Fundamental Research Corp.
Investment Analysis for Intelligent Investors

December 6, 2023

AWM Diversified Mortgage Investment Corporation

Boosting Yields

Expected Yield (FY2024): 8.3%
Rating*: 2
Risk*: 2

Sector / Industry: Mortgage Investment Corporations

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Highlights

- In FY2023 (ended March 2023), **mortgage receivables increased 20% YoY to $223M** vs our estimate of $206M, amid robust lending.
- In FY2023, **the yield increased by 0.57 pp to 8.1%**, beating our estimate of 7.8%, driven by increased leverage.
- As of June 2023, 63% of mortgages were in Ontario; 98% in urban areas. The weighted average loan-to-value was 69%.
- Since our previous update in August 2022, AWM has **raised its exposure to second mortgages**, from 14% to 34%, for enhancing yields. In order to mitigate the risks associated with second mortgages, the MIC employs considerably smaller loan sizes for second mortgages.
- We anticipate **the Bank of Canada will initiate rate cuts** within the next six months, driven by rising unemployment, financial instability, and mortgage costs, falling consumer confidence, and cooling inflation. Last month, major Canadian banks slashed their mortgages rates an average of 20 bp. We anticipate an increase in mortgage originations in 2024, driven by lower interest rates.
- As of June 2023, AWM had $14M (6% of the portfolio) in impaired mortgages, spread across 27 out of 923 properties. However, AWM **is not anticipating any material losses from these impaired mortgages.** Management's conviction is evident in their decision to allocate only 0.5% of the portfolio for loan loss allowances. For conservatism, we are modelling higher loss allowances for all of the lenders under our coverage.
- As of November 2023, **residential real estate prices in key areas continue to display resilience**, with a 0.1% YoY increase in Toronto, and a notable 4.4% YoY surge in Vancouver.
- Anticipating a decline in rates within the next 12 months, we find high-yielding funds, such as AWM, increasingly appealing. **We are projecting a yield of 8.3% in FY2024.**

Sid Rajeev, B.Tech, CFA, MBA
Head of Research

Offering Summary	
Issuer	AWM Diversfied MIC
Securities Offered (FundSERV Code: BEL 1801)	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 + up to 100% of lending/placement fees from borrowers
Sales Commissions	up to 5%, none paid since fund inception
Auditor	Czechowsky, Graham & Hanevelt CPAs

Key Financials	2021	2022	2023	2024E	2025E
Mortgage Receivables	$145,927,974	$185,840,848	$223,206,672	$250,000,000	$275,000,000
Debt to Capital	31%	39%	41%	43%	43%
Revenue	$11,066,099	$12,723,579	$18,432,420	$23,305,429	$23,940,000
Net Profit (before paying investors)	$5,233,631	$8,661,145	$9,799,201	$11,464,420	$12,770,031
Dividend Yield	5.6%	7.5%	8.1%	8.3%	8.5%

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

The following table illustrates a comparison between AWM's portfolio and that of other similar MICs (with AUM of over $100M) focused on single-family residential units.

AWM has lower exposure to first mortgages, significantly smaller loan sizes, and higher debt/capital, LTV, and defaults

AWM's yields are higher as well

June 2023	AWM	Average
First Mortgage	66%	80%
B.C.	15%	40%
ON	63%	46%
AB	22%	6%
Others	0%	8%
LTV	69%	58%
Yield	8.1%	7.8%
Debt to Capital	45%	23%
Average Loan Size	$234,951	$596,004
Impaired Mortgages	6.3%	2.1%
Provision	0.5%	0.5%

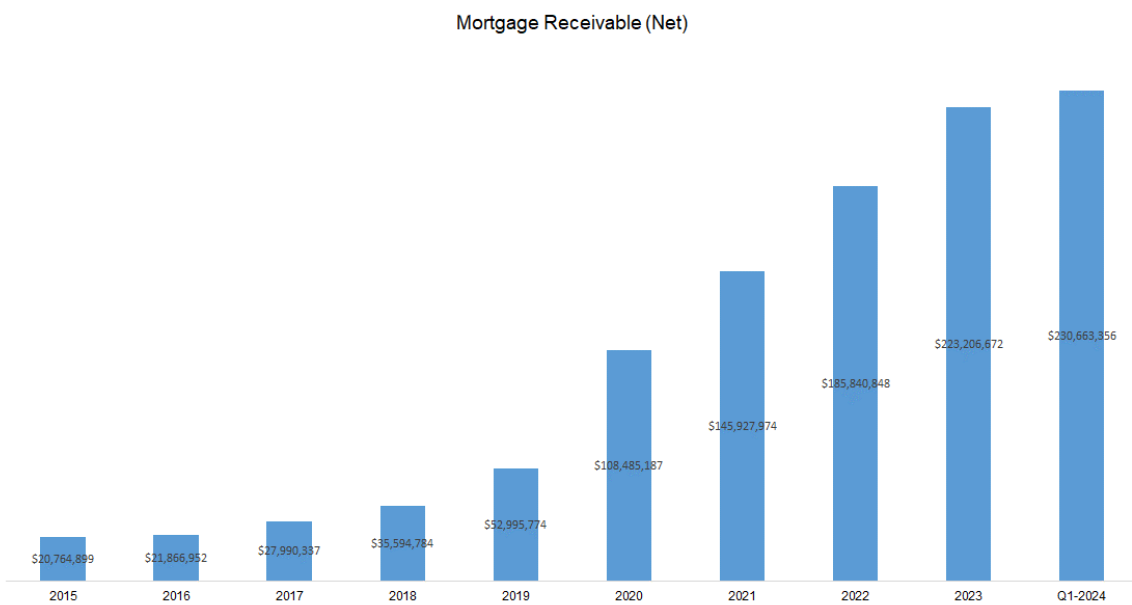
Source: FRC / Various

Portfolio Details (YE – March 31st)

In FY2023, mortgage receivables were up 20% YoY to $223M vs our estimate of $206M

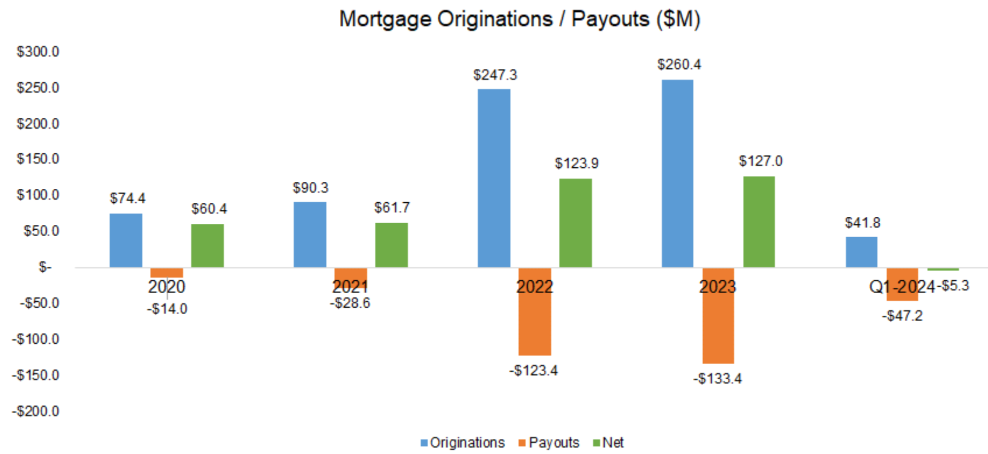
In Q1-FY2024, receivables increased 3% QoQ to $231M

By the end of FY2024, management foresees receivables surpassing $250M



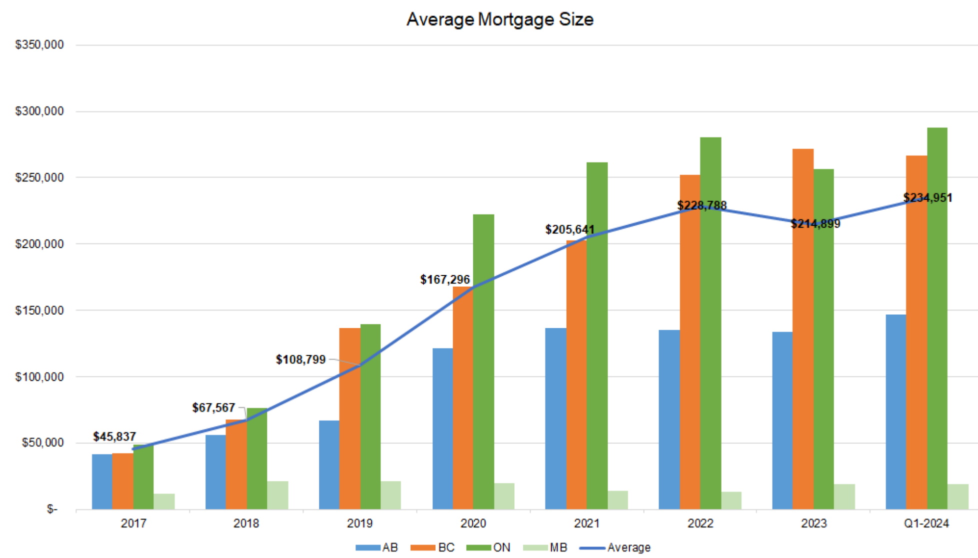
Source: Company / FRC

In FY2023, mortgage advancements were up 5% YoY; payouts were up 8% YoY

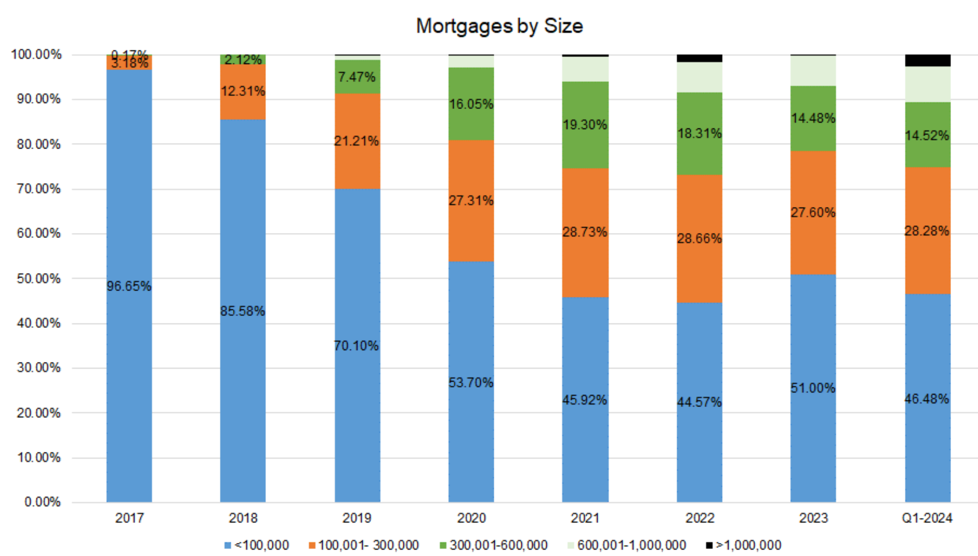


*Note that the MIC's manager originates, and sell mortgages, to third-parties as well.

In Q1-FY2024, the average mortgage size was up 9% QoQ to $235k



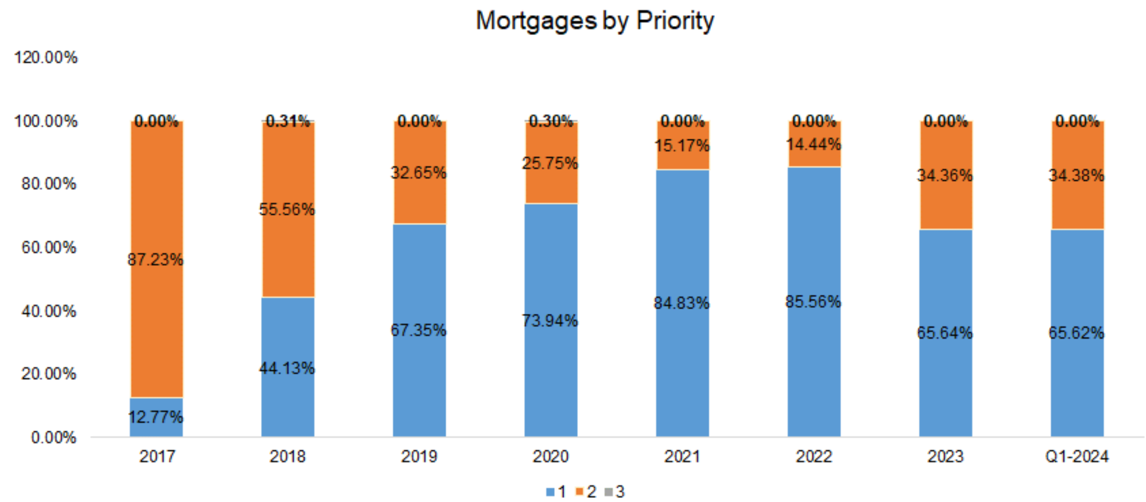
75% of mortgages are <$300k



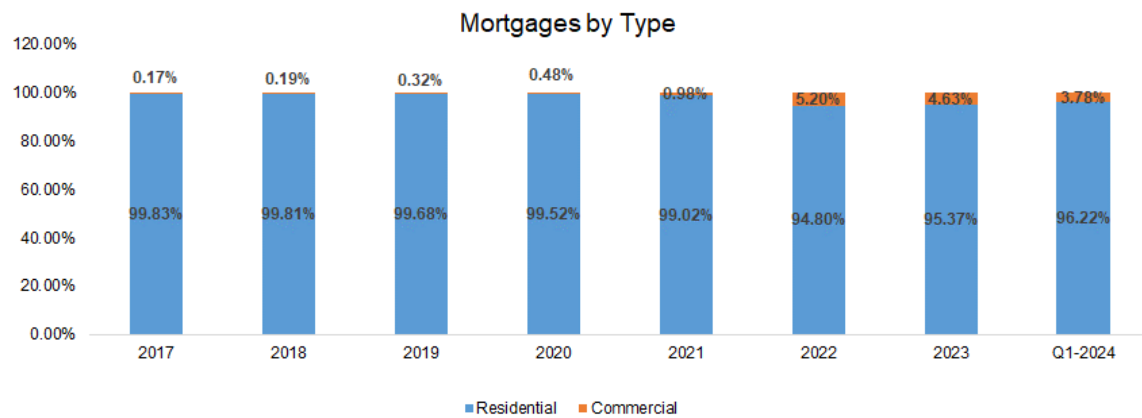
Source: Company / FRC

To enhance returns, AWM increased exposure to second mortgages, implying higher risk

To mitigate these risks, the MIC employs considerably smaller loan sizes for second mortgages; at the end of Q1-FY2024, the average size for second mortgages was $114k vs the portfolio average of $235k



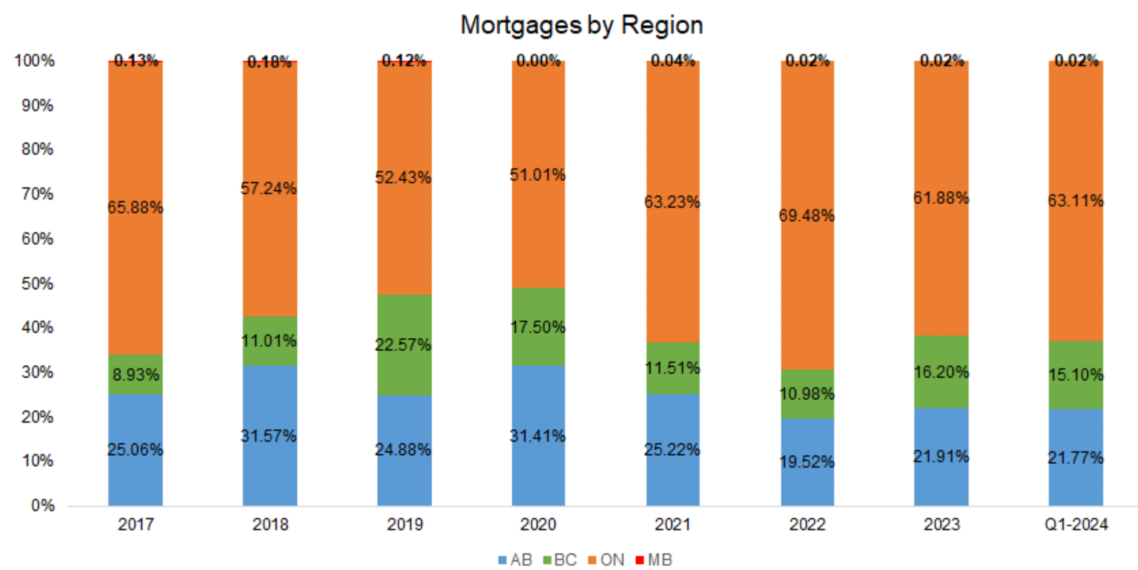
Focus remains on already-built residential properties



Trimmed ON exposure, and concurrently expanded exposure to B.C.

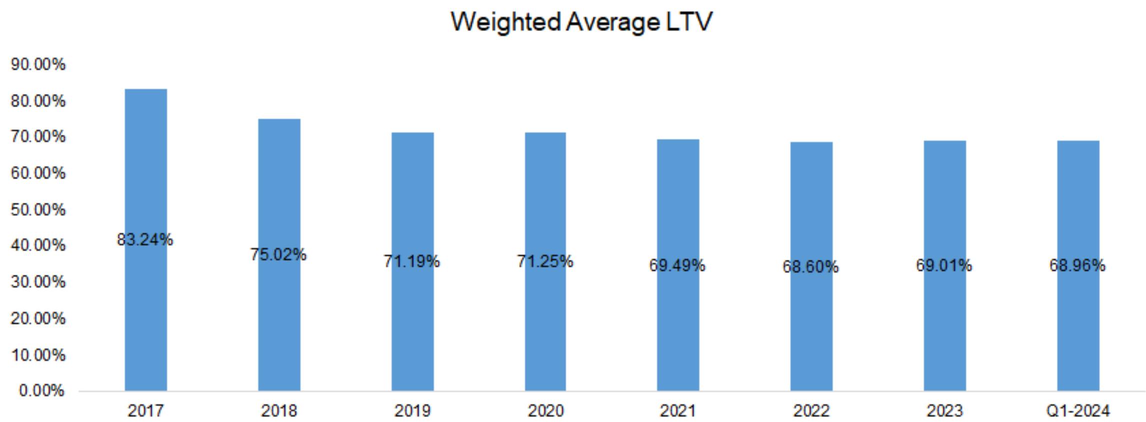
Focus remains on urban areas

Management's projected mix by the end of FY2024 is 60% (ON): 25% (AB): 15% (B.C.)



Source: Company / FRC

LTV remained relatively flat



Negligible realized losses in FY2023

However, impaired mortgages increased from 4.2% at the end of FY2022, to 6.2% by the end of FY2023

	2018	2019	2020	2021	2022	2023
Loan loss allowances (end of period)	$683,166	$1,105,526	$758,983	$1,797,375	$1,196,105	$1,000,272
% of Total Mortages	1.92%	2.09%	0.70%	1.23%	0.64%	0.45%
Actual/Realized Losses	$48,434	$0	$423,390	$653,370	$75,258	$11,523
% of Total Mortages	0.2%	0.0%	0.5%	0.51%	0.05%	0.01%
Impaired Mortgages	$1,080,667	$1,189,799	$5,670,851	$6,732,514	$7,734,025	$13,746,130
% of Total Mortages	3.0%	2.2%	5.2%	4.6%	4.2%	6.2%

Source: Company / FRC

For conservatism, we are modelling a 100% increase in loan loss allowances in the next 12 months

In summary, we believe the portfolio's risk profile has increased (three red vs two green signals), attributed to lower first mortgages, and higher impaired mortgages

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

- red (green) indicates an increase (decrease) in risk level

Source: FRC

Financials

Investors hold Class B shares, **allowing shareholders to request redemptions monthly** without incurring fees, or facing a lock-up period. It is noteworthy that many MICs typically impose lock-up periods, and early redemption fees. That said, redemptions are not guaranteed.

In FY2023, net income (before paying investors) was up 13% YoY, but fell 1% below our estimate, due to higher than expected interest expenses from increased leverage

Income Statement (YE - Mar 31)	2020	2021	2022	2023	Q1-2024
Interest	$7,095,432	$10,634,816	$11,897,883	$17,602,235	$5,126,825
Lender Fees	$258,757	$431,283	$825,696	$830,185	$414,605
Revenue	**$7,354,189**	**$11,066,099**	**$12,723,579**	**$18,432,420**	**$5,541,430**
G&A and Others	$186,722	$221,293	$305,625	$576,830	$195,008
Manager's fees	$1,376,508	$2,112,076	$2,287,158	$2,465,432	$680,829
Interest	$632,313	$1,217,297	$1,628,976	$5,775,267	$1,744,014
Interest (Investors)	$5,085,051	$4,530,441	$8,639,501	$9,776,858	$2,625,133
Loan loss provision	$73,229	$2,281,802	-$159,325	-$184,310	$39,305
Expenses	**$7,353,823**	**$10,362,909**	**$12,701,935**	**$18,410,077**	**$5,284,289**
Net Income (Loss) - before paying inve	**$5,085,417**	**$5,233,631**	**$8,661,145**	**$9,799,201**	**$2,882,274**
Net Income (after paying investors)	$366	$703,190	$21,644	$22,343	$257,141

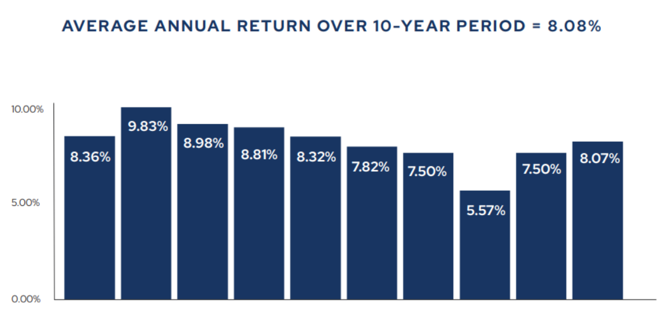
In FY2023, the yield increased by 0.57 pp to 8.1%, beating our estimate of 7.8%, driven by increased leverage

% of Mortgage Receivables (net)	2020	2021	2022	2023	Q1-2024
Revenues	9.11%	8.70%	7.67%	9.01%	9.77%
Less:					
G&A and Others	0.23%	0.17%	0.18%	0.28%	0.34%
Manager's fees	1.70%	1.66%	1.38%	1.21%	1.20%
Interest	0.78%	0.96%	0.98%	2.82%	3.07%
Loan loss provision	0.09%	1.79%	-0.10%	-0.09%	0.07%
Net Income (before paying investors)	**6.3%**	**4.11%**	**5.22%**	**4.79%**	**5.08%**
Investors' Returns (% of Invested Capital)	7.4%	4.6%	8.1%	8.0%	8.1%
Dividends	**7.5%**	**5.6%**	**7.5%**	**8.1%**	8.0%

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.

Source: FRC

Dividends are paid monthly



Source: Company

$230M in mortgages at the end of Q1-FY2024

Increased leverage for enhancing yields

At the end of Q1-FY2024, debt to capital was 45%, which we note is on the higher-end among comparables

Management anticipates maintaining debt levels within the range of 35% to 45%

Balance Sheet (YE - Mar 31)	2019	2020	2021	2022	2023	Q1-2024
Cash and Equivalents	$4,110,664	$1,497,822	$3,557,128	$11,884,344	$13,321,354	$8,348,334
Interest and other receivables	$452,739	$819,074	$992,575	$1,096,375	$1,620,149	$6,400,189
Prepaid		-	$33,390	$133,841	$158,521	$442,194
Mortgage Receivables (net)	$52,995,774	$108,485,187	$145,927,974	$185,840,848	$223,206,672	$230,663,356
Total Assets	**$57,559,177**	**$110,802,083**	**$150,511,067**	**$198,955,408**	**$238,306,696**	**$245,854,073**
Accounts Payable and Accrued liabilities	$65,077	$55,702	$202,752	$1,208,664	$1,314,026	$267,309
Debt	$14,831,022	$15,184,805	$49,514,217	$83,739,426	$104,595,783	$114,700,000
Related Parties	$75,318	$125,353	$174,988	$197,998	$434,169	$206,113
Total Liabilities	**$14,971,417**	**$15,365,860**	**$49,891,957**	**$85,146,088**	**$106,343,978**	**$115,173,422**
Share Capital	$42,481,811	$95,329,909	$99,809,606	$112,978,172	$131,109,227	$129,570,021
Retained Earnings (Defecit)	$105,949	$106,314	$809,504	$831,148	$853,491	$1,110,630
Total SE	$42,587,760	$95,436,223	$100,619,110	$113,809,320	$131,962,718	$130,680,651
Total Liabilities and SE	**$57,559,177**	**$110,802,083**	**$150,511,067**	**$198,955,408**	**$238,306,696**	**$245,854,073**
Debt to Capital	20%	13%	31%	39%	41%	45%

*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

FRC Rating

We are projecting a yield of 8.3% in FY2024

Our estimate for the FY2024 yield varies between 7.1% and 8.9% using various YoY increases in loan loss allowances

	FY2024E (Old)	FY2024E (New)	FY2025E (Introducing)
Mortgage Receivables (net)	$225,000,000	$250,000,000	$275,000,000
Revenue	$20,332,526	$23,305,429	$23,940,000
Net Income	$11,813,036	$11,464,420	$12,770,031
Debt/Capital	37%	43%	43%
Dividend Yield	8.40%	8.32%	8.52%

Loan Loss Allowances (X% Increase)	FY2024 Yield
0%	8.93%
50%	8.62%
100%	8.32%
200%	7.71%
300%	7.10%

Source: FRC

We are reiterating our overall rating of 2, and risk rating of 2. Anticipating a decline in rates within the next 12 months, **we find high-yielding funds, such as AWM, increasingly appealing.** Key risks include a softer mortgage origination market, and higher default rates.

Risks

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

- Rapid sourcing and timely replacement are vital for short-term loans
- Concentration risk - 60%+ of mortgages are in ON
- Lower housing prices will result in higher LTVs
- **Shareholders' principal is not guaranteed**
- The MIC utilizes leverage, amplifying exposure to adverse events
- Second mortgages carry higher risk
- **Default rates can rise during recession**

APPENDIX

Income Statement (YE - Mar 31)	2022	2023	2024E	2025E
Interest	$11,897,883	$17,602,235	$22,140,157	$22,743,000
Lender Fees	$825,696	$830,185	$1,165,271	$1,197,000
Revenue	**$12,723,579**	**$18,432,420**	**$23,305,429**	**$23,940,000**
G&A and Others	$305,625	$576,830	$650,659	$721,875
Manager's fees	$2,287,158	$2,465,432	$2,839,240	$3,150,000
Interest	$1,628,976	$5,775,267	$7,510,852	$6,990,000
Interest (Investors)	$8,639,501	$9,776,858	$11,407,098	$12,706,181
Loan loss provision	-$159,325	-$184,310	$840,257	$308,094
Expenses	**$12,701,935**	**$18,410,077**	**$23,248,106**	**$23,876,150**
Net Income (Loss) - before paying investors	**$8,661,145**	**$9,799,201**	**$11,464,420**	**$12,770,031**
Net Income (after paying investors)	$21,644	$22,343	$57,322	$63,850

Balance Sheet (YE - Mar 31)	2022	2023	2024E	2025E
Cash and Equivalents	$11,884,344	$13,321,354	$3,738,277	$3,777,733
Interest and other receivables	$1,096,375	$1,620,149	$1,701,156	$1,786,214
Prepaid	$133,841	$158,521	$166,447	$174,769
Mortgage Receivables (net)	$185,840,848	$223,206,672	$250,000,000	$275,000,000
Total Assets	**$198,955,408**	**$238,306,696**	**$255,605,880**	**$280,738,717**
Accounts Payable and Accrued liabilities	$1,208,664	$1,314,026	$1,379,727	$1,448,714
Debt	$83,739,426	$104,595,783	$110,000,000	$123,000,000
Related Parties	$197,998	$434,169	$206,113	$206,113
Total Liabilities	**$85,146,088**	**$106,343,978**	**$111,585,840**	**$124,654,827**
Share Capital	$112,978,172	$131,109,227	$143,109,227	$155,109,227
Retained Earnings (Defecit)	$831,148	$853,491	$910,813	$974,663
Total SE	$113,809,320	$131,962,718	$144,020,040	$156,083,890
Total Liabilities and SE	**$198,955,408**	**$238,306,696**	**$255,605,880**	**$280,738,717**
Debt to Capital	39%	41%	43%	43%

- **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)	2024E	2025E
Net Income (Loss)	$57,322	$63,850
Non-Cash Items		
Change in WC	-$251,288	-$24,394
Cash from Operating Activities	**-$193,966**	**$39,456**
Equity	$12,000,000	$12,000,000
Debt	$5,404,217	$13,000,000
Cash from Financing Activities	**$17,404,217**	**$25,000,000**
Increase in mortgage loans (net)	-$26,793,328	-$25,000,000
Cash from Investing Activities	**-$26,793,328**	**-$25,000,000**

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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