Chicago Atlantic Real Estate Finance, Inc.

Second Quarter 2022 Financial Results

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CORPORATE PARTICIPANTS

Tripp Sullivan – *President, SCR Partners*

John Mazarakis – *Executive Chairman*

Tony Cappell – *Chief Executive Officer*

Andreas Bodmeier – *Co-President and Chief Investment Officer*

Lindsay Menze – *Chief Financial Officer*

PRESENTATION

Operator
Good morning, afternoon, evening, and welcome to the Chicago Atlantic Real Estate Finance conference call. All participants will be in listen only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask a question. To ask a question, you may press star then one on your telephone keypad. To withdraw your question, please press star then two. Please note, this event is being recorded.

I would now like to turn the conference over to Tripp Sullivan. Please go ahead.

Tripp Sullivan
Thank you. Good morning. Welcome to the Chicago Atlanta Real Estate Finance conference call to review the company's results for the second 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 Lindsay Menze, 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, it reminds you that the remarks made herein are as of today, August 9, 2022, 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 law, 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 could 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, and thank you for joining us. We have a real “tale of two cities” today. On the one hand, our fundamentals are strong in the states where we're focused and within our portfolio. On the other hand, the state of the stock market and the capital markets in general is showing vulnerability. We've invested a lot of time instilling the right perspective into the discussion around the growth potential of this industry, its countercyclical nature, and how it responds much like the pharmaceutical, alcohol and tobacco industries. The focus on limited license states and operators who are vertically integrated is a far superior approach, in our opinion, to trying to pick winners and losers in crowded markets with significant price compression, destroying the margins of weaker operators.

What we've experienced to date backs up every thesis we've ever had about this industry and how well it can perform. As Tony will note in a moment, we are busier than ever across our platform. New markets such as New Jersey, New York, Ohio, and others are gradually adding new licenses and creating new demand. Our operators continue to be in good shape, with lowered leverage and no other debt on their capital structure except ours. They have entrusted us with the growth of their business, and Chicago Atlantic will be there with them for the long term.

Private market and industry participants understand the real value we're creating. In the public markets, everything in this sector appears to be trading at a fire sale. I don't think it's our job to calm all fears about the broader market that we can’t control, but it is our responsibility to make the right strategic decisions to ensure the long-term growth of the REIT and the success of the platform we've established at Chicago Atlantic.

Until the broader capital markets can experience more stability and clarity, we have ruled out the pursuit of any debt or equity offering to provide additional growth in the REIT portfolio. Our threshold has always been that any new growth had to be funded with accretive capital. It's obvious that is only available today in the form of our credit facility. Therefore, we're redoubling our efforts to expand our existing facility through its existing accordion feature or pursue other growth options that are accretive to book value.

As noted in our earnings release, we have provided a range of estimates for our expected performance in the second half of the year. We're currently anticipating that Q3 and Q4, absent any additional increase in the facility, would look a lot like Q2, with adjusted distributable earnings in the range of $1.00 to $1.05 for the second half of 2022. That would equate to $1.95 to $2.00 for the full year of 2022. We would also expect our dividend to be at least $0.47 per share for both quarters, which, if too conservative might require a special dividend at the end of the year to true up our taxable income.

Given what the market is presenting, we believe this the right calibration to make for the REIT. We're very under-levered, at only 17% to book value, and our dividend is well covered. We have a fortress balance sheet and generating strong returns for our shareholders. This is the right move to make for the REIT today.

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

Tony Cappell
Thanks, John. Good morning, everyone. 2022 has proven to be one of the more volatile years in a while, both with macroeconomic issues, including inflation and rising interest rates, and a lot of volatility within the cannabis industry. More specifically on the cannabis market, we have seen some adjustments to reality on the pace of regulatory reform and price compression in many states, primarily the largest western states.

All of these challenges are why it's important to have robust structuring on the front end as well as intensive loan monitoring during the borrower relationship. Cannabis lending is not high yield or liquid credit, where you buy and sell paper in your ivory tower. It is direct lending that requires a significant amount of oversight.

Some examples of our approach include all asset liens that encumber all of the borrower's assets beyond their real estate, stock pledges on all of their subsidiaries, particularly those that own the license, and getting some form of personal guarantee on the majority of our borrowers.

On the monitoring side, we employ strict financial covenants that provide early warnings that are designed to create tabling events long before you get any material deterioration in value. And we require monthly reporting and covenant compliance in the vast majority of our borrowers, so we're able to maintain the most up to date information, compared with others who might wait 30 days after quarter end to get their data. As lenders it's our job to underwrite risk. As one of the first in this space of any size, I believe we've demonstrated we know how to do it and protect our capital.

The demand for capital remains extremely strong. We intend to meet that demand through the Chicago Atlantic platform. When capital markets become less volatile, the REIT will be able to immediately increase its participation in the leading origination platform we have created.

Now, Andreas will walk us through our investments and capital plan.

Andreas Bodmeier
Thanks, Tony. Good morning. At June 30 our loan portfolio had grown to total loan commitments of $357 million across 22 portfolio companies. It has a weighted average yield to maturity of 17.7%, up from 17.2% at March 31.

New originations during the quarter were $51 million, comprised of $17 million to a new borrower and $34 million of incremental advances to existing borrowers. During the quarter, we had one loan pay off at maturity.

All loans are current and performing. Our portfolio is currently 60% floating rate based off the prime rate, so we have been able to effectively manage the impact of rising rates.

To reinforce what John said at the beginning of the call, there isn't a demand problem in the cannabis space at this time, whether we're talking about consumers or the demand from borrowers for growth capital. The main issue from our perspective is the lack of available capital in this current environment to fund incremental growth on terms that would be accretive to book value. We have never contemplated a dilutive capital raise, whether debt or equity. An accretive raise has always been our threshold, and if our stock has been trading down in anticipation that we would either lock in fixed interest rates at these elevated levels with long dated maturities, or issue equity at huge discounts to prices that have existed for most of this year solely to grow the portfolio, then hopefully today's comments have cleared that up.

I'll now turn it over to Lindsay to review our financials.

Lindsay Menze
Thank you, Andreas. Turning now to our financial results for the second quarter, as expected, we saw the full benefit of the deployment of our IPO proceeds and the use of the credit facility in Q2. Net interest income increased sequentially to $11.4 million from $9.8 million in Q1.

Total operating expenses for the quarter were $2.9 million, which includes management and incentive fees of $1.2 million, G&A of $777,000 and professional fees of $744,000. The incentive and management fees were up sequentially in line with the higher interest income, while the other expenses were up as compared to prior quarter, primarily due to non-recurring professional fees incurred during Q2. G&A is still within our previous guidance of $2.5 million to $3.0 million for the year.

Pursuant to ASC 326, we increased our provision for expected credit losses by $1.0 million in Q2, or $0.06 per weighted average diluted common share. The company's reserve has not increased due to any specific factors impacting the credit quality of our borrowers, but rather is primarily due to our quarterly reevaluation of overall current macroeconomic conditions. In determining this reserve, we noted that 95% of the portfolio is fully secured by real estate, and 5% has limited or no real estate collateral. Our portfolio, on average, had real estate collateral coverage of 1.9 times as of June 30,

2022. As Tony mentioned earlier, real estate is not our only collateral; all of our loans are secured by equity pledges of the borrower and all asset liens.

While the CECL reserve was added back in our calculation of distributable earnings consistent with previous quarters, recall that we are not adding back the incentive fees to our calculation of distributable earnings and adjusted distributable earnings to provide a clearer indication of our ability to pay dividends to shareholders.

After factoring in these items, our adjusted distributable earnings per share was $0.50 per diluted share for Q2, up sequentially from $0.45 in Q1.

Our book value as of June 30 was $15.13 per common share.

Operator, we're now ready to take questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question-and-answer session. To ask a question, you may press star then one on your telephone keypad. If you're using a speakerphone, please pick up your headset before pressing the keys. To withdraw your question, please press star then two.

Our first question comes from Aaron Hecht with JMP Securities. Please go ahead.

Aaron Hecht
Good morning, everyone. Thanks for taking my questions. John, you highlighted the capital markets volatility that's been going on out there, limited options of accretive capital available to you guys. Debt markets, they've calmed down a little bit over the last couple of weeks. Are you getting any closer to expanding that credit facility today, given what's gone on with the markets, or is that relatively closed off? And then secondly, are you considering any other potential financing options that are less traditional, maybe preferreds or converts?

John Mazarakis
I'm going to start from the second part of the question. We're not considering any other options; any converts are off limits. We looked at them, frankly, they don't make any sense. And in terms of the revolving facility, I think that's the best source of capital we can rely on. It's very inexpensive relative to our rates. And I think we're going to double down and go after the remaining $35 million. And I believe within Q3, early Q4 we will probably have another $35 million as part of that facility, as the markets hopefully are calming down on the debt side of the market.

Aaron Hecht
Gotcha. And in terms of the near-term liquidity until you get that $35 million, I think you have a little over $25 million of commitments, $26 million of liquidity between your existing facility and cash. How do you manage that liquidity near term and how much do you need just to operate the business on a day-to-day basis?

Tony Cappell
Aaron, I can take—oh, go ahead, John.

John Mazarakis
No, no, I was going to say, Tony, that's yours. Go ahead.

Tony Cappell
Yes. So, for that, Aaron, a lot of that in terms of some of the commitments, there are some discretionary items in there in the credit facility. So, there's some items there. But for now, and the foreseeable future, the private fund has been taking all of the demand that would be normally slated for the REIT, and that has all been funded through the private fund.

Aaron Hecht
It makes sense. Okay, thanks. I'll jump back in the queue.

John Mazarakis
Thanks, Aaron.

Operator
Our next question comes from Gaurav Mehta with EF Hutton. Please go ahead.

Gaurav Mehta
Thanks. Good morning. You made some comments about meeting demand through your Chicago Atlantic platform, and I think you just talked about the private fund. So, can you maybe provide some color on that side, the Chicago Atlantic platform and how you guys are meeting demand?

Tony Cappell
Yes, the private fund, this was launched last year and has been raising money at a pretty fast pace ever since. So, just to give you an example, year-to-date we've funded about $120 million of deals. And there's a fair amount of continued liquidity in that vehicle. So, the deals that are normally slated for the REIT, which are fully real estate conforming, they're being funded through the private fund. But normally, and once everything settles down, these deals will go back to the REIT because they have a preference when it comes to the fully conforming real estate deals.

Gaurav Mehta
Okay. Second question on your credit line. Just to clarify, did you guys say that you're looking to expand up to an additional $35 million on the line?

Tony Cappell
Yes, the existing credit facility has an accordion feature going from $65 million to $100 million subject to syndication. And currently, we're broadening our spectrum of options to bring other banks as co-lenders and participants into the facility.

Gaurav Mehta
Okay, thank you.

Operator
Our next question comes from Mark Smith with Lake Street. Please go ahead.

Mark Smith
Hi, guys. Just looking for more of a broad update on the industry. What are you guys seeing day to day in the states where you operate? Have you seen some continued market downturn as bleed over from some of these bigger states, or do you feel like we're near a bottom? Any thoughts on the industry would be great.

John Mazarakis

Thank you for that question. This is John Mazarakis. I think the meaningful compression that we see is primarily focused in the western states, California, Colorado, Oregon, and Washington State. Obviously, for some of the medical states out east we have seen a little bit of a bottoms-down. There has been limited type of growth in states like PA. Michigan surprised us. I think Michigan is a really strong state, cannabis is performing really well in that state, and it has continuously grown and it's continuing to grow. Massachusetts also has surprised us, even though it has a sort of hybrid environment between an oligopoly and a perfectly competitive market, depending on how you see it. Massachusetts has been performing strongly. Of course, New York is coming online, New Jersey has basically knocked it out of the park. Everyone knows that that state has performed extremely well.

Delaware was a surprise. We thought that Delaware was going to turn rec, the Senate and the House voted for recreational sales. The governor, unfortunately, vetoed that bill. And even though they had supermajority rights, they decided to join the governor and Delaware never turned rec.

Other states that are coming online, Ohio issued a few more licenses. We're very excited about Ohio. We think it's going to perform really well long term. PA has a little bit of compression, but it's a medical state with a ton of upside. I think Florida is a huge success story, although I think from a medical perspective it may be reaching its peak before recreational sales kick in.

I think that's a broad overview of the way I see the market. I think the medical states, even if they're kind of reaching a plateau, are still looking at an upside of maybe 3x to 5x from a top line perspective and maybe 5x to 10x from a bottom-line perspective once recreational sales kick in. So, for the medical states, we're still very excited. We've seen it time and time again, in Illinois, in Massachusetts, Michigan, whenever a state moves from medical to rec, the top line and the bottom line has serious multiple effect. So that's my perspective on the overall state of the industry.

Mark Smith
Perfect. And then similar, you hit on some certain states, but any thoughts or updates on, as you guys look at regulatory environment at the federal level?

John Mazarakis
I think there is a possibility that some sort of federal relief may actually surprise us this time. But I've gotten this question wrong so many times, so I don't even want to even try to answer it. There is a lot of talk that something will happen. We're not holding our breath, but it would be beneficial overall. I think it would lower our cost of capital; it will bring more capital into the markets. I think we've built a phenomenal brand, and we will be the beneficiaries of that growth.

Mark Smith
Excellent. Thank you, guys.

John Mazarakis
Thank you.

Operator
Again, if you have a question, press star then one. Our next question comes from Harrison Vivas with Cowen.

Harrison Vivas
Great. Thanks so much for taking my questions. I wanted to double back on Mark's question, but maybe reframe it in terms of the portfolio. So, there's been a little bit of a step up in the risk rating of your portfolio. Understanding that might not reflect the fundamental performance of the names, I guess

my question is, what geographies are you incrementally concerned about? And how is that driving your risk evaluation of the portfolio?

John Mazarakis
Lindsay, do you want to take that one?

Lindsay Menze
Certainly, John. Yes, I think that's a good point, noting that our risk ratings have increased across the portfolio. This isn't related to any specific borrower, or any particular issue related to a borrower, but rather is related to general market conditions with interest rates and spreads. I think John mentioned earlier that kind of a “tale of two cities,” there have been two consecutive quarters of negative GDP growth; however, cannabis has grown 30% nationally in the first half of the year, most of that coming from markets transitioning from medical to recreation. So, overall, we think the credit quality of our borrowers is strong in the states that we're in, but we just don't want to ignore what's going on with the broader market with our portfolio.

Harrison Vivas
Okay. So, it’s really just broad and not specific market driven, just to confirm?

Lindsay Menze
That's correct, yes.

John Mazarakis
Correct.

Harrison Vivas
Okay, understood. And then I guess as we think about New York, it appears that the regulations really aren't going to favor the established MSOs. So, I guess, as you evaluate that as a potential opportunity, what are your considerations in terms of the borrower profile? And I guess, how big of an opportunity do you think that state is?

John Mazarakis
I think New York will be a huge success. It's a massive state. Everyone is talking about how that might be the biggest state, it may even surpass California. We know that there is a meaningful, sizable black market in New York that is operating pretty much in the open. And then to answer your question directly, I think any sort of fragmentation within the state is benefiting us as lenders. It drives our risk—probably the risk remains the same because New York will be a great market, but the return is significantly higher in the middle market. So, any type of fragmentation is benefiting us as credit providers.

Harrison Vivas
Okay, understood. Last one for me, Tony, you talked about the floating rate portion of the portfolio being around 60%. How is that tracking relative to internal targets? And as you execute new loans, obviously I imagine the focus is executing floating rate loans, but how do you balance your execution between floating and fixed rate?

Tony Cappell
Yes, so pretty much everything that we've done for the last few months has been floating, and everything that we plan to do in the future will be floating. So, if anything, I think that's going to tick up, as new loans are paid off and done. So, I think that it's just really one of those things that we're much more resolute on, on the front end. So, I think that 60% is a good benchmark, but our plan is to keep

increasing that over a longer period of time.

Harrison Vivas
Understood. Thanks very much. I'll jump back in the queue.

CONCLUSION

Operator
There are no further questions at this time. This concludes today's earnings call. Thank you for attending. You may now disconnect.