Chicago Atlantic Real Estate Finance, Inc. (Q1 2024 Earnings)
May 7, 2024

Corporate Speakers

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

Participants

- Mark Smith; Lake Street; Analyst

PRESENTATION

Operator^ Good day. Thank you for standing by. Welcome to the Chicago Atlantic Real Estate Financing First Quarter 2024 Earnings Call.

(Operator Instructions) Please be advised that today's conference is being recorded.

And I would now like to hand the conference over to your first speaker today, Tripp Sullivan with Investor Relations.

You may begin.

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 John Mazarakis, Executive Chairman; 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 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 John Mazarakis.

Please go ahead.

John Mazarakis^ Thanks, Tripp. Good morning, everyone.

We started 2024 much like we ended 2023, growing the loan portfolio in a disciplined fashion, maintaining strong credit quality and an attractive weighted average portfolio yield, and diversifying across operators and states. The biggest news on the regulatory front was, of course last week's announcement that the DA has pledged to reschedule cannabis.

We're thrilled by this significant step in the process.Once enacted, the policy change is likely to bring significant benefits to the industry including the elimination of 280E that we discussed last quarter, increased access to capital and increased employment and investment.

The state level news on legalization continues to remain positive as well with the Florida Supreme Court recently approving ballot language to have a referendum in front of orders in November and Ohio likely to have the recreational rollout soon. We're staying in front of these developments in both states, as well as in PA.

Our pipeline of actionable deals across the Chicago Atlantic platform currently stands at $585 million with our focus remaining on operators and limited license states and those transitioning from medical to adult use.

For the last two quarters, we've called out the improving sentiment in the cannabis industry. That has translated into loan demand, and it has helped in accessing additional capital to deploy. Peter will touch on our expansion of the credit facility, but I'd like to highlight our use of the ATM in an accretive fashion during the quarter.

We issued approximately 896,000 shares through the ATM program at a weighted average price of $15.93, raising net proceeds of approximately $13.9 million. Most importantly, we sold those shares at a premium to book value. The same discipline we brought to underwriting new opportunities is the same one we've used to determine the best time and manner to access capital.

Peter, why don't you take it from here?

Peter Sack^ Thank you, John. Good morning.

At March 31, our loan portfolio had total commitments of $401 million across 28 portfolio companies, with a weighted average yield to maturity of 19.4%, which remained consistent with December 31.

Our weighted average loan-to-enterprise value was 40.5% compared with 44.1% at year-end.

We had another strong quarter of gross originations with $22.5 million of principal fundings of which $6.7 million and $15.8 million was funded to new borrowers and existing borrowers, respectively.

We had no unscheduled principal repayments during the quarter.

Our portfolio remains predominantly floating rate with 77% of the portfolio based off of the prime rate. We continue to pursue floating rate loans with floors set at the prevailing prime rate.

We have seven fixed rate loans in the portfolio with a weighted average yield on the fixed-rate loans of 18.9%. The balance sheet retains low leverage at 28% of book equity, compared with 24% at year-end.

Our debt service coverage ratio on a consolidated basis for the quarter was approximately 5:1, compared with the requirement of 1.35:1.

As noted on the Q4 call we extended the maturity of our credit facility to June 2026 and increased the accordion up to $150 million.

As of March 31, we had $82.3 million outstanding on the revolving credit facility, and we subsequently drawn down another $1.5 million. That leaves us to a total of approximately $22 million in operational and liquidity, net of estimated liabilities.

I'll now turn it over to Phil.

Phillip Silverman^ Thanks, Peter.

Our net interest income for the first quarter declined sequentially from the fourth quarter of 2023 from $14.8 million to $13.2 million or 10.8%.

However, gross interest income from recurring cash interest, PIK interest unused fees, and amortization of discounts increased by $0.2 million for the comparable period. The sequential decline results primarily from the lack of unscheduled principal payments during the quarter, which generated no prepayment fees compared with $11 million of repayments during the fourth quarter of 2023, which generated $1.8 million of prepayment fee income.

Prepayments on our loans remain idiosyncratic, and the first quarter was representative of the portfolio's run rate performance.

Additionally, interest expense increased by $413,000 or 24.5% as a result of greater weighted average borrowings.

The company had $81.3 million outstanding on the credit facility as of March 31, compared with $66 million as of December 31, 2023. Total operating expenses before the provision for credit losses decreased approximately $1.6 million from Q4 2023, primarily resulting from the decrease in management and incentive fees of $1.5 million.

Other administrative and professional fees remain consistent.

Our CECL reserve as of March 31, was approximately $5.4 million compared with $5 million as of December 31, 2023, an increase of approximately $400,000.

On a relative size basis, our reserve for expected credit losses represents 1.4% of outstanding principal at both March 31 and December 31, 2023.

Credit quality of the portfolio also remained stable with 78% and 77% of the portfolio risk rated three or better as of March 31 and December 31.

We downgraded the risk rating for one position from a two to a three during the quarter, while we closely monitor its performance.

However, the loan continues to perform and meet its debt service obligations.

Loan nine remains on nonaccrual status, and it's included in risk rating four and carries a reserve for credit losses of approximately $1.3 million. Approximately 66% of the portfolio based on outstanding principal is fully secured by real estate collateral. 30% is partially secured with the remaining 4% having no real estate collateral.

Our portfolio on a weighted average basis had real estate coverage of 1.3x as of March 31, compared with 1.5x as of December 31, 2023. The real estate coverage ratio decline is partially driven by the funding of loan 31, which is secured by collateral other than real estate.

Adjusted distributable earnings per weighted average diluted share was $0.52 for Q1 2024, compared with $0.53 for the fourth quarter ended December 31.

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

Our book value as of March 31 was $14.97 per common share compared with $14.94 as of December 31. The sequential increase in book value is due to first quarter basic earnings per share in excess of the regular quarterly dividend of $0.47 and accretion from the issuance of common stock at a premium to book value.

Lastly, we affirmed our guidance we issued in conjunction with our Q4 release.

Operator, we're now ready to take questions.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question today will come from Mark Smith with Lake Street.

Mark Smith^ I just wanted to ask kind of a big picture question here as we think about DA and rescheduling, can you just give some more insight in kind of the short and long-term impacts primarily on your business, more so than kind of the broad cannabis industry including kind of longer-term increased competition that could come into the lending space?

John Mazarakis^ Thanks, Mark.

We don't expect anything to change with respect to the announcement for another 18 to 24 months. Kilpatrick and Townsend had a very nice report prepared.

This is just the first step. Nothing has really been accomplished yet. So we're just waiting to see. So, I think any impact if or when there is an impact will be after the 24-month mark.

Mark Smith^ As we think about it, -- and I know there's just a lot of unknowns on what could really happen though.

Obviously, a lot of positives that come from this for the entire industry.

But anything you can speak to as you look at competition for you guys and maybe how that landscape changes over time with this.

Or would we have just -- would it need to be more regulatory changes to see kind of traditional lenders and others kind of come more into the space?

John Mazarakis^ I think Mark, more the latter.

I can sit here and just be speculative. The truth is based on multiple recent deals that we've seen across the platform, there are no signs of competition. So that's the report based on data.

On a more speculative basis, obviously capital is efficient and at some point, likely probably after 24 months, we will start seeing compression. So, I can speak further to that point.

Mark Smith^ Okay. That's fair.

Then just any changes as we look at the industry and kind of what's happening with operators out there today.

Any changes here in the near term that you guys saw over the quarter positive or negative?

Or any -- maybe even any states to call out that are maybe picking up?

John Mazarakis^ I think our interaction with operators has been very positive.

I think the creditworthiness is improving as we can see from the public markets just purely on a multiple basis.

But more importantly, we only deal with operators that kind of meet the criteria that we set forth in the last 24 months. The credits have been very, very strong. EBITDA has been very strong.

We haven't really focused in any early-stage operations. There's plenty of capital to be deployed in mature businesses with meaningful EBITDA numbers.

Operator^ (Operator Instructions) We are showing no further questions at this time. Thank you so much for your participation in today's call.

Feel free to follow up with any questions you may have. This does conclude our program.

You may now disconnect.