**Chicago Atlantic Real Estate Finance, Inc.(Q4 2022 Earnings)**

**March 09, 2023**

**Corporate Speakers:**

- Tripp Sullivan; SCR Partners; President
- John Mazarakis; Chicago Atlantic Real Estate Finance; Executive Chairman of the Board of Chicago Atlantic REIT Manager
- Anthony Cappell; Chicago Atlantic Real Estate Finance; CEO & Director of Chicago Atlantic REIT Manager
- Andreas Bodmeier; Chicago Atlantic Real Estate Finance; Co-President and Chief Investment Officer
- Phillip Silverman; Chicago Atlantic Real Estate Finance; Interim CFO, Company Secretary & Controller

**Participants:**

- Aaron Hecht; JMP Securities; Research Division - MD & Equity Research Analyst
- Gaurav Mehta; EF Hutton; Analyst
- Mark Smith; Lake Street Capital Markets; Analyst

## PRESENTATION

Operator^ Good day, and thank you for standing by. Welcome to the Chicago Atlantic Real Estate Finance Inc. Fourth Quarter 2022 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Tripp Sullivan of SCR Partners.

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 2022. On the call today will be John Mazarakis, Executive Chairman; Tony Cappell, Chief Executive Officer; Andreas Bodmeier, Co-President and Chief Investment Officer; and Phil Silverman, Interim 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 9, 2023, 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 activity. 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, and thank you for joining us today. As this quarter represents the completion of our first full year as a public company, I'd like to take a moment to thank our Chicago Atlantic team members and our investors who have made this year phenomenal success.

When we entered the cannabis space in 2019, we saw it as one of the few true sources of alpha available in the market. As we all know, those opportunities don't come around very often. We believe this industry has barely scratched the surface of its true growth potential. I provided a number of stats last quarter on comparing this industry over the last three years to beer, wine, tobacco and pharmaceuticals. I don't want to tread that ground again, but I do encourage everyone to look at how fast cannabis has grown compared to those industries.

No matter which source you use, the industry is sized anywhere from $30 billion to $40 billion currently with expectations of growing somewhere in the neighborhood of $50 billion to $75 billion in top line retail sales within the next five years. The capital need for such growth will also be in the tens of billions of dollars, considering that on the one hand, we're converting the illicit market to a legal market, and on the other hand, we have few new adopters trying the medical and adult-use products.

The size of this market, along with the lack of institutional capital in the space, represents tremendous outlook. And in addition to this dislocation that we have exploited for the better part of the last four years, top-tier existing debt in the cannabis space will soon be within a year of maturity and will need to be refinanced and thus repriced.

To be honest, this is why we elected from day one to stick with shorter-term maturities on our loans. Operators are perpetual optimists by nature and continue to believe that federal legalization or some other legislation like SAFE, will pass soon. As a result, they have been hesitant to lock in longer-term loans. That has put us in a better negotiating position with more flexibility in the rising interest rate environment.

Our thoughts on the impact of SAFE Banking Act are also well established. We don't think it's imminent. We believe that if some form of the SAFE banking act passes in the

end, we benefit more than others because we have the largest credit platform in the space. Capital providers that are not currently in the space will want to put sizable capital to work quickly with platforms like ours rather than to build up the expertise within their own underwriting and lending groups.

In addition to the SAFE Act, I also want to mention the state-level initiatives we're tracking. Missouri and Maryland have turned adult-use, and we're actively working on deals in both states. Minnesota is also a state that we expect to soon legalize adult-use cannabis.

What is particularly intriguing is recent speculation that AG Garland is working on a new memo regarding cannabis scheduling that would replace the core memo that AG Sessions rescinded during the Trump administration. While the DOJ has been working on that for some time, should it be issued, it could potentially have as much impact for us as SAFE Banking. It could once again free up the capital markets to funnel more capital to proven platforms like ours and result in an overall lower cost of capital for the REIT and for our borrowers.

Our best source of capital currently is our credit facility. We have expanded it to $92.5 million last quarter, and we have extended it to the end of 2024. We also retained the extra one-year extension option without any fees. As Andreas will note later, we're actively working to expand that banking group and grow the facility further.

Last month, we also took advantage of a request from some institutional investors to sell $6 million of common stock at $15.16 per share. This was obviously above book. So we thought it was great execution and did not involve any underwriters.

As we disclosed in our earnings release, we initiated an outlook for 2023. Rather than a specific range, we believe a better way to project the year is in terms of our expected regular quarterly dividend and our targeted payout based on distributable earnings. We expect our dividend to be at least $0.47 each quarter. We also expect to continue to pay out 90% to 100% of distributable earnings. Should we need to pay out more of a dividend to maintain our taxable income thresholds, our intent is to meet that with a special dividend. We believe the conservative longer-term approach will be better rewarded in the end.

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

Anthony Cappell^  Good morning, everyone. I would like to focus my time today on how to think about our originations, the pipeline and our thoughts on the state of the industry in general. We continue to focus on the best-in-class operators, many of whom are vertically integrated and are the lowest cost producers in their markets.

As we described before, we monitor local market pricing every week and closely monitor how that's trending for both cultivation and retail and stay in regular contact with our borrowers. The opportunities we're seeing vary state by state. We're experiencing a spike

in opportunities within states on the verge of recreational or adult-use approval. Recall that we target limited license states with a preference for those that have yet to go recreational and then grow with those operators as they see more demand. We like Missouri, Maryland and Arkansas for that reason.

Turning to our existing pipeline. We continue to be very active across the entire Chicago Atlantic platform. As we discussed on our last call, we believe we reset the pricing among cannabis operators by serving as the lead and agent for a new four-year $350 million facility for our largest multistate operator. The REIT retained its $30 million commitment in that facility.

In addition, the REIT made an $11.25 million real estate backed loan to MariMed in early January. MariMed continues to outperform many of its peers even with exposure to markets with more pricing compression.

With these loans and others, we have maintained our robust structuring upfront, intensive loan monitoring and strict financial covenants. Recall that we also have all asset liens from borrowers that are in addition to the 1.7x real estate collateral coverage we have on our portfolio. As anticipated, we are also able to increase the percentage of the amount of floating rate loans from 60% a quarter ago to 83% as of year-end with attractive primary floors.

We are well aware of the pressures operators are facing with price compression continuing in many markets, higher labor costs, inflation and the increasing likelihood of some form of recession later in the year. As lenders, it's our job to assess these risks on a regular basis and to ensure the preservation of capital. This nascent industry is not risk free, no industry is. We believe our history of direct lending within cannabis, commercial real estate and other sectors have better prepared us to address any challenges this environment might present.

As John noted earlier, with many capital providers having exited or in the process of exiting the sector, we have the opportunity to be even more selective with the operators we underwrite. This has created an environment where demand far exceeds the supply of capital, which enables us to tighten structures even further and increase what we are able to charge and that increases the return on a risk-adjusted basis. We have proven we can source attractive debt and equity capital across Chicago Atlantic platform to meet this demand. We're confident that our stringent underwriting combined with the leading platform and long-term commitment to sector will keep us positioned to continue to drive value for our shareholders.

Now Andreas will walk us through our investments.

Andreas Bodmeier^ Thanks, Tony. At December 31, our loan portfolio had grown to total loan commitments of $351 million across 22 portfolio companies. It has a weighted average yield to maturity of 19.7%, up from 18.3% at September 30. Net new originations during the quarter were $5.9 million, comprised of subsequent advances on

delayed draw term loans to four existing borrowers. Our new originations also include the refinancing of two credit facilities with outstanding principal balances of $30 million and $10.6 million for a combined total of $40.6 million. We increased our position in one of those facilities from $10.6 million to $13.1 million and retained our $30 million hold in the other. We continue to be very disciplined in deploying the REIT's available capital to focus on strong credit operators and fulfilling the growth capital needs of existing borrowers.

In the period subsequent to year-end, we received approximately $6.5 million in early principal repayments and raised another $6 million in equity capital last month. With the increase in the REIT's credit facility to $92.5 million, we currently have $20 million of liquidity to put to work in the coming months.

The originations pipeline remains full with the Chicago Atlantic platform continuing to address that demand. We still view our credit facility as the primary means for funding our portfolio growth and have continued discussions with banks to potentially join the facility later in the year.

All loans are performing. Our portfolio is currently about 83% floating rate based off of the prime rate, which is a substantial increase from only 60% floating within the portfolio as of Q3. That increase was made possible by the new loans closed during the quarter, allowing us to benefit from rising rates more directly. The 140 basis point improvement in our weighted average portfolio yield of 19.7% this quarter was primarily due to the 125 basis point increase in the prime rate.

With the Federal Reserve expected to continue raising the Fed funds rate in the first half of this year, we should expect to see another increase in the portfolio yield in Q1. Our leverage increased slightly from 20% in Q3 to 22% at year-end, but we are still well below our original leverage targets.

I'll turn it over to Phil now to review our financial results.

Phillip Silverman^  Thank you, Andreas. Turning now to our financial results. Net interest income increased $1.8 million or 14.1% to $14.8 million compared to $12.9 million in Q3. Total net interest income was $48.9 million for the year. The improvement in Q4 resulted from the two increases in the prime rate and the refinancings in Q4 of approximately $40 million in principal and improved yield economics.

Total operating expenses for the quarter were $5 million compared with $2.9 million in Q3. These expenses included management and incentive fees of $3.3 million and aggregate G&A and professional fees of $1.6 million.

Total operating expenses for the year were approximately $16.6 million, including management and incentive fees of $6.6 million and aggregate G&A and professional fees of $5.7 million.

The primary driver of the increase in operating expenses in Q4 as compared to Q3, is the incentive fee expense of $2.3 million in Q4, which compares to the $519,000 in Q3. This is in line with expectations.

As discussed last quarter, the incentive fee is calculated on a rolling 12-month basis. And in Q4 2022, the impact of the prior year incentive fee waiver of $1.1 million in connection with our IPO is no longer a reduction to the annual incentive fee calculation.

I'd like to highlight that the larger quarterly incentive fee paid in Q4 2022 will contribute in a similar way to the rolling 12-month incentive fee calculation throughout fiscal year 2023. Adjusted distributable earnings per share was $0.57 per diluted share for Q4 and $2.11 for the year ended December 31, 2022. In January, we distributed a Q4 regular dividend of $0.47 per common share, plus a special dividend of $0.29 per share with total dividend distributions to shareholders amounting to $2.10 per share for the year. This was approximately 99.5% of adjusted distributable earnings.

Diluted earnings per common share was $1.82 for the year ended December 31, 2022. The Q4 diluted earnings per share was $0.41 compared to $0.55 in Q3. The decrease of $0.14 per common share was primarily due to the increased provision for expected credit losses of $2.5 million to a total reserve of approximately $4 million at December 31, 2022.

The quarterly CECL reserve considers both macroeconomic conditions and borrower financial performance as well as third-party loan loss data representative of our portfolio. Our borrowers are currently performing and portfolio outlook remains strong. However, the continued rising rate environment and our current expectations of portfolio company performance through the forecast period contributed to our CECL reserve, which approximated 1.2% of outstanding principal as of Q4. Approximately 87% of the portfolio based on outstanding principal is secured by real estate with 13% having limited or no real estate collateral. Our portfolio on a weighted average basis had real estate collateral coverage of 1.7x as of December 31, 2022.

Consistent with prior quarters, adjustments to distributable earnings included adding back to GAAP net income the CECL reserve, stock-based compensation and depreciation and amortization. Our book value as of December 31 was $14.86 per common share compared with $15.23 as of September 30. The sequential decline in book value was attributable to the $0.29 per share special dividend declared in Q4 and paid in January and the $0.14 fourth quarter CECL provision.

Operator, we're now ready to take questions.

## QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question comes from Aaron Hecht with JMP Securities.

Aaron Hecht^ You highlighted the multiple pressures that are impacting the industry, whether that be regulatory or product pricing for the availability of capital. And I think those concerns has been priced into your stock here for quite a while. So how would you describe your investors just the health of your borrower base, your pool of investments, anything to give more comfort or to understand the underwriting better because the performance of the portfolio has been really strong to date.

John Mazarakis^ Yes. I think, Aaron, obviously, we have those two issues in the space, which is the capital that you're describing and the price pressures declining pricing environment is never good. I think our portfolio is very robust. As you will see, kind of like I mentioned, we've committed to $0.47 a share per quarter, and we are also committed to distributing 90% to 100%. We do want to reserve that special dividend in the end just to be conservative. But our approach is long term. We're not here for this year or this quarter. We're here to deliver like solid returns for the next 5 years.

Having said that, we do see isolated price compression in PA. Maybe a little bit in Michigan. But we -- again, our underwriting is based on two things. On the retail side, we're focused on dollar per square foot, and we try to target over $3,000 per square foot. If we find a dispensary over $3,000 per square foot in California, and I say that all the time, we will fund that expense rate, and we will fund it based on the parameters that we fund real estate on the retail side. And conversely, on the cultivation side, if we have a cultivator that has 60% to 70% gross margin, it doesn't really matter what the selling price is. We will fund that cultivator. Now that cultivator is very hard to find in states like California, Washington State or Oregon, but we happen to be associated with a cultivator in Michigan that has those metrics. So it all depends. Generally, the portfolio is performing very well, and we don't foresee any issues.

Aaron Hecht^ Got you. There were a couple of loans, I think, you took reserves on this quarter. Any kind of insight there into what caused that? Were they move within the CECL ratings for certain loans and -- what's the driver of that? And I guess, secondly, if you guys just look at any of those buckets we talked about on the risk side or the regulatory product pricing and availability of capital, what -- which 1 of those is the most problematic or carried the most risk? Do you think for your portfolio in 2023?

John Mazarakis^ I'm going to take the first question first. We just want to be conservative. As you see, our competitors are reserving a lot more than we are. But we don't want to take any unnecessary risks. We want to incrementally price or value our assets based on third-party valuations and -- we just want to be respectful to the headwinds, but not just the cannabis space is exhibiting but also the broader economy. Interest rates will continue to go up as we know, and maybe a little more aggressively than everybody anticipated. So we're just trying to take it 1 step at a time, evaluate on a daily basis our portfolio. And what you see with respect to CECL is just an outcome in a culmination of multiple factors, including third-party valuations.

So I -- the second part of the question, I think, is a little more difficult to sort of quantify what, I guess, your question is what are we worried about the most?

Aaron Hecht^  Yes.

John Mazarakis^  We would like to see isolated transition from medical to recreational sales and adult-use in certain markets. And the faster that happens, obviously, the better our position, the longer it takes, the more the concern and the risk. And those states would be Ohio, PA. The states are medical, they are very conservative, they're very limited in license number, number of licenses. So that would be probably something we would like to see change.

The SAFE Banking Act is a secondary concern for us. And then I would say a tertiary concern is how much higher the interest rates will rise. If interest rates rise another 200 basis points, obviously, we've got a broader sort of bearish environment beyond cannabis that we're going to have to deal with. Disposable income will crash. That's just going to reverberate throughout the economy. So we're just trying to prepare and balance all these outcomes.

Operator^  Our next question comes from Gaurav Mehta with EF Hutton.

Gaurav Mehta^  I wanted to maybe ask you about some of the headwinds that you talked about. And in that context, how should we think about loan deployment volume that you guys might see in 2023?

Anthony Cappell^  So right now, in terms of the next quarter one and Q2, we're planning between $20 million and $30 million. And again, I think the key for us from a capital perspective is to continue to work on building to grow the revolver, and that's really where we expect the incremental growth to come from.

Gaurav Mehta^  So $20 million to $30 million in gross or net originations?

Anthony Cappell^  $20 million to $30 million. That's right.

Gaurav Mehta^  Okay. And I guess in terms of expanding credit line, how is your compensation going with your lending partners? And do you expect any expansion this year?

Phillip Silverman^  Gaurav, yes, I mean we're continually out there in the market. We're speaking with banks on a regular basis, and we expect to be able to exercise the full accordion up to $125 million by the end of this year.

Operator^  (Operator Instructions) We'll go to Mark Smith of Lake Street.

Mark Smith^  First off, I just wanted to talk a little bit about geographies. You talked about some of the states that you're more optimistic about. Maybe any call-outs on states that currently maybe give you a little more stress than others, where you're currently operating?

Anthony Cappell^  I was actually -- when I referred to PA, it was actually the main state that we are concerned with. In terms of states that we're optimistic that I haven't mentioned, Maryland, we're extremely optimistic. We were actually growing our presence in Maryland and Missouri. Missouri has exceeded every expectation. And again, with respect to the states like Pennsylvania and Ohio, this goes back to our strategy from the beginning. These are still medical states. There has been some compression. But having that transition to adult-use still has -- is to come. So that really is a mitigant in terms of overall value.

Mark Smith^  Okay. And then similarly, as you guys think about the pipeline, what maybe gives you some confidence in being able to continue to originate new loans as you guys look at the pipeline?

Anthony Cappell^  Yes. I mean, obviously, you've seen a lot of other reports going around. From a supply and demand perspective, there is significantly more demand than supply of capital. So as far as new loans, it is -- we have the pick of the litter and ultimately can maximize our returns on a risk-adjusted basis because there's just not that much competition out there.

Mark Smith^  Okay. And as you guys look at the pipeline, any breakdown or thoughts on existing states where you operate versus kind of new states? Either new to you or new states, regulatory-wise coming online like Minnesota that you talk about, as you think about the pipeline, what's kind of the breakdown of new states versus where you currently operate?

John Mazarakis^  There are two ways, Mark, that you can define the term new states, right? You can have states that are currently listed that have no presence of medical or adult-use markets. those are harder to identify. Who knows. I don't have a crystal ball. In terms of medical state that will convert to adult-use, that would be my guess, Minnesota would be high on the list to convert because Minnesota is -- has turned democratic both on the Senate side and the house side, which is an unusual phenomenon. It hasn't happened in several decades. So that is the 1 state that kind of stands out.

In terms of others, I would just be guessing. Obviously, Maryland is already rec. Everyone is saying that adult-use sales will commence July 1, but that has not been confirmed yet. And Missouri has had one complete full month, which exceeded everyone's expectations. I think the -- Missouri has gone up once the transition occurred somewhere in the ballpark of 2 to 3x of top line retail revenue in one month, month over month. We exceeded $100 million in sales the first month that they were open for business.

Operator^  That concludes our Q&A session today. Thank you for joining.