivan, Investor Relations.

Please go ahead.

Tripp Sullivan^ Thank you. Good morning.

Welcome to the Chicago Atlantic Real Estate Finance conference call to review the company's results.

On the call today will be Peter Sack, Co-Chief Executive Officer; David Kite, Chief Operating Officer; and Phillip Silverman, Chief Financial Officer.

Our results were released this morning in our earnings press release, which can be found on the Investor Relations section of our website, along with our supplemental filed with the SEC. A live audio webcast of this call is being made available today.

For those who'll listen to the replay of this webcast, we remind you that the remarks made herein are as of today and will not be updated subsequent to this call.

During this call certain comments and statements we make may be deemed forward-looking statements within the meaning prescribed by the securities laws including statements related to the future performance of our portfolio, our pipeline of potential loans and other investments, future dividends and financing activities.

All forward-looking statements represent Chicago Atlantic's judgment as of the date of this conference call and are subject to risks and uncertainties that can cause actual results to differ materially from our current expectations.

Investors are urged to carefully review various disclosures made by the company including the risk and other information disclosed in the company's filings with the SEC.

We also will discuss certain non-GAAP measures including but not limited to distributable earnings and adjusted distributable earnings.

Definitions of these non-GAAP measures and reconciliations to the most comparable GAAP measures are included in our filings with the SEC.

I'll now turn the call over to Peter Sack.

Please go ahead.

Peter Sack^ Thanks, Tripp. Good morning, everyone. These are fascinating times to operate a business and invest.

Cannabis is uniquely enmeshed in this country's debates on health and wellness, criminal justice, individual choice and cultural identity. This week, a majority of voters in Florida supported legalization of adult-use cannabis, but they fell short of the 60% threshold needed for the measure to pass.

Nebraska voters overwhelmingly approved a medical cannabis program. And in the Dakotas, voters rejected initiatives that would have legalized adult-use cannabis.

On this news yesterday, the ETF MSOS, which tracks U.S. cannabis equities, fell by more than 25%.

For Chicago Atlantic Real Estate Finance, it is business as usual, and we are as enthusiastic as ever.

From inception, we aim to build an investment platform focused on serving the strongest operators in the most attractive markets with fundamental underwriting, differentiated returns and downside protection in an industry known for volatility.

We execute through a platform that includes the industry's most expansive origination, real estate diligence, analytics and operational teams.

We underwrite to leverage levels well below the traditional private credit and commercial mortgage markets and returns well above the traditional mortgage REIT market.

We can do so because of our unique competitive position and our market focus.

The election results change little for refi.

Florida represents 7% of our portfolio. And as always, we underwrote our Florida investments assuming the continuance of the existing medical market.

We do not invest based upon the expectation of speculative political or regulatory events, and that principle is fundamental to our focus on comfortable debt service coverage, collateral quality and deep understanding of our limited license markets.

Still the passage of Amendment three in Florida would have opened up additional opportunities for investment.

We do believe that federal rescheduling will likely occur in 2025 as President-elect Trump has endorsed the effort. And conceivably, an aligned Republican Senate and House could facilitate bipartisan progress on other initiatives such as SAFE Banking. The translation of campaign promises to congressional and executive action is an arena in which we can speculate, but is not a basis on which we invest. Chicago Atlantic Real Estate Finance will continue to focus on generating differentiated risk-adjusted returns by its focus on disciplined expertise and the unique competitive position.

Today, we report positive Q3 earnings results and subsequent events that reflect the fruits of these efforts. The pipeline across the Chicago Atlantic platform has grown to \$560 million, and we continue to prioritize operators in limited license states and those positions to transition from medical to adult use.

We have liquidity in excess of \$75 million to fund new investments. Last quarter, we noted that we were exploring other sources of accretive capital to accelerate our deployment this year and next.

In October, we entered into a \$50 million unsecured term loan from two institutional private lending platforms. The interest-only unsecured loan matures in October 2028, bears a fixed interest rate of 9% and may be repaid in whole or in part at any time. After two years, the loan may be repaid without penalty.

We also received a rating of BBB+ from Egan-Jones on both the company and this unsecured term loan.

Before I close, there are two data points on portfolio management that I'd like to highlight and at which I'd like to congratulate our team for execution.

First, on interest rates, which David will touch on in more detail, we have successfully taken actions to limit our exposure to benchmark interest rate declines.

Second, on 2024 maturities, we entered 2024 with \$151 million in loans maturing this year, excluding Loan #9, which remains on nonaccrual status. \$89 million of these loans we successfully retained and extended through amendment. \$15 million were extended

with new terms and \$47 million were repaid with full recovery of principal and accrued interest.

By every available metric we track, the portfolio's credit quality has improved throughout this transition and our management of rate risk. David, why don't you take it from here?

David Kite^ Thanks, Peter. Good morning.

As of September 30, our loan portfolio totaled \$362 million across 29 portfolio companies with a weighted average yield to maturity of 18.3%. That's down from 18.7% at June 30 due primarily to work Peter mentioned earlier around repricing amendments related to improving our collateral and better borrower performance.

It also reflects the 50 basis point decrease in the prime rate across our floating rate portfolio.

Gross originations during the quarter were \$32.7 million of principal funding, of which \$24 million and \$8.7 million was funded to new borrowers and existing borrowers, respectively. To date, in the fourth quarter, we funded an additional \$36.5 million of originations including a \$25 million new credit facility to an operator in Illinois.

Peter noted earlier how well we've executed on our maturities this year. Another point to highlight is how we've managed the portfolio throughout a declining rate environment.

During the last 10 months, the prime rate was cut by 50 basis points from 8.5% to 8%. And we have worked hard to protect our portfolio yield against further interest rate cuts by the Federal Reserve.

We achieved this through a series of amendments focused on increasing prime rate floors and converting certain loans to fixed interest rates.

At year-end 2023, approximately 24% of our loan portfolio based on outstanding principal was comprised of fixed rate loans and floating rate loans with floors greater than or equal to the prevailing prime rate.

As of October 30, 2024, this percentage has increased to approximately 52%.

In summary, we've decreased the percentage of our portfolio exposure to additional interest rate cuts by approximately 28%. Meanwhile, the 63% of the portfolio that remains floating is not exposed to interest rate caps at current rate levels, and we expect to be able to take advantage should the Federal Reserve decide to reverse course and increase interest rates. The potential for tax cuts, economic stimuli, tariffs on imports and a possible escalation of the wars in Europe and the Middle East all create uncertainty with regard to medium- and long-term rates, but our current mix of floating and fixed rate loans leaves us well positioned.

Total leverage was at 18% of book equity at quarter end compared to 24% at year-end.

Our debt service coverage ratio on a consolidated basis for the quarter was approximately 7.2:1 compared with the requirement of 1.35:1.

During the quarter, we increased the size of our revolving credit facility again to \$110 million in total.

As of September 30, we had \$54 million outstanding on the facility.

Subsequent to quarter end, we drew down the full amount on the new unsecured term loan and used the proceeds to temporarily repay outstanding borrowings on our revolving credit facility.

As of today, we have \$15.5 million outstanding on the revolving credit facility and \$94.5 million of available borrowing capacity.

I'll now turn it over to Phil.

Phillip Silverman^ Thanks, David.

Our net interest income for the third quarter increased to \$14.5 million from \$13.2 million during the second quarter. Gross interest income from recurring cash interest, PIK interest, unused fees and amortization of discounts increased by \$0.6 million or 4% for the comparable period.

During the third quarter, we received full repayment of three loans totaling \$32.3 million.

In connection with these repayments during Q3, we recognized approximately \$0.7 million of prepayment and exit fees compared with \$0.1 million of such fees during the second quarter.

Interest expenses during the third quarter decreased modestly by approximately 2% to \$1.8 million due to lower weighted average borrowings of \$76.4 million during the third quarter compared with \$78.4 million during the second quarter.

Total operating expenses before the provision for credit losses remained consistent quarter-over-quarter at approximately \$4.2 million.

Our CECL reserve as of September 30, 2024, was approximately \$4.1 million compared with \$5.1 million as of June 30, 2024. And on a relative size basis, our reserve for expected credit losses represents 1.1% of outstanding principal of our loans held for investment.

During the quarter, \$13 million of principal of Loan #2 was transferred at held-for-sale classification and subsequently sold to a third party at par.

In connection with the sale, we decreased the provision for credit losses by approximately \$0.2 million.

Credit quality of the portfolio on a risk rating basis improved with approximately 72% of the portfolio at carrying value risk rated two or better as of September 30 compared to 61% as of June 30.

Loan #9 remains on nonaccrual status and is included in risk rating #4 and carries a reserve for credit losses of approximately \$1.4 million.

In October, subsequent to quarter end, we received a full repayment of Loan # 11, together with all applicable interest and fees payable. This loan is included in risk rating one as of September 30 and carry no CECL reserve at quarter end.

Our portfolio on a weighted average basis had real estate coverage of 1.2x as of both September 30 compared to 1.3x as of June 30, 2024.

Adjusted distributable earnings per weighted average diluted share was \$0.56 for Q3 2024 compared with \$0.50 for the second quarter.

In October, we distributed the third quarter regular dividend declared by our Board of \$0.47 per common share, which was consistent with the prior quarter and the third quarter of last year.

Our book value as of September 30 was \$15.05 per common share compared with \$14.92 as of June 30.

On a fully diluted basis, there are approximately 20.1 million common shares outstanding as of both September 30 and June 30.

Lastly, we've affirmed our guidance previously issued on March 12.

Operator, we're now ready to take questions.

QUESTIONS AND ANSWERS

Operator^ And the first question comes from Mark Smith with Lake Street Capital.

Mark Smith^ First question for me. You addressed a lot of kind of the election and results and kind of any potential changes for you.

But I'm curious, as we look at kind of the core industry today, what you're seeing, any weakness in certain states? Any places where cannabis market seems to be improving? Just a general update on the industry would be great.

Peter Sack^ Sure. Thanks for the question.

We focus on -- we tend to dissect our portfolio in terms of states that are nascent markets, emerging markets and mature markets. And we are -- because of our -- the duration of our portfolio and duration of our loans, we're able to pivot from one of those segments to another part of the market relatively quickly. And that's part of our active portfolio management and the platform that we've built to originate and underwrite markets and new operators.

We're spending a lot of effort on Missouri operators, Ohio operators, Maryland operators and brands that are perhaps expanding from one region of the country to another region of the country. And these are generally operators that are leveraging their success in their core market and looking to expand into neighboring markets.

And we tend to spend less time thinking about what is the cannabis market as a whole in the U.S. because there is, in some ways, not a cannabis market in the U.S. There's 40 distinct relatively uncorrelated markets. And so we tend to focus in isolation on what are the competitive dynamics in each of these states and who are some of the best operators working in them.

Mark Smith^ Okay. And any thoughts around kind of your pipeline for new loans, kind of how that looks? And I guess, any state in particular that seems to be driving more opportunities in the pipeline?

Peter Sack^ As I said, we're spending a lot of time in Ohio, Missouri and Maryland operators. The pipeline is strong at approximately \$560 million today. And -- but for us, we're just focused on finding the right operators in the right markets. And we're going to continue to focus on executing that and finding the best talent to support us in that process.

Operator^ (Operator Instructions) With no further questions, I would like to conclude the question and answer session and turn the conference back over to Peter Sack for any closing remarks.

Peter Sack^ Thank you for the support and the attendance, and we remain available to speak after the call. Thank you.

Operator^ The conference has now concluded. Thank you for attending today's presentation.

You may now disconnect.