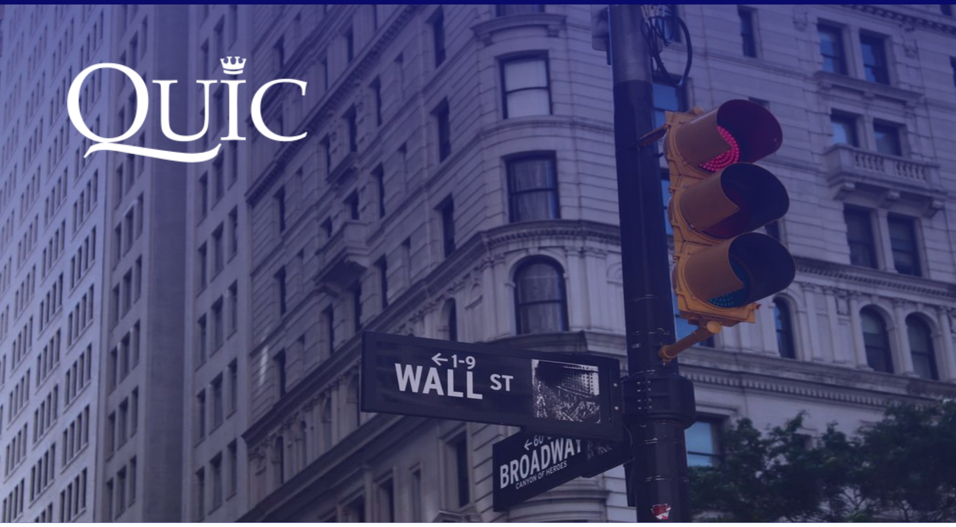


RESEARCH REPORT

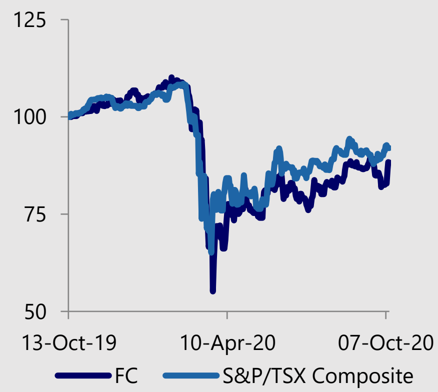
October 12, 2020

Stock Rating	HOLD
Price Target	CAD $13.18
Current Price	CAD $12.39

Bear Case	Price Target	Bull Case
$11.59	$13.18	$14.79

Ticker	FC
Market Cap. (MM)	$355.6
Dividend Yield	8.1%
P / TBV	1.12x

52 Week Performance



Firm Capital Mortgage Investment Corp

Standing Firm

Firm Capital Mortgage Investment Corporation (TSX:FC) ("FC" or "Firm Capital") is a mortgage investment corporation under the Income Tax Act and provides residential and commercial real estate financing.

Through a conservative underwriting philosophy and an experienced management team, the corporation has never had a loan loss and has been excellent at protecting shareholders' capital in a variety of market environments.

Due to a larger market sell-off, the corporation's share price has declined approximately 15% since the start of the fiscal year. We view this decline as overly punitive given the impact the pandemic is likely to have on its profitability

Given that the corporation must payout 100% of its earnings due to the relevant tax provisions, we chose to value the corporation as a perpetuity. We understood that return on equity was greater than its cost of equity. As a result, it should trade above 1.00x for P / TBV. We believe the corporation's fair value is around 1.15x P / TBV based on historical trends.

Through our analysis, we believe that Firm Capital offers a mediocre risk-adjusted return and will continue to monitor the equity.

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Company Overview

Business Overview and History

Firm Capital is a boutique non-bank lender serving primarily the GTA. As a mortgage investment corporation, it focuses on being a provider of short term real estate finance. It focuses on loaning to under-serviced markets segments to maximize yield and avoid competition from the big 5 Canadian banks. Firm Capital generates interest, fees, and income from its investments, and can therefore offer a stable dividend to shareholders. Its dividend consists of monthly payments of $0.078, and includes a "yearly top up" at year end, ranging from $0.108 to $0.148 in the past five years.

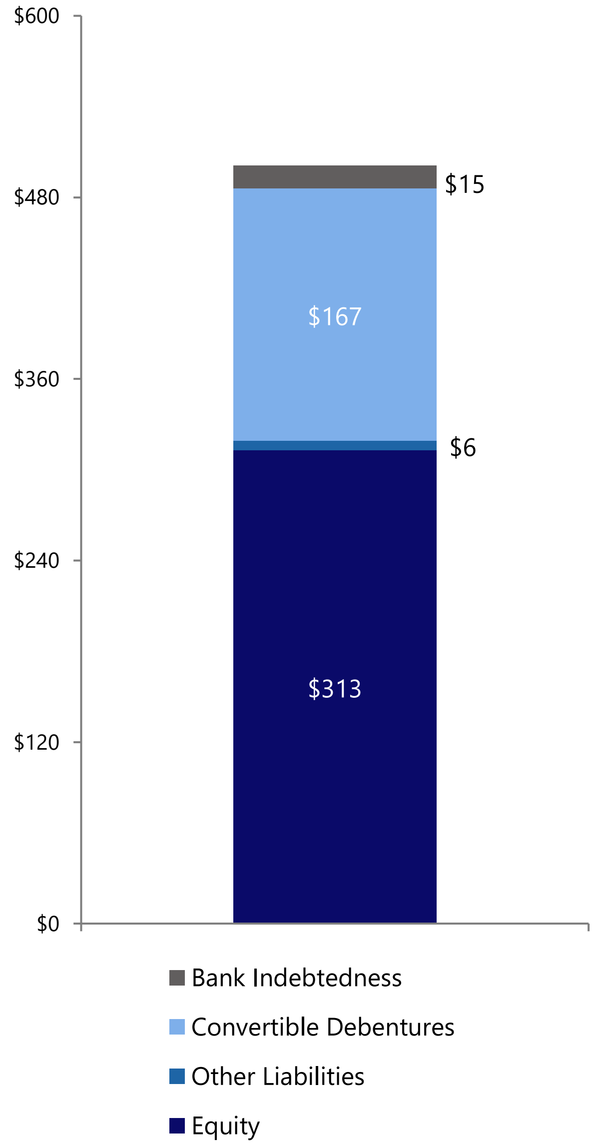
Firm Capital was incorporated 32 years ago in 1988 in Toronto, Ontario. It was founded with the initial vison to invest with discipline and preserve capital, which it still follows to date. Since 1988, Firm Capital has since grown its mortgage portfolio to over $521M. 11 years after incorporating, Firm Capital went public with a $24M IPO, issuing 2.4M shares for $10 per share. The proceeds were then used to acquire an initial portfolio of 77 mortgages. Since 2010 it has grown its mortgage portfolio by 250%, and has accessed the capital market 15 times including equity and convertible options. In the same period, Firm Capital has maintained yearly transaction volumes of over $500M, and is on pace to continue this volume in 2020 despite COVID-19.

Niche Market Provides Pricing Power

Firm Capital serves the GTA's residential development market. Operating within this niche confers a high degree of pricing power, as the Big 5 Canadian banks typically prefer to fund larger projects executed by large, well-established developers. Firm Capital is thus able to charge rates significantly higher than a typical mortgage. The weighted average interest rate of its mortgage portfolio as of Q2 2020 was 8.15%. Its portfolio consists of 182 investments as of Q2 2020, of which approximately 90% are maturing by the end of 2021. Almost all Firm Capital's revenue is derived from the interest payments.

EXHIBIT I

Capital Stack ($MM)



Source(s): Company Filings

Company Overview

Risk Mitigation

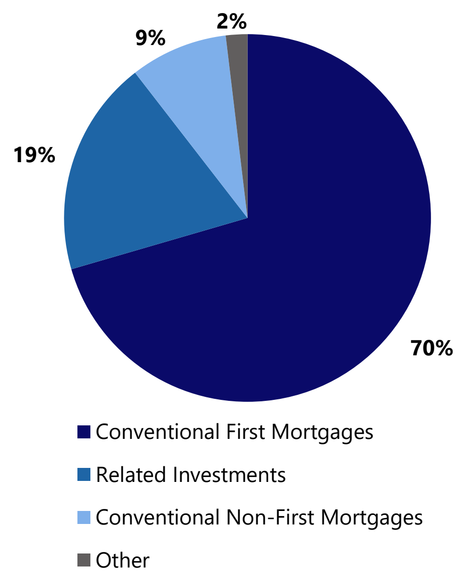
Firm Capital employs several risk mitigation strategies. For example, loans over $2,000,000 must receive approval from at least three senior executives. The Company has a conservative underwriting philosophy with restrictions on portfolio concentration and has limits on the maximum loan-to-value (LTV) it is willing to lend to (75%).

Management ensures that they would be content to own the assets they lend to, should they be required to foreclose on the property. This attitude is reinforced through management's policy of frequent co-investment in the MIC's loans. For example, management commits a 25% pari-passu investment in all non-conventional mortgages, further aligning their interests.

Over 70% of the Company's loans are conventional first mortgages. Other segments include conventional non-first mortgages, related investments, and others. These risk mitigation strategies have allowed Firm Capital to operate for over 30 years ***without experiencing a single loan loss***.

EXHIBIT II

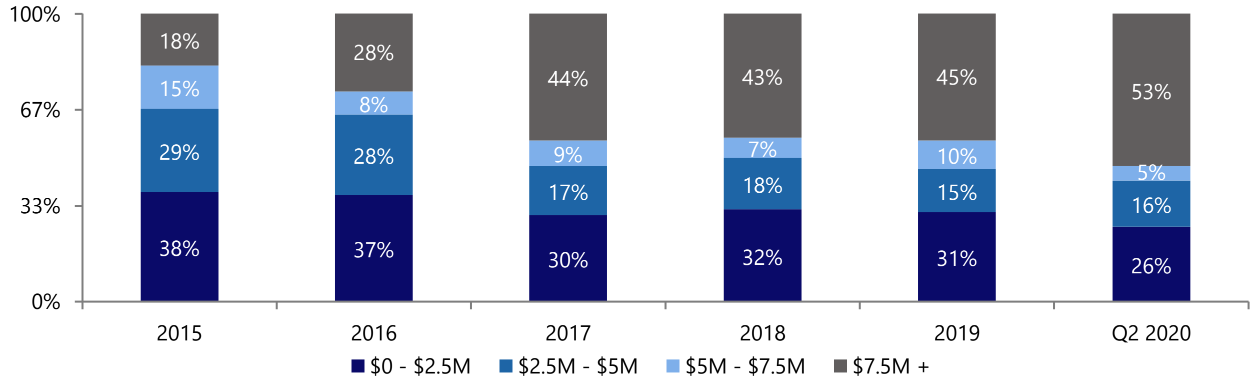
Loan Portfolio Breakdown by Loan Type



Source(s): Company Filings

EXHIBIT III

Historical Loan Book Breakdown by Value (%)



Source(s): Company Filings

Industry Overview: Mortgage Investment Corporations

Mortgage Market

The Canadian mortgage market can be divided into three broad categories, primarily separated by the degree of regulatory oversight. The first segment includes regulated lenders which is comprised of the big six banks, trust companies, credit unions, and caisses populaires. This is by far the largest segment accounting for 89% of the market in 2018. The second segment includes quasi-regulated lenders which includes mortgage finance corporations (MFCs). Most mortgages underwritten by an MFC are sold to federally regulated financial institutions (FRFIs) or securitized through the Canada Mortgage and Housing Corporation (CMHC). Since mortgage purchases by FRFIs and the CMHC must follow federal mortgage lending rules, MFCs are indirectly tied to the same regulations. This is the second largest segment accounting for 6% of the market in 2018.

Mortgage Investment Corporations (MICs)

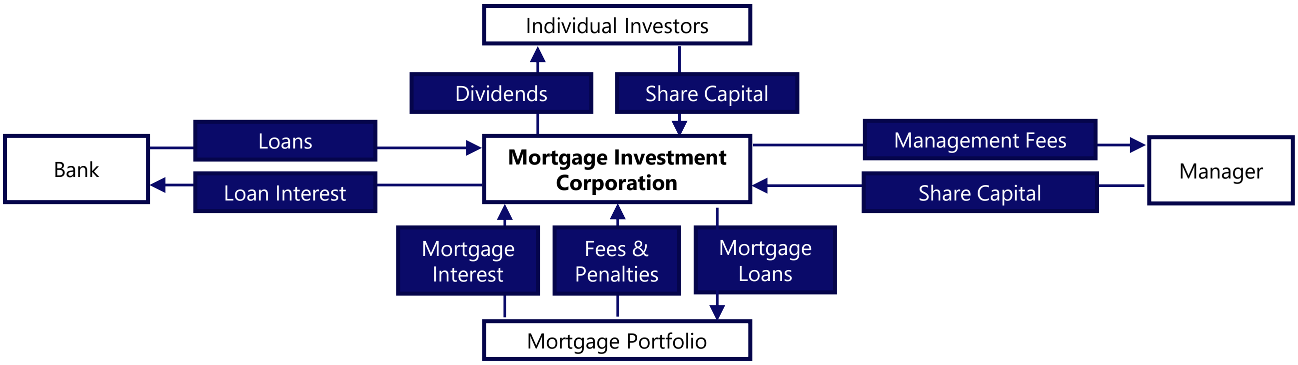
The last segment includes unregulated lenders which include MICs and other lenders. These corporations do not take deposits, and thus are not subject to federal regulations and oversight such as capital requirements or loan-to-value (LTV) limits. This segment is the smallest accounting for 1% of the market in 2018.

MICs were created in 1973 to increase the flow of mortgage funds and allow for niche investors to take part in the market. Under Canadian law, MIC lending is restricted to the financing of real property and at least 50% of its assets must be invested in residential mortgages or insured deposits. MICs pay no corporate taxes, as the corporations issue all earnings as dividends (Exhibit I). The Income Tax Act requires that MICs must have a debt-to-equity ratio between 3 and 5, depending on the percentage of assets invested in residential mortgages or insured deposits. MIC loans typically have LTVs ranging from 50% to 85%, creating protection against asset value declines. MICs provide short-term mortgages with terms ranging from 6 to 24 months. The short duration of loans creates protection against fluctuations in interest rates and asset values.

MICs provide mortgages to borrowers with a higher risk profile or in special situations – the corporations are able to capture a market that is not covered by traditional banks, allowing for higher rates in the range of 7% to 15%. The top MICs in Canada include Antrim, Firm Capital, Atrium, Timbercreek, MCAN, and Rompsen – however, there are many small players, with an estimated total of 200-300 MICs in Canada.

EXHIBIT IV

Structure of a Mortgage Investment Corporation



Source(s): Canada Mortgage and Housing Corporation

Industry Overview: Mortgage Investment Corporations

Growth in MICs

The Canadian MIC market has grown consistently since the financial crisis at nearly an 11% CAGR (Exhibit II), with an asset value of approximately $30 billion in 2019. The growth in the market was primarily driven by a steady increase in mortgage regulations from the government. In 2010, the government increased the minimum down payment for an uninsured mortgage to 10%. In 2011, the maximum amortization period was shortened from 35 years to 30 years. It was subsequently reduced to 25 years. In 2018, the government introduced a stress test which included a maximum 44% total debt ratio and maximum 32% of income going towards housing costs. These hurdles from the government fueled the rise in unregulated lending.

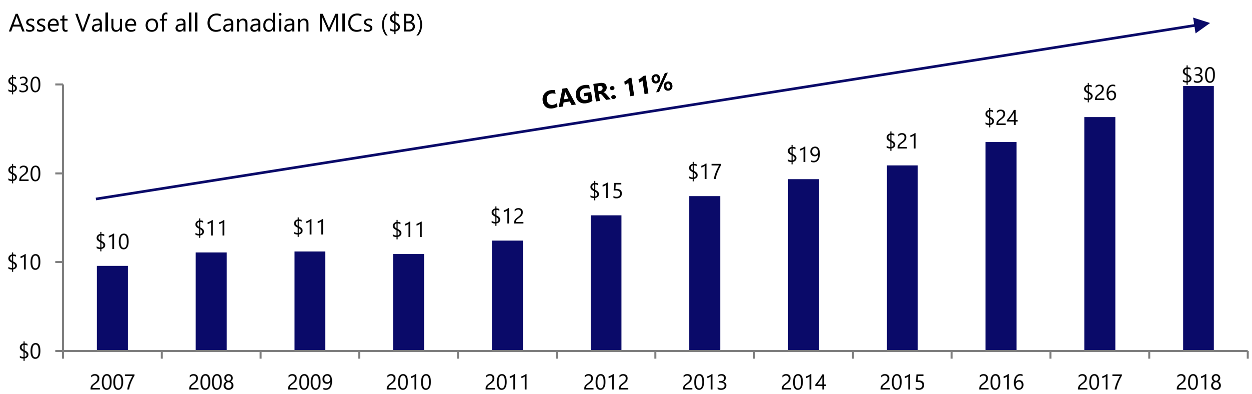
Risk Factors in the Industry

The delinquency rate for MICs is significantly higher than other regulated lending corporations. Banks, credit unions and caisses populaires, and MFCs had delinquency rates of 0.24%, 0.17%, and 0.25%, respectively, in 2018. Meanwhile, MICs had a delinquency rate of 1.93% in 2018. While this difference may seem insignificant, delinquency rates in recessionary periods can increase substantially. The skill with which the Company navigated the GFC, coupled with the unblemished loan loss record, give the Team confidence that this will not pose a substantial risk in the coming recession. Unregulated lending companies were severely impacted during the financial crisis and many went out of business entirely. As well, the big banks pulled back from extending mortgages to riskier customers or in special situations. The industry relies on short term credit to finance operations – the share of MIC mortgage originations is close to double the share of uninsured mortgage stock – this makes downturns in the economy particularly painful. This credit can become more expensive or dry up entirely if market conditions tighten. Another risk factor includes mortgage refinancing at lower rates. Given today's low rate environment and the potential for further cuts in Canada, it could encourage refinancing at more attractive rates.

In addition, the government is not very supportive of MICs, given the steep interest rates the corporations are able to charge. However, the MIC market is very small relative to the entire mortgage market, so government intervention is unlikely.

EXHIBIT V

Asset Value of all Canadian MICs ($B)



Source(s): Statistics Canada

Management Overview

Key Individuals

Eli Dadouch is the CEO, President, and Director at the corporation. He owns approximately 0.8% of the total shares outstanding (TSO). Jonathan Mair is the COO, Executive VP, and Director at the corporation. He owns approximately 0.28% of the TSO. Joseph Fried is a director and officer at the corporation. He owns approximately 0.16% of the TSO. Total insider ownership represents approximately 2.27% of the TSO.

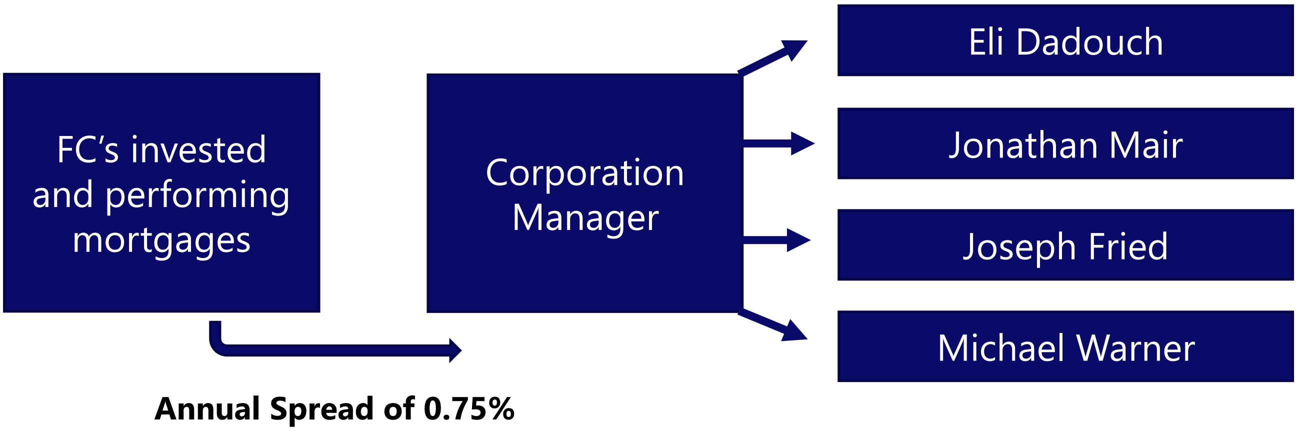
External Structure

Firm Capital does not pay compensation to or employ any of the executive officers, other than the credit manager, Victoria Granovski. She is responsible for operational work and reports directly to the Chairman of the board of directors. The corporation does not have a compensation committee, rather, the entire board of directions is responsible for compensation matters.

According to the Management Agreement, the Corporation Manager receives an annual amount of spread interest income equal to 0.75% of the total invested and performing mortgages (Exhibit III). For the years ended December 31, 2018, 2017 and 2016, the Corporation Manager received spread interest income equal to $3,932,134, $3,639,094 and $3,152,050, respectively. Joseph Fried and Michael Warner each own, directly or indirectly, 10% of the Corporation Manager. Eli Dadouch and Jonathan Mair, both of whom are directors or officers of the Corporation, are also directors, officers and/or are related to entities that directly or indirectly own an interest in the Corporation Manager. The other non-executive members, 10 in total, earn a fixed annual salary for their membership on the board of directors. In 2018, the total fixed salaries were $307,000. The reasonable salary expense, relatively high insider ownership, and strong track record gives us confidence in the corporation's management, despite the external structure.

EXHIBIT VI

Compensation Structure



Source(s): Statistics Canada

Valuation

As a qualified mortgage investment corporation under the Income Tax Act, FC must distribute 100% of its net Taxable Income to shareholders. This makes it difficult for the Company to retain earnings and grow its book value (intrinsic value) organically. Minor discrepancies between taxable income and IFRS net income and capitalization decisions have allowed the Company to compound its per share tangible book value at approximately 1.5% annually for the past 5 years. The impressive stability of the Company's ROE can be seen below in Exhibit XI. This stability is a result of the low levels of competition in the Company's core lending niche and its fanatical focus on risk management and capital preservation.

Due to the stability of the Company's book value per share, capital structure, cost of funds, mortgage pricing and payout policy, it is best thought of as a perpetuity. The stability of earnings, distribution payouts and the cost of funds makes the Company highly conducive to this valuation approach. This method is also supported by its conceptual (and mathematical) relationship with economic theory. It is well known that companies which earn returns on capital in excess of their cost of capital are worth more than the value of their capital (i.e. if ROE > CoE → P/B > 1). If the company exactly earns its cost of capital, it should be valued at "par", and so on. This relationship is derived (roughly) from the perpetuity formula, as shown below:

Equity Value = PV(Cash Flows to Equity)

= Earnings / Discount Factor

= [(ROE) x E x (1 + g)] / (CoE – g)

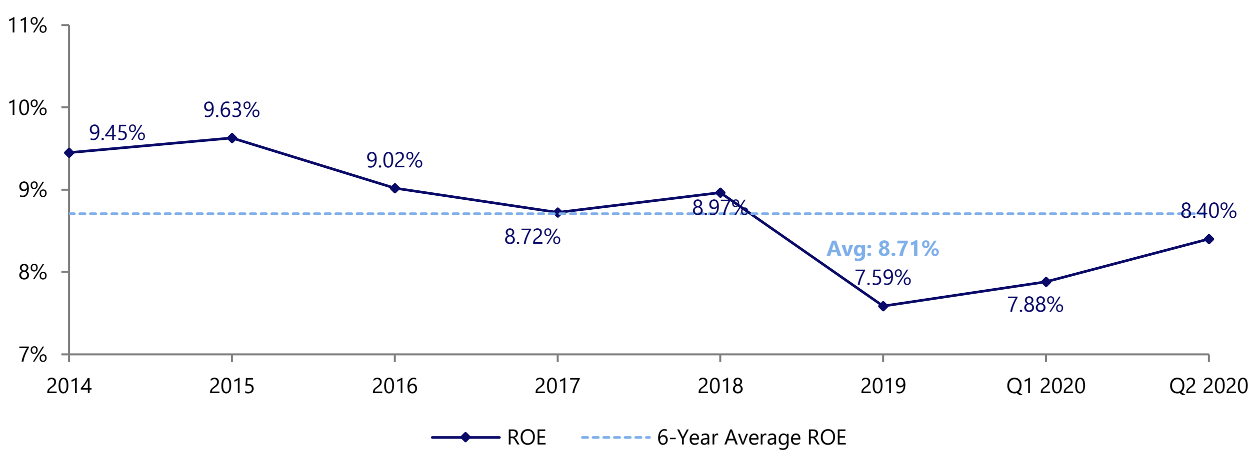
Because payout ratio = 100%, g = 0

= [(ROE) x E] / CoE

If ROE = CoE, the terms cancel, and the firm is worth the book value of its equity.

Exhibit VII

Historical ROE



Source(s): Company filings

Valuation

Based on this intuition, the FIG team believes that FC should trade closer to the low end of its long-term historical P/B ratio range of 1.2-1.3x. While the Company's ROC is likely to remain well above its WACC, the team believes that the current low interest rate environment is likely to persist, putting pressure on the Company's ROE. The Company's current financial position and P/B multiple, along with the returns implied by varying degrees of P/B mean reversion and the current yield, can be seen below in Exhibit VIII. The margin of safety provided by this price level is unattractive relative to the current FIG portfolio holdings.

Exhibit VIII

Summary Financials and Valuation Output

Market Value Balance Sheet	
Assets	
Cash and cash equivalents	$ 3,816,639
Amounts receivable and prepaid expenses	4,630,919
Marketable securities (FCD.UN; 219,586 shares)	1,185,764
Investment portfolio	517,449,491
Total assets	**527,082,813**
Liabilities	
Credit facility and bank indebtedness	39,363,612
Accounts payable and accrued liabilities	1,290,959
Deferred revenue	962,713
Shareholders' dividends payable	2,238,776
Loans payable	27,000,000
Convertible debentures	141,591,000
Total liabilities	**212,447,060**
Shareholders' Equity	
Total shareholders' equity	**314,635,753**
Total liabilities and shareholders' equity	**527,082,813**

Convertible Debentures

Ticker Symbol	Coupon	Issue Date	Maturity Date	Current Principal	Strike Price Per Share	Carrying Value
FC.DB.E	5.30%	Apr. 17, 2015	May. 31, 2022	$ 22,111,000	$13.95	$ 21,779,714
FC.DB.F	5.50%	Dec. 22, 2015	Dec. 31, 2022	$ 20,497,000	$14.00	$ 19,995,691
FC.DB.G	5.20%	Dec. 21, 2016	Dec. 31, 2023	$ 22,500,000	$15.25	$ 21,751,298
FC.DB.H	5.30%	Jun. 27, 2017	Aug. 31, 2024	$ 26,500,000	$15.25	$ 25,597,124
FC.DB.I	5.40%	Jun. 21, 2018	Jun. 30, 2025	$ 25,000,000	$15.00	$ 23,912,154
FC.DB.J	5.50%	Nov. 23, 2018	Jan. 31, 2026	$ 24,983,000	$14.60	$ 23,446,352
Total / Average	**5.37%**			**$ 141,591,000**		**$ 136,482,333**

Summary Output:	
FC Current Price	$11.58
Shares Out.	29,517,250
Market Cap.	$341,809,755
Book Value	$314,635,753
P/B	**1.09 x**
Bear Case Return (1.0x P/B) + Yield	**0.1%**
Base Case Return (1.15x P/B) + Yield	**13.9%**
Bull Case Return (1.3x P/B) + Yield	**27.7%**

Source(s): Company filings, S&P Capital IQ (for market value of FCD.UN stake)

References

1. Canada Mortgage and Housing Corporation
2. Company filings
3. Google Images
4. S&P Capital IQ
5. Statistics Canada