Chicago Atlantic Real Estate Finance, Inc(Q4 2023 Earnings)

March 12, 2024

Corporate Speakers:

- Tripp Sullivan; SCR Partners; President
- John Mazarakis; Chicago Atlantic Real Estate Finance; Executive Chairman
- Peter Sack; Chicago Atlantic Real Estate Finance; Co-Chief Executive Officer
- Phillip Silverman; Chicago Atlantic Real Estate Finance; Chief Financial Officer

Participants:

- Pablo Zuanic; Zuanic & Associates; Analyst
- Mark Smith; Lake Street; Analyst

PRESENTATION

Operator^ Good day. And thank you for standing by. Welcome to the Chicago Atlantic Real Estate Finance Conference Call. (Operator Instructions)

Please note that today's conference is being recorded.

I will now hand the conference over to your speaker host, Tripp Sullivan.

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 for the fourth quarter of 2023.

On the call today will be John Mazarakis, Executive Chairman; Tony Cappell, Co-Chief Executive Officer; Peter Sack, Co-Chief Executive Officer; and Phil 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 listen to the replay of this webcast, we remind you that the remarks made herein are as of today March 12, 2024, 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.

And now I'll turn the call over to John Mazarakis. Please go ahead.

John Mazarakis^   Thanks, Tripp. Good morning, everyone. To allow time for more robust discussions in the Q&A, we plan on keeping our prepared comments shorter than usual today.

This was a good quarter for us that wrapped up an exceptional year. We grew our portfolio in a measured fashion while improving credit quality, increasing our weighted average portfolio yield and delivering a sector-leading total return of approximately 22.3% all while keeping leverage well below sector averages.

We're incrementally positive with our outlook on the industry and our operators as they benefit from the improving sentiment and strong demand. I think we're all aware of what's going on at the federal level with HHS' recommendation on cannabis rescheduling.

We're equally focused on the positive credit quality impact that would result from the elimination of 280E associated with that rescheduling. The elimination of this tax burden will be a huge win for the industry as a whole, leading to significantly improved cash flow generation among our borrowers.

At the state level, we're excited about the forthcoming rollout of the adult-use sales in Ohio expected in 2024 and other potential voter referendum changes in Florida and recreational sales in Pennsylvania in the medium term. We're well positioned in these states and continue to leverage Chicago Atlantic's platform and relationships to be at the forefront of capitalizing on the evolving state legislative landscape.

The demand for credit in this capital-constrained industry should only accelerate as a result. The maturity wall we have previously discussed is also beginning to materialize. Our pipeline of actionable deals across the platform has increased from $400 million in mid-2023 to approximately $600 million today.

As the leading and most consistent platform committed to the cannabis industry, Chicago Atlantic remains positioned to be the first call for borrowers and financial institutions alike who want to deploy capital in this space. Providing our investors with attractive returns and protecting principal drives every decision we make at Chicago Atlantic. With improving sentiment in the space and better access to capital to fund growth in the portfolio, we hope for another good year.

I will now turn it over to Peter.

Peter Sack^ Thank you, John. Good morning. On December 31, our loan portfolio had total loan commitments of $379 million across 27 portfolio companies with a weighted average yield to maturity of 19.4% compared with 19.3% on September 30. Our weighted average loan-to-enterprise value was 44.1% compared with 42.5% on September 30.

We had another strong quarter of originations with $25 million of principal fundings, of which approximately $9 million and $16 million was funded to new borrowers and existing borrowers, respectively. Our gross originations total was partially offset by $14 million of principal repayments, $11 million of which was related to unscheduled early repayments.

Our portfolio is 81% floating rate based off the prime rate, which is consistent with last quarter. We have only six fixed rate loans in the portfolio with a weighted average yield on these fixed rate loans of 16%.

The balance sheet remains well positioned with low leverage of 24% of book equity at year-end compared with 22% a year ago. Our debt service coverage ratio on a consolidated basis for the year was approximately 8:1 compared with the requirement of 1.35:1.

We continue to lead the industry in developing relationships with banking institutions seeking exposure to the sector. Last month, we amended our credit facility to extend the maturity from December 2024 to June 2026, and we amended the accordion feature to permit the facility to grow from $125 million to up to $150 million.

As of December 31, we had $66 million outstanding on the revolving credit facility, and we've subsequently drawn down another $28 million. That leaves us with a total of approximately $10 million in operational liquidity, net of estimated liabilities.

With an ultimate goal of approaching leverage equal to 100% to 200% of book equity, we remain under lever. We stated a short-term goal of getting to 50% of book equity, which would equate to significant portfolio growth and keep us well under the leverage held by many other mortgage REITs. We continue to actively pursue expansion of our banking syndicate this year to continue to increase the size of the line and fund additional growth in the portfolio.

I'll now turn it over to Phil.

Phillip Silverman^ Thanks, Peter. Net interest income for the fourth quarter increased 8% sequentially to $14.8 million. Gross interest income increased as a result of $1.8

million in prepayment fees earned on the $11 million of repayments as compared to $1.3 million of such fees earned during the third quarter. Additionally, we deployed approximately $25 million in new loan principal at a weighted average yield to maturity of 18.6%.

For the year, net interest income increased 22%. The increase was driven by the 100 basis point increase in the prime rate throughout 2023, impacting approximately 80% of our portfolio that bears a variable rate as well as the impact of new deployments resulting from the year-over-year portfolio growth. Additionally, total prepayment fees recognized to interest income were $3.5 million during 2023 compared to $1.2 million during 2022.

Total operating expenses before the provision for credit losses increased approximately $1.9 million from the third quarter primarily from the increase in incentive fees of $1.6 million as well as $0.3 million of incremental general, administrative and professional fee expenses. I'd like to highlight that the larger quarterly incentive fee paid in Q4 2023 will contribute in a similar way to the rolling 12-month incentive fee calculation throughout fiscal year 2024.

For fiscal year 2023, total operating expenses before the provision for credit losses and stock-based compensation increased $4 million primarily due to the $2.2 million increase in net management and incentive fees aligned with the increase in distributable earnings year-over-year and an increase in general, administrative expenses. Professional fees remained consistent at approximately $2.2 million.

Our CECL reserve as of December 31, 2023, is approximately $5 million compared with $5.2 million and $3.9 million as of September 30, 2023, and December 31, 2022, respectively. The reserve determination for the quarter considered reversals attributable to the principal repayments received during the fourth quarter, which included the full repayment of prior loan numbers 10 and 22 and was offset by new reserves on fourth quarter originations.

Credit quality of the portfolio remains stable with 88% of the portfolio risk rated three or better as of December 31 and September 30. On a relative size basis, our reserve for credit losses represents 1.4% of outstanding principal as of December 31. Approximately 70% of the portfolio based on outstanding principal is fully secured by real estate collateral. 27% is partially secured with the remaining 3% having no real estate collateral. Our portfolio on a weighted average basis had real estate collateral coverage of 1.5x.

Adjusted distributable earnings per weighted average diluted share was $0.53 for Q4 and $2.26 for the year ended December 31, 2023, representing a year-over-year increase of 7.6%. In January, we distributed a Q4 regular dividend of $0.47 per share plus a special dividend of $0.29 per share. Total dividend distributions in 2023 amounted to $2.17 per share, which is approximately 94.3% of adjusted distributable earnings per weighted average share.

Our book value as of December 31 was $14.94 per common share compared with $15.17 as of September 30. The sequential decline in book value is primarily attributable to the $0.29 per share special dividend declared in Q4.

Lastly, I'd like to highlight the guidance we shared for 2024. Similar to last year, we are expecting to maintain a dividend payout ratio based on distributable earnings per share of 90% to 100% for the full year. If our taxable income requires additional distributions in excess of the regular quarterly dividend to meet our taxable income requirements, we would expect to meet that requirement with a special dividend in Q4 2024.

Operator, we're now ready to take questions.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) And I'm showing we have a question from Pablo Zuanic from Zuanic & Associates.

Pablo Zuanic^ Yes. Look. I mean the first question relates to the transaction that was announced within your parent company and Silver Spike. I'm just trying to understand whether -- I understand that's a separate portfolio, cannabis loan-related portfolio, totally different from your company. But did you have a right of first refusal? Or did you have an opportunity to look at those loans, whether you wanted to buy them before the transaction was announced?

If you can comment on that, please.

John Mazarakis^ Pablo, this is an unrelated transaction to the REIT. So we will just keep it at that. Thank you for your question.

Pablo Zuanic^ Okay. If I can ask a follow-up then. In terms of -- obviously you have deployed more capital now. In the first quarter, you've made additional use of the credit facility. So that speaks well about the outlook, the growth outlook.

But when we look at that refinancing from MariMed with Bank Needham, I'm just trying to understand from your point of view, aside from the demand side of things, right, yes, the outlook is improving, companies have probably expansion plans in Pennsylvania and Ohio so the demand for your product is stronger. But are you facing more competition in terms of debt capital out there from the banks such as Bank Needham or for Citizens Bank as others have mentioned?

John Mazarakis^ We actually consider this an isolated incident. We have not seen any signs of compression. We -- our pipeline, as we mentioned, has increased significantly. And we look forward to a good year.

Pablo Zuanic^ Okay. And if I can, one last question. This morning, Ascend on their conference call, they talked about receiving or planning to receive tax refunds on 280E.

They're going to start providing a normal tax rate going forward, not applying 280E on their provisions for taxes, very similar to what Trulieve has done.

So companies, your potential clients in general are taking what I would call a more proactive or more aggressive stance in terms of providing for 280E. How does that color or impact the way you evaluate these credits or you are totally agnostic to what they're doing?

John Mazarakis^   We are agnostic, and we defer to the accounting firms that service our clients. We evaluate the process by which they service our clients. And we are a third party. So overall, that is a very positive development, and we look forward to those cash flows increasing.

Operator^   (Operator Instructions) And our next question coming from the line of Mark Smith with Lake Street.

Mark Smith^   Just curious, any thoughts -- very heavily on variable rate loans. Any thought on perhaps adding more fixed rate loans or kind of your feelings on the market today?

John Mazarakis^   Mark, after the announcement of the CPI today I think we're pretty safe in floating rates. So I don't expect rates to come down even with the adjusted guidance from the Fed. So we will continue to operate in a floating rate environment with solid floors. That has been our strategy, and it has paid dividends so far.

Mark Smith^   And then the next question, just kind of broadly, would love more insight into kind of your outlook for the industry, what you're seeing out there as far as kind of pricing today and barring no changes in -- I guess your outlook especially barring no changes in regulatory environment.

John Mazarakis^   We're continuing to see leverage in the 2x EBITDA level or below. We won't look at anything above that. Obviously the equities have increased in value, and that has trickled down into the private markets.

We are very pleased with what we see in the cannabis space. And we're also very happy that the recession has delayed and maybe it won't even -- everyone is talking about a soft landing now. All these are positive developments, and we're sitting at all-time highs across all the indices. So that's a -- it's a positive environment.

Operator^   (Operator Instructions) And ladies and gentlemen. I see no further questions in the queue at this time. And that does conclude our conference for today. We thank you for your participation. And you may now disconnect.