AWM Diversified Mortgage Investment Corporation

Rising Demand for Alternative Lending Amid Tighter Traditional Lending

Expected Yield (FY2023): 7.8%
Rating*: 2
Risk*: 2

Sector / Industry: Mortgage Investment Corporations

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Highlights

- In FY2022 (year ended March 2022), mortgage receivables increased 27% YoY to $186M vs our estimate of $175M, **amid stronger than expected lending.**
- **Yield was 7.5% in FY2022** vs 5.6% in FY2021 (our estimate was 7.1%), which we note is on the higher-end of comparable MICs.
- Focus remains on first mortgages on single family units. At the end of FY2022, 69% of mortgages were in Ontario; 98% in urban areas. The weighted average loan-to-value was 69%.
- Although inflation has started to taper, the Bank of Canada (BoC) is expected to continue raising its benchmark rate. Higher lending rates imply higher interest revenue for MICs, but they can potentially slow mortgage originations and increase default rates. However, we believe **alternative lenders, such as AWM, should experience relatively strong growth** as they should attract borrowers unable to qualify with traditional lenders. This is evident from our interviews with MIC managers, who have indicated that they have been receiving unusually high loan requests in the past few months.
- We are **expecting lower repayments** as borrowers are likely to renew their loans due to increased difficulty in obtaining loans from traditional lenders. As a result, we believe MICs should be able to expand their loan portfolios in the coming 12 months. Although AWM expects to exit FY2023 with $225M+ in mortgages, we are conservatively modeling $205M.
- Residential real estate prices in Toronto and Vancouver are down 16% and 5%, respectively, from their peaks earlier this year. **The CMHC is expecting prices to fall another 5% over the next 12 months, before climbing back.** Although we are expecting near-term weakness in prices, we have a **positive longer-term outlook due to rising immigration**. Canada remains a popular destination for immigrants and international students. The Canadian government is expecting an 8% increase in immigration this year. In the past 12 months, the immigration backlog has more than doubled to 2.7M people.
- For conservatism, **we are modelling a 100% increase in the provision for loan losses** in the next 12 months. Banks and conventional lenders had raised their provision for credit losses by 100-200% during past recessions. As unemployment levels are at historical lows, we are expecting a relatively modest spike in loan losses this time.
- **Management is targeting a yield of 8.0-8.5% in FY2023 vs 7.5% in FY2022**. Based on our conservative estimates mentioned above, we are projecting 7.8% in FY2023. We believe low-duration funds, such as MICs, offer attractive opportunities in a rising interest rate environment.

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Head of Research

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Equity Analyst

Offering Summary	
Issuer	AWM Diversfied MIC
Securities Offered	Class B Non-Voting Shares
Unit Price	$100
Minimum Subscription	$10K
Distribution to Investors	Monthly, plus potential for year-end top up
Redemption Fees	n/a
Management Fee	2% p.a. of share capital + 100% of Origination/Lending Fee from Borrowers
Sales Commissions	up to 5%
Auditor	Czechowsky, Graham & Hanevelt CPAs

Key Financials	2021	2022	2023E	2024E
Mortgage Receivables	$145,927,974	$185,840,848	$205,840,848	$225,840,848
Debt to Capital	32%	39%	37%	37%
Revenue	$11,066,099	$12,723,579	$17,958,895	$20,332,526
Net Profit (before paying investors)	$5,233,631	$8,661,145	$9,912,867	$11,813,036
Dividend Yield	5.6%	7.5%	7.8%	8.4%

*See last page of this report for important disclosures, rating, and risk definitions. All figures in C$ unless otherwise specified.

AWM has higher exposure to first mortgages, smaller average mortgage size, and higher than average yield due to higher use of debt, and higher LTV

The following table shows how AWM's portfolio compares to that of other similar MICs (with AUM of over $100M) focused on single-family residential units.

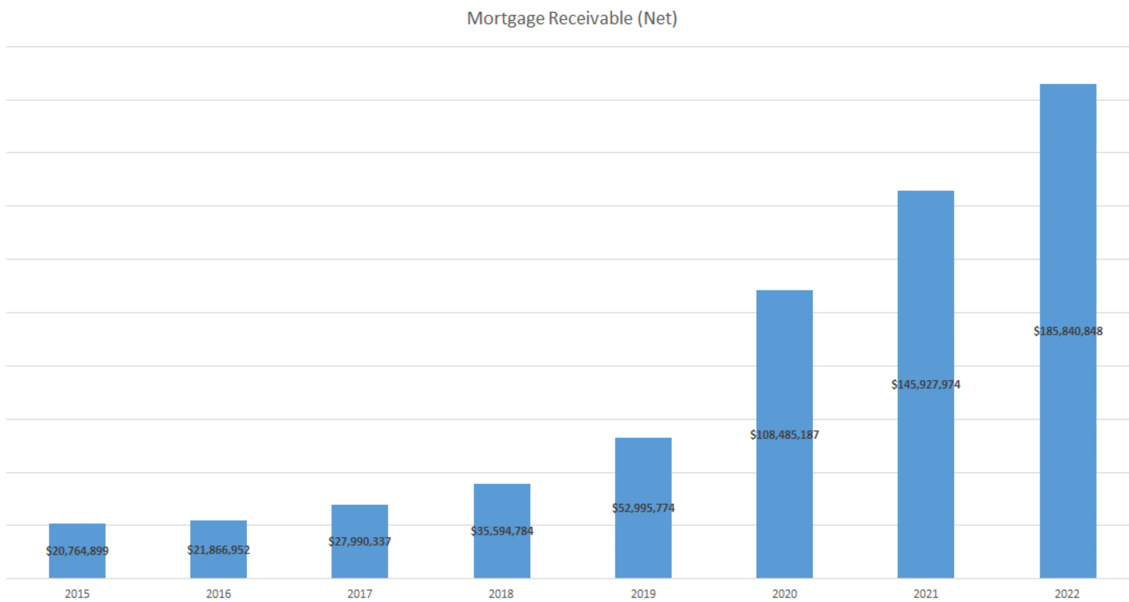
	AWM	Average
First Mortgage	86%	84%
B.C.	11%	44%
ON	69%	43%
AB	20%	7%
Others	0%	6%
LTV	69%	58%
Yield	7.5%	7.0%
Debt to Capital	39%	20%
Average Loan Size	$228,788	$508,191
Delinquent/Foreclosures	3.0%	2.6%
Provision	0.6%	0.6%

Source: FRC / Various

Portfolio Details (YE – March 31st)

In FY2022, mortgage receivables were up 27% YoY to $186M vs our estimate of $175M

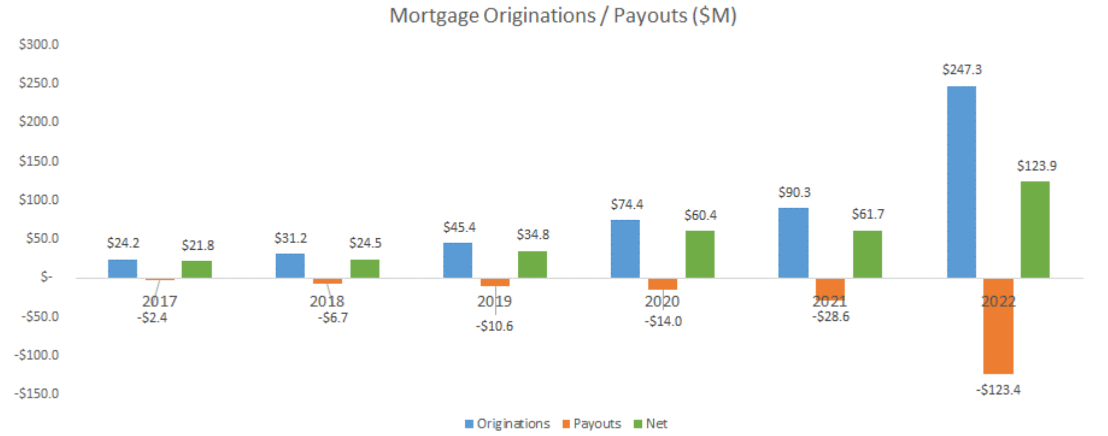
Management expects to surpass $225M by the end of FY2023



Source: Company / FRC

Originations up 174% YoY

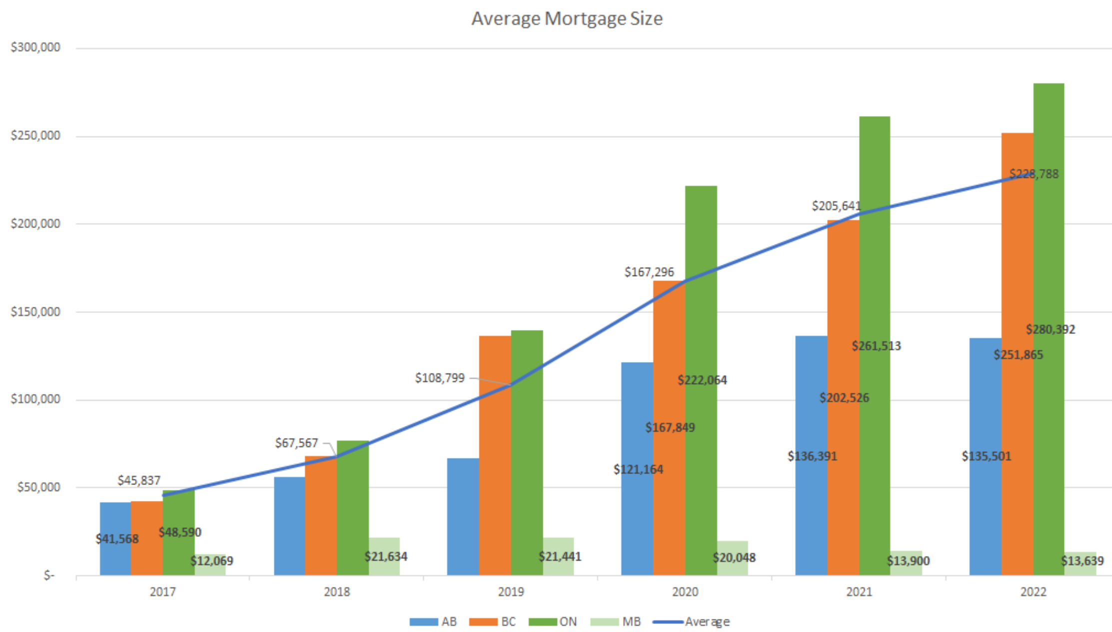
Payouts increased 331% YoY

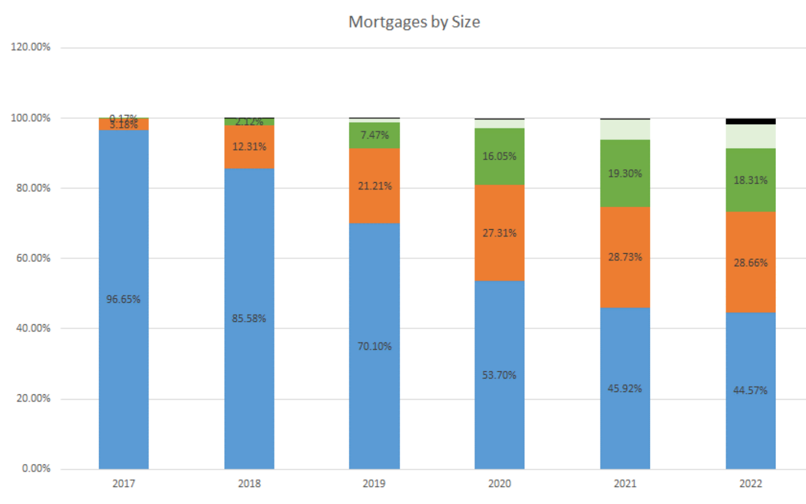


*Note that the MIC's manager also originates and sell mortgages to third-parties.

Average mortgage size up 11% YoY, to $229k

70%+ of mortgages are less than $300k

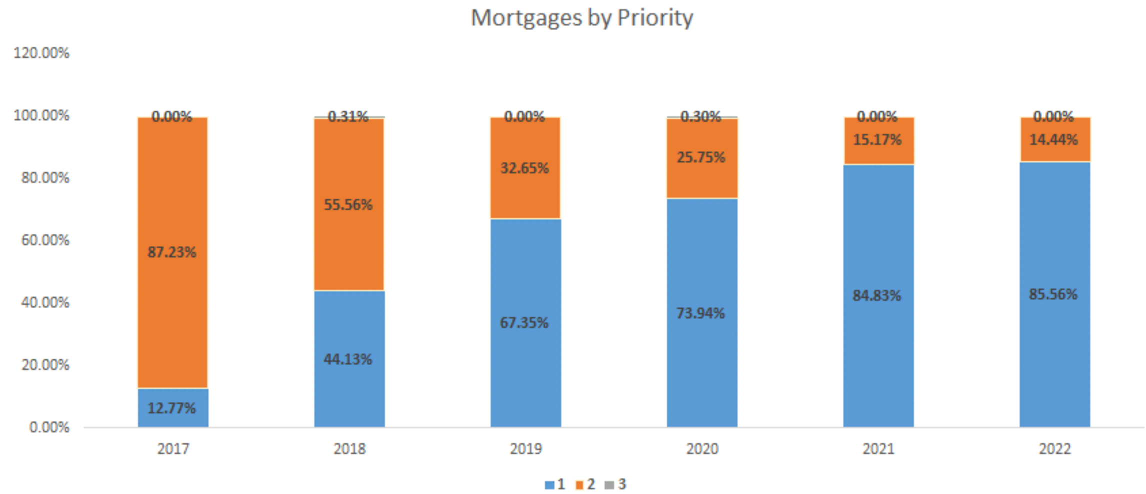




Source: Company / FRC

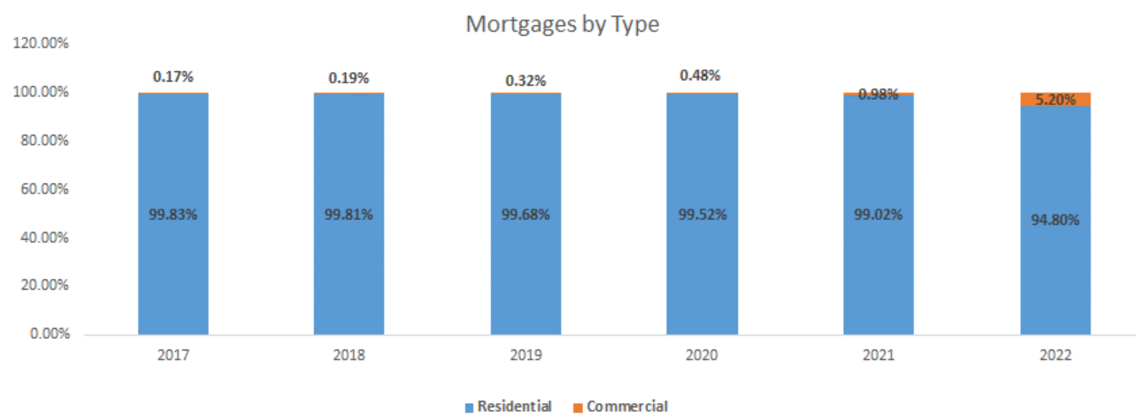
Increased exposure to first mortgages; implying lower risk

Management expects to reduce exposure to first mortgages to 75%–80% to enhance returns



Focus remains on already-built residential properties

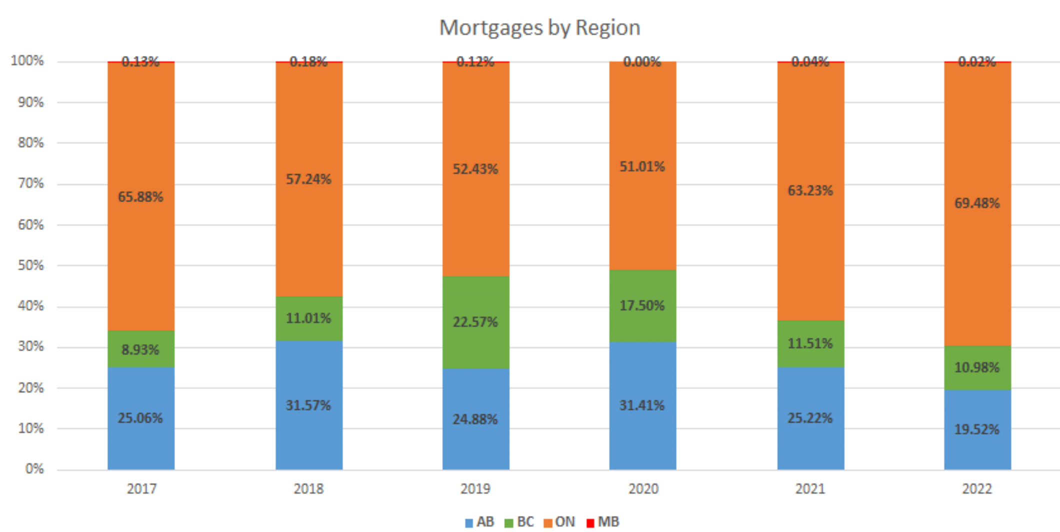
Increased exposure to commercial (relatively higher risk segment vs single family residential units); management expects to maintain a 5% exposure to commercial properties



Increased exposure to ON, while reducing exposure to AB

Focused on urban areas

Management's projected mix by the end of FY2023 is 60% (ON): 25% (AB): 15% (B.C.)



Source: Company / FRC

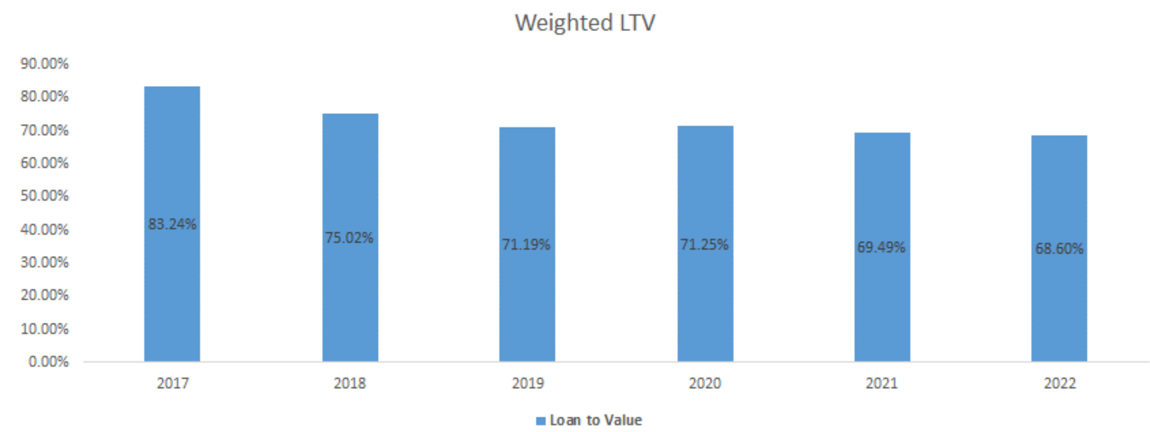
LTV declined due to higher first mortgages, implying lower risk

Realized losses declined from 0.51% to just 0.05% of mortgages outstanding

Impaired mortgages declined from 4.6% at the end of FY2021, to 4.2% at the end of FY2022, to 3% by the end of Q1-FY2023

For conservatism, we are modeling a 100% increase in provisions in the next 12 months

In summary, we believe the portfolio's risk profile has declined due to higher first mortgages, lower LTV and defaults



	2015	2016	2017	2018	2019	2020	2021	2022
Loan loss provision (end of period)	$325,718	$957,687	$1,103,308	$683,166	$1,105,526	$758,983	$1,797,375	$1,196,105
% of Total Mortages	1.57%	4.38%	3.94%	1.92%	2.09%	0.70%	1.23%	0.64%
Actual/Realized Losses	$16,718	$118,081	$117,306	$48,434	$0	$423,390	$653,370	$75,258
% of Total Mortages	0.1%	0.6%	0.5%	0.2%	0.0%	0.5%	0.51%	0.05%
Impaired Mortgages	$971,136	$517,669	$1,222,074	$1,080,667	$1,189,799	$5,670,851	$6,732,514	$7,734,025
% of Total Mortages	4.7%	2.4%	4.4%	3.0%	2.2%	5.2%	4.6%	4.2%

Source: Company / FRC

Parameter	Risk Profile
Average Mortgage	↑
Diversification	↓
Priority	↑
Property Type (lower-risk properties)	↓
LTV	↓
Default	↓
Debt to Capital	↑

• red (green) indicates an increase (decrease) in risk level
Source: FRC

Financials

Investors hold Class B preferred shares. **Shareholders can request for redemptions monthly, with no fees or lock-up period.** We note that most MICs have lock-up periods, and early redemption fees. Redemptions are not guaranteed.

Income Statement (YE - Mar 31)	2015	2016	2017	2018	2019	2020	2021	2022
Interest	$2,067,933	$2,910,366	$1,778,706	$2,696,385	$4,798,910	$7,095,432	$10,634,816	$11,897,883
Lender Fees	-	$221,026	$1,059,905	$163,979	$148,916	$258,757	$431,283	$825,696
Revenue	**$2,067,933**	**$3,131,392**	**$2,838,611**	**$2,860,364**	**$4,947,826**	**$7,354,189**	**$11,066,099**	**$12,723,579**
G&A and Others	$130,250	$212,501	$18,462	$65,125	$81,135	$186,722	$221,293	$305,625
Manager's fees	$207,156	$337,360	$383,430	$493,827	$737,300	$1,376,508	$2,112,076	$2,287,158
Interest	$356,527	$469,255	$472,971	$622,746	$938,509	$632,313	$1,217,297	$1,628,976
Interest on Preferred Shares	$857,295	$1,445,290	$1,664,800	$1,948,349	$2,611,885	$5,085,051	$4,530,441	$8,639,501
Loan loss provision	$317,876	$750,050	$262,927	-$336,036	$528,064	$73,229	$2,281,802	-$159,325
Expenses	**$1,869,104**	**$3,214,456**	**$2,802,590**	**$2,794,011**	**$4,896,893**	**$7,353,823**	**$10,362,909**	**$12,701,935**
Net Income (Loss) - before paying investors	**$1,056,124**	**$1,362,226**	**$1,700,821**	**$2,014,702**	**$2,662,818**	**$5,085,417**	**$5,233,631**	**$8,661,145**
Net Income (after paying investors)	$198,829	-$83,064	$36,021	$66,353	$50,933	$366	$703,190	$21,644
NAV per Share (Preferred)	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00
Preferred Shares Outstanding	140,433	175,126	206,412	276,624	426,494	955,071	999,930	1,131,419

In FY2022, net income (before paying investors) was up 65% YoY, beating our estimate by 12% due to lower-than-expected loan loss provisions

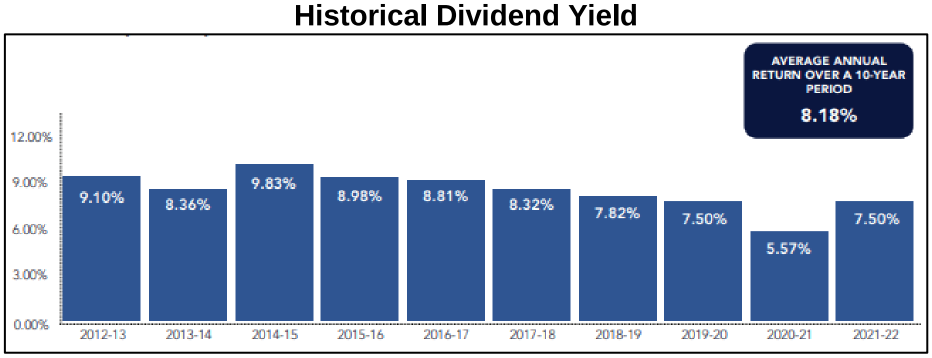
% of Mortgage Receivables (net)	2016	2017	2018	2019	2020	2021	2022
Revenues	14.7%	11.4%	9.0%	11.2%	9.1%	8.7%	7.7%
Less:							
G&A and Others	1.0%	0.1%	0.2%	0.2%	0.2%	0.2%	0.2%
Manager's fees	1.6%	1.5%	1.6%	1.7%	1.7%	1.7%	1.4%
Interest	2.2%	1.9%	2.0%	2.1%	0.8%	1.0%	1.0%
Loan loss provision	3.5%	1.1%	-1.1%	1.2%	0.1%	1.8%	-0.1%
Net Income (before paying investors)	**6.4%**	**6.8%**	**6.3%**	**6.0%**	**6.3%**	**4.1%**	**5.2%**
Investors' Returns (% of Invested Capital)	9.2%	8.7%	8.1%	7.4%	7.4%	4.6%	8.1%
Dividends	**9.0%**	**8.8%**	**8.3%**	**7.8%**	**7.5%**	**5.6%**	**7.5%**

Dividend yield increased YoY from 5.6% to 7.5% vs our estimate of 7.1%

Note that the above figures may be slightly different from the figures reported by the MIC due to the difference in the method of calculation. We used the average of the opening balance, and year-end balance of the mortgages outstanding, and invested capital, to arrive at the above figures.

Dividends paid monthly

Historical Dividend Yield



Source: FRC, Company

$186M in mortgages at the end of FY2022, up 27% YoY; our estimate was $175M

As expected, the MIC increased leverage to enhance yields

Debt to capital increased YoY from 32% to 39%, which is on the higher-end of comparables

Management expects to maintain debt levels at 35%-40%

Balance Sheet (YE - Mar 31)	2015	2016	2017	2018	2019	2020	2021	2022
Cash and Equivalents	$132,895	$1,103,346	$283,413	$100,629	$4,110,664	$1,497,822	$3,557,128	$11,884,344
Interest and other receivables	$255,394	$200,263	$224,169	$279,779	$452,739	$819,074	$992,575	$1,096,375
Prepaid	$46,815					-	$33,390	$133,841
Mortgage Receivables (net)	$20,764,899	$21,866,952	$27,990,337	$35,594,784	$52,995,774	$108,485,187	$145,927,974	$185,840,848
Total Assets	**$21,200,003**	**$23,170,561**	**$28,497,919**	**$35,975,192**	**$57,559,177**	**$110,802,083**	**$150,511,067**	**$198,955,408**
Accounts Payable and Accrued liabilities	$34,040	$62,696	$72,492	$72,084	$65,077	$55,702	$202,752	$1,208,664
Debt	$1,000,000	$5,485,000	$7,710,000	$8,285,000	$14,831,022	$15,184,805	$49,514,217	$83,739,426
Related Parties	$6,004,851	$62,992	$4,273	$48,409	$75,318	$125,353	$174,988	$197,998
Preferred Shares	$14,043,338	$17,512,632	$20,641,281	$27,662,441	$42,649,365	$95,507,123	$99,993,036	$113,141,924
Issuance Costs	-$105,677	-$93,146	-$106,535	-$148,084	-$167,880	-$177,540	-$183,756	-$164,078
Total Liabilities	**$20,976,552**	**$23,030,174**	**$28,321,511**	**$35,919,850**	**$57,452,902**	**$110,695,443**	**$149,701,237**	**$198,123,934**
Share Capital	$326	$326	$326	$326	$326	$326	$326	$326
Retained Earnings (Defecit)	$223,125	$140,061	$176,082	$55,016	$105,949	$106,314	$809,504	$831,148
Total SE	$223,451	$140,387	$176,408	$55,342	$106,275	$106,640	$809,830	$831,474
Total Liabilities and SE	**$21,200,003**	**$23,170,561**	**$28,497,919**	**$35,975,192**	**$57,559,177**	**$110,802,083**	**$150,511,067**	**$198,955,408**
Debt to Capital	33%	20%	26%	23%	20%	13%	32%	39%

*MICs generally do not hold significant cash, and instead use excess cash to pay down debt. In our discussions with management, the high cash position at year-end was merely due to timing differences, as the MIC had to hold cash to fund mortgages.

Source: Company / FRC

Management expects the FY2023 yield to be within 8.0%-8.5%; we are projecting 7.8%

Our forecasts are conservative as we are assuming a 100% increase in loan loss provisions over the next 12 months

Our estimate for the FY2023 yield varies between 6.3% and 8.6%, using various YoY increases in the provision for loan losses

FRC Rating

Key Financials	2021	2022	2023E	2024E
Mortgage Receivables	$145,927,974	$185,840,848	$205,840,848	$225,840,848
Debt to Capital	32%	39%	37%	37%
Revenue	$11,066,099	$12,723,579	$17,958,895	$20,332,526
Net Profit (before paying investors)	$5,233,631	$8,661,145	$9,912,867	$11,813,036
Dividend Yield	5.6%	7.5%	7.8%	8.4%

Provision for Losses (X% Increase)	FY2023 Yield
	7.8%
0%	8.55%
50%	8.18%
100%	7.81%
200%	7.06%
300%	6.32%

Source: FRC

We are reiterating our overall rating of 2, and risk rating of 2. We believe low-duration funds, such as MICs, offer attractive opportunities in a rising interest rate environment.

FRC Rating	
Expected Yield (FY2023/Year-Ending Mar 2023)	7.8% p.a.
Rating	2
Risk	2

Risks

We believe the MIC is exposed to the following key risks:

- Loans are short term and need to be sourced and replaced quickly.
- Concentration risk - 60%+ of its mortgages are in Ontario.
- Lower housing prices will result in higher LTVs.
- **Shareholders' principal is not guaranteed.**
- The MIC uses leverage, which increases exposure to negative events.
- Second mortgages carry higher risk.
- Timely deployment of capital is critical.
- **Default rates can rise during recession.**

APPENDIX

Income Statement (YE - Mar 31)	2021	2022	2023E	2024E
Interest	$10,634,816	$11,897,883	$17,060,950	$19,315,900
Lender Fees	$431,283	$825,696	$897,945	$1,016,626
Revenue	**$11,066,099**	**$12,723,579**	**$17,958,895**	**$20,332,526**
G&A and Others	$221,293	$305,625	$350,754	$386,574
Manager's fees	$2,112,076	$2,287,158	$2,741,772	$3,021,772
Interest	$1,217,297	$1,628,976	$4,008,152	$4,416,549
Interest on Preferred Shares	$4,530,441	$8,639,501	$9,417,223	$11,222,384
Loan loss provision	$2,281,802	-$159,325	$945,350	$694,595
Expenses	**$10,362,909**	**$12,701,935**	**$17,463,251**	**$19,741,874**
Net Income (Loss) - before paying investors	**$5,233,631**	**$8,661,145**	**$9,912,867**	**$11,813,036**
Net Income (after paying investors)	$703,190	$21,644	$495,643	$590,652
NAV per Share (Preferred)	$100.00	$100.00	$100.00	$100.00
Preferred Shares Outstanding	999,930	1,131,419	1,281,419	1,401,419

Balance Sheet (YE - Mar 31)	2021	2022	2023E	2024E
Cash and Equivalents	$3,557,128	$11,884,344	$0	$0
Interest and other receivables	$992,575	$1,096,375	$1,151,194	$1,208,753
Prepaid	$33,390	$133,841	$140,533	$147,560
Mortgage Receivables (net)	$145,927,974	$185,840,848	$205,840,848	$225,840,848
Total Assets	**$150,511,067**	**$198,955,408**	**$207,132,575**	**$227,197,161**
Accounts Payable and Accrued liabilities	$202,752	$1,208,664	$1,269,097	$1,332,552
Debt	$49,514,217	$83,739,426	$76,586,649	$84,015,129
Related Parties	$174,988	$197,998	-	-
Preferred Shares	$99,993,036	$113,141,924	$128,141,924	$140,141,924
Issuance Costs	-$183,756	-$164,078	-$192,213	-$210,213
Total Liabilities	**$149,701,237**	**$198,123,934**	**$205,805,457**	**$225,279,392**
Share Capital	$326	$326	$326	$326
Retained Earnings (Defecit)	$809,504	$831,148	$1,326,791	$1,917,443
Total SE	$809,830	$831,474	$1,327,117	$1,917,769
Total Liabilities and SE	**$150,511,067**	**$198,955,408**	**$207,132,575**	**$227,197,161**
Debt to Capital	32%	39%	37%	37%

- **Even though the Manager has rights to 100% of lender fees, they have historically paid a portion of the fees to the fund, which we believe is a good sign for investors. We also understand that there is no guarantee that management will do so going forward.**

Cash Flow (YE - Mar 31)	2022	2023E	2024E
Net Income (Loss)	$21,644	$495,643	$590,652
Non-Cash Items	$5,658,002	-$28,135	-$18,000
Change in WC	-$2,207,746	-$199,076	-$1,131
Cash from Operating Activities	**$3,471,900**	**$268,433**	**$571,520**
Equity	$7,351,240	$15,000,000	$12,000,000
Debt	$34,248,219	-$7,152,777	$7,428,480
Cash from Financing Activities	**$41,599,459**	**$7,847,223**	**$19,428,480**
Increase in mortgage loans (net)	-$39,753,549	-$20,000,000	-$20,000,000
Cash from Investing Activities	**-$39,753,549**	**-$20,000,000**	**-$20,000,000**

Fundamental Research Corp. Rating Scale:

Rating – 1: Excellent Return to Risk Ratio
Rating – 2: Very Good Return to Risk Ratio
Rating – 3: Good Return to Risk Ratio
Rating – 4: Average Return to Risk Ratio
Rating – 5: Weak Return to Risk Ratio
Rating – 6: Very Weak Return to Risk Ratio
Rating – 7: Poor Return to Risk Ratio
A "+" indicates the rating is in the top third of the category, A "-" indicates the lower third and no "+" or "-" indicates the middle third of the category.

Fundamental Research Corp. Risk Rating Scale:
1 (Low Risk)
2 (Below Average Risk)
3 (Average Risk)
4 (Speculative)
5 (Highly Speculative)

FRC Distribution of Ratings			
Rating - 1	0%	Risk - 1	0%
Rating - 2	31%	Risk - 2	9%
Rating - 3	47%	Risk - 3	40%
Rating - 4	8%	Risk - 4	33%
Rating - 5	4%	Risk - 5	8%
Rating - 6	1%	Suspended	10%
Rating - 7	0%		
Suspended	9%		

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