Fundamental Research Corp.
Investment Analysis for Intelligent Investors

April 18, 2023

Frontenac Mortgage Investment Corp.

Expecting Yield to Rise to Highest Level Since 2011

Expected Yield (2023): 6.6%
Rating*: 2-
Risk*: 2

Sector / Industry: Mortgage Investment Corporations

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Highlights

- **In 2022, Frontenac yielded 6.02% (beating our estimate by 72 bps)** vs 5.53% in 2021.
- At the end of 2022, mortgage receivables were $217M (**the highest in Frontenac's history**), up 18% YoY.
- Frontenac remains focused on first mortgages on residential properties in Ontario. Since our previous report in December 2021, the MIC has **started allowing redemptions** once a quarter (previously once a year). In addition, the MIC has retained MNP to generate monthly audited reports, reviewing the fund's NAV, and fair value of mortgages. **We view these initiatives as attractive risk-mitigating features for investors.**
- We believe alternative lenders, such as Frontenac, **should be able to continue to grow their loan portfolios**, amid lower repayments and new loan requests from borrowers unable to qualify with traditional lenders.
- That said, we are expecting defaults and foreclosures to rise, as rates are likely to remain relatively high this year. At the end of 2022, Frontenac had 0.95% in loan loss allowances. **We are modelling significant YoY increases in loan loss allowances for all of the lenders under our coverage**. Banks and conventional lenders had raised their allowances by 100%-200% during past recessions.
- Residential real estate prices in Ontario are up 0.3% MoM, but down 19% YoY. Consensus estimates indicate that prices could fall another 5% this year, before climbing back. **We believe Frontenac's low LTV (<60%) puts them in a comfortable position.**
- **We are projecting a yield of 6.6%** in 2023, up from 6.0% in 2022.

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Head of Research

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Equity Analyst

Offering Summary	
Issuer	Frontenac Mortgage Investment Corporation
Securities Offered	Common Shares (Voting Rights)
Unit Price	NAV
Minimum Subscription	$5,000
Distribution to Investors	Monthly
Redemption	Quarterly
Management/Admin Fee	Management Fee: 1% of AUM + Administration Fee: 1% of AUM
Sales Commissions	N/A
Auditor	MNP LLP

*Unlike most private MICs, Frontenac offers voting rights to holders of common shares
*Shares are offered by a prospectus instead of an offering memorandum, which we believe provides more transparency and regulatory oversight

Financial Summary	2019	2020	2021	2022	2023E	2024E
Mortgage Receivables (net)	$173,315,185	$160,810,418	$183,318,440	$216,933,310	$230,000,000	$250,000,000
Debt as % of Mortgage Outstanding	6.5%	0.0%	0.0%	10.7%	5.2%	5.0%
Revenues	$15,810,099	$15,086,513	$15,671,183	$19,571,337	$22,905,332	$24,000,000
Net Income	$9,656,983	$9,136,321	$10,402,243	$12,251,460	$14,232,897	$15,382,924
Investors' Returns (% of Invested Capital)	5.1%	5.2%	5.5%	6.0%	6.6%	6.5%

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

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

We believe Frontenac has a relatively low risk-profile and yield, due to higher exposure to first mortgages

The MIC does not use leverage to enhance returns

Focused primarily on rural and small to mid-sized cities in ON

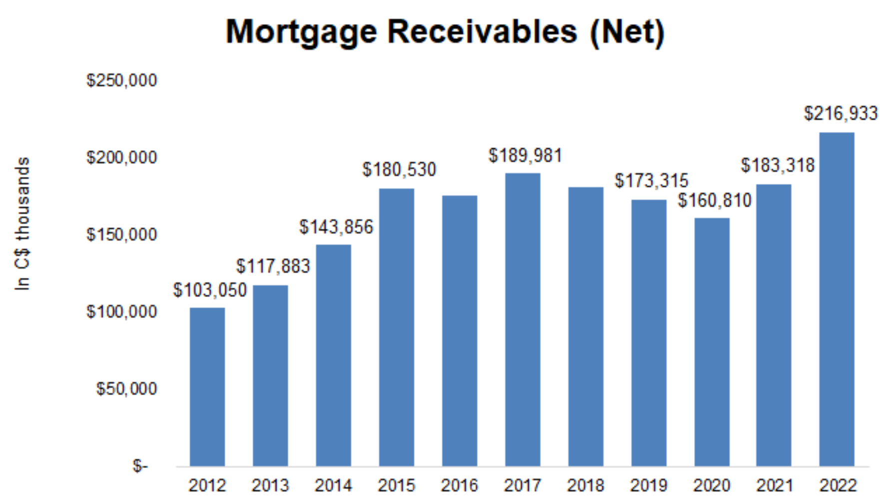
	Frontenac	Average
First Mortgage	99.9%	84%
B.C.	0%	41%
ON	100%	44%
AB	0%	6%
Others	0%	9%
LTV	<60%	58%
Yield (2022)	6.0%	7.0%
Debt to Capital	10%	25%
Average Loan Size	$517,657	$557,231
Actual Loss	0.0%	2.6%
Provision	1.0%	0.6%

Source: FRC / Various

Portfolio Update

Mortgage receivables were up 18% YoY, to $217M by the end of 2022 vs our estimate of $210M

In 2022, originations increased by 36%, and repayments increased by 29%



Source: Company / FRC

The average mortgage size was up 21% YoY

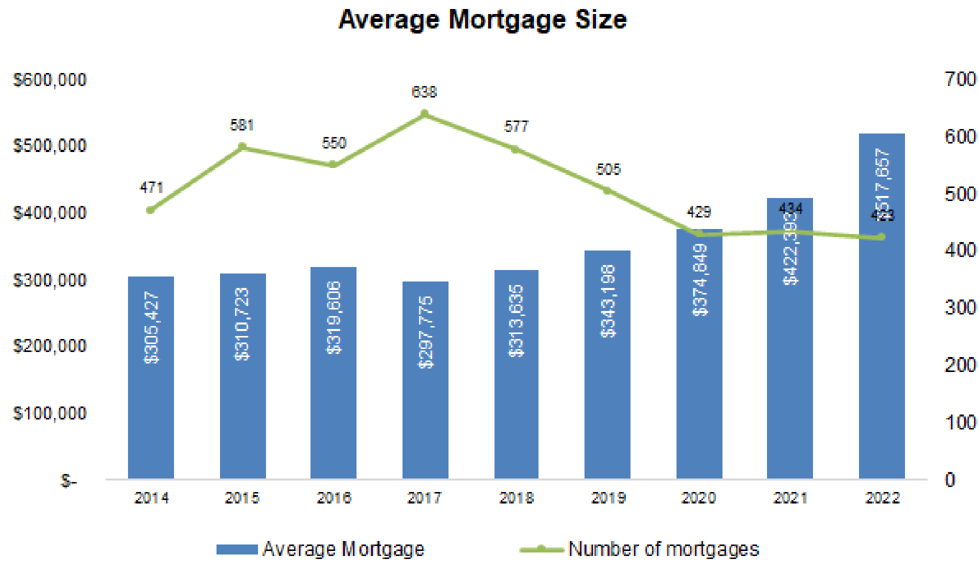
Remains focused on first mortgages, implying management's low risk tolerance

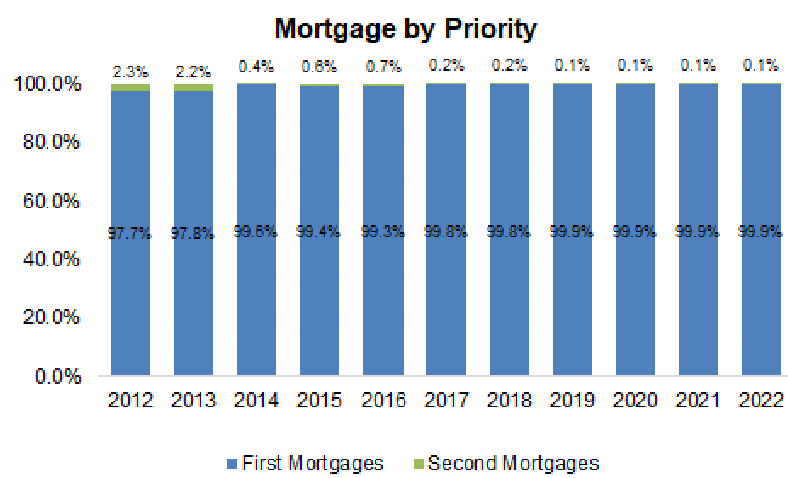
Exposure to residential properties remained close to 90%

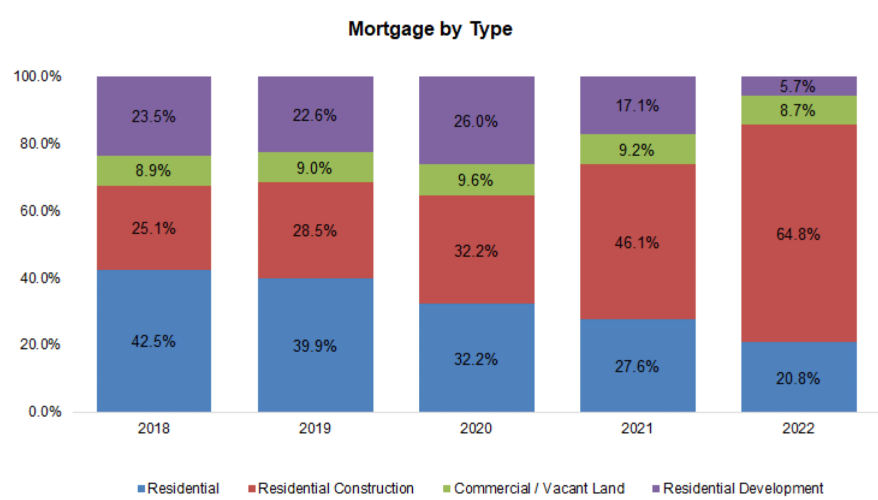
The portfolio is dominated by construction mortgages, which primarily includes loans to individuals constructing single-family units, with plans to refinance with a conventional lender upon completing construction

Exposure to construction mortgages increased, by lowering exposure to already-built properties (a low-risk segment), and development properties (a high-risk segment)

Management believes they have lowered the portfolio's risk profile by focusing on higher-quality collateral, and borrowers with higher credit scores



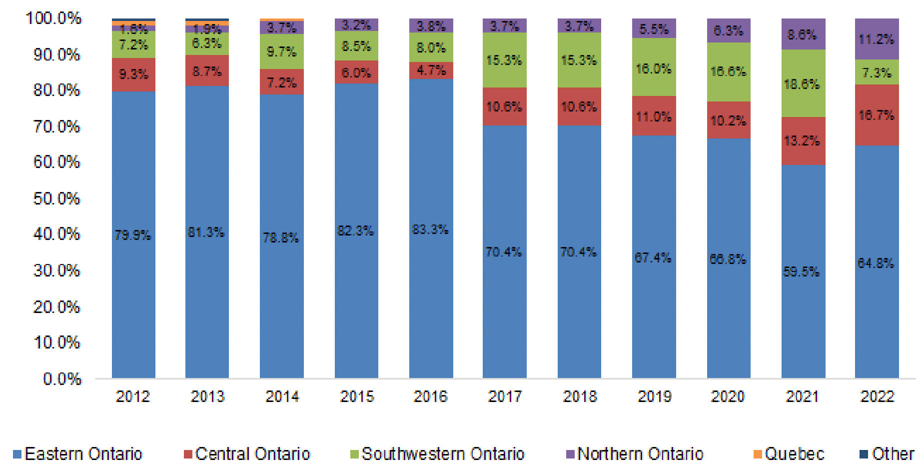




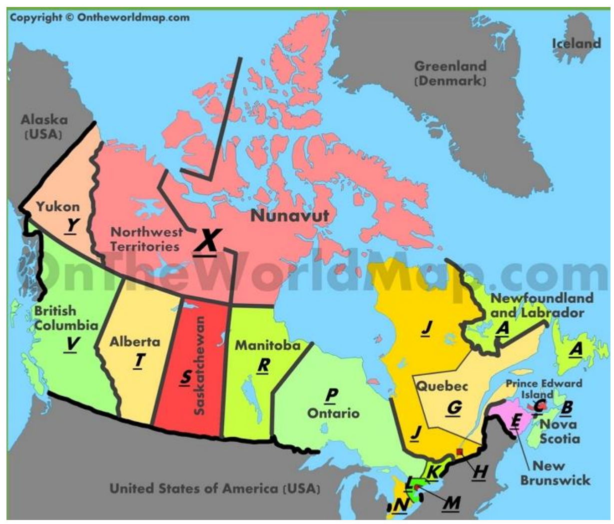
Source: Company / FRC

Frontenac continues to avoid highly competitive large urban centres, and remains focused on rural and small to mid-sized cities in ON

Mortgage by Geographical Mix

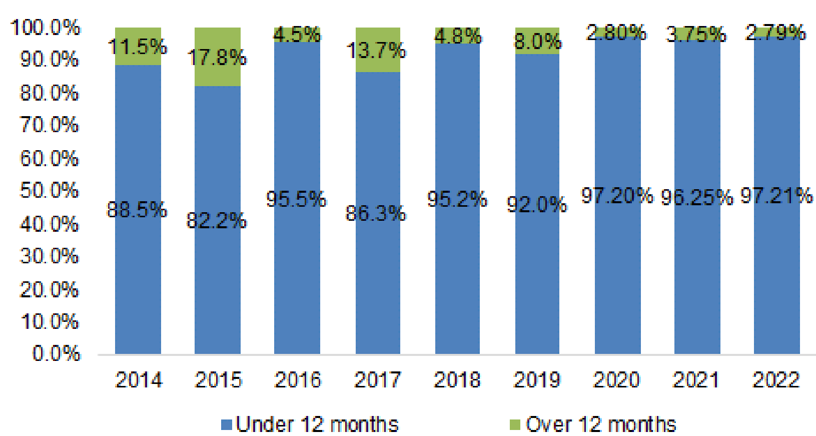


Focused on areas with postal codes starting with K, N, L, and P



Duration decreased, implying lower risk

Mortgage by Duration



Source: Company / FRC

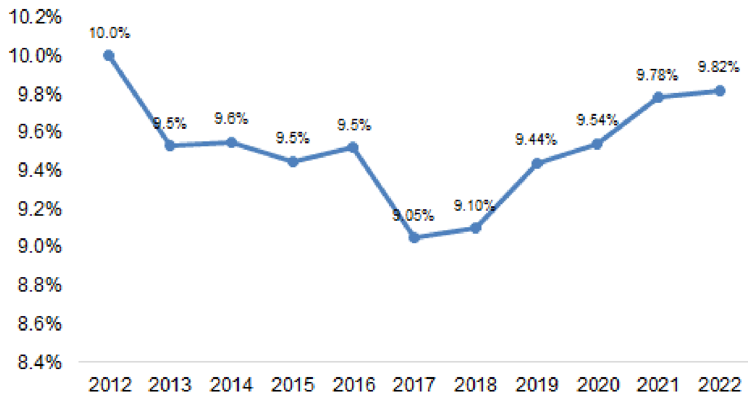
Lending rates increased

Management expects lending rates to average 11% p.a. this year

No realized losses in 2022

Impaired mortgages increased significantly (1.5% to 6.7% of total mortgages), as four mortgages (totaling $13.6M) associated with a large development project became impaired; management is working with the borrower to recover these loans

Weighted Average Lending Rate



	2019	2020	2021	2022
Actual Losses	1,238,987	572,776	3,061,946	-
Actual Losses (% of mortgage receivable)	0.70%	0.34%	1.78%	0.00%
Distributions	$9,656,983	$9,136,319	$10,402,243	$12,251,460
Reinvested	$5,767,877	$4,314,616	$3,907,184	$6,230,020
Reinvested (as a % of Distributions)	60%	47%	38%	51%
Redemptions	$34,873,262	$20,450,731	$11,216,252	$55,441,719
Redemption (% of invested capital)	20%	12%	6%	27%
Stage 3	$18,155,907	$17,060,635	$2,672,805	$14,484,975
% of Receivable	10.48%	10.61%	1.46%	6.68%
Loan Loss Provision	$1,292,201	$1,071,835	$249,018	$1,148,185
Loan loss allowance (year/quarter ended)	$3,148,902	$3,647,961	$835,033	$2,052,661
Allowance % of Receivable	1.82%	2.27%	0.46%	0.95%

Past Due / Not Impaired	2017	2018	2019	2020	2021	2022
1 - 30 days	$2,658,036	$2,794,179	$2,603,431	$2,522,035	$0	$398,952
31 - 90 days	$525,474	$1,224,841	$2,258,383	$672,774	$0	$199,443
90+ days	$5,871,121	$808,907	$789,817	$2,688,880	$56,815	$56,815
Total	**$9,054,631**	**$4,827,927**	**$5,651,631**	**$5,883,689**	**$56,815**	**$655,210**

Past Due / Not Impaired as a % of Mortgage Receivable	2017	2018	2019	2020	2021	2022
1 - 30 days	1.40%	1.54%	1.50%	1.57%	0.00%	0.18%
31 - 90 days	0.28%	0.68%	1.30%	0.42%	0.00%	0.09%
90+ days	3.09%	0.45%	0.46%	1.67%	0.03%	0.03%
Total	**4.77%**	**2.67%**	**3.26%**	**3.66%**	**0.03%**	**0.30%**

Past Due and Impaired	2017	2018	2019	2020	2021	2022
#	24	27	16	9	5	10
Amount	$7,930,370	$22,043,064	$18,155,907	$17,060,636	$2,672,805	$14,484,975
% of Mortgage Recivable	4.2%	12.2%	10.5%	10.6%	1.5%	6.7%
FV of Collateral	$9,524,000	$29,443,500	$21,317,000	$21,026,722	$3,475,000	$19,329,000
LTV	83.3%	74.9%	85.2%	81.1%	76.9%	74.9%
Past Due and Impaired	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Commercial		$537,996	-	-	-	-
Residential		$3,615,332	$2,635,674	$3,012,161	$2,477,966	$848,243
Residential Construction		$813,584	$339,699	$148,790	-	-
Residential Development		$16,142,873	$14,475,541	$13,713,369	-	$13,636,732
Vacant Land		$933,278	$704,993	$186,315	$194,839	-
		$22,043,063	**$18,155,907**	**$17,060,635**	**$2,672,805**	**$14,484,975**
Total Past Due or Impaired	$16,985,001	$26,870,991	$23,807,538	$22,944,325	$2,729,620	$15,140,185
% of Mortgage Recivable	8.9%	14.8%	13.7%	14.3%	1.5%	7.0%

Source: Company / FRC

Due to higher originations, debt to capital increased, but remain below that of comparable MICs (15%-25%)

We note that management uses leverage to fund working capital/redemptions, and not to enhance yields

Management expects debt/capital to be <5% going forward

Balance Sheet	2017	2018	2019	2020	2021	2022
Assets						
Cash	$0	$45,324	$56,779	$1,142,552	$14,114,425	$122,558
Due from Administrator in Trust	$574,788	$120,053	$658,402	$73,878	$6,275	$1,436,778
Interest Receivable	$10,251,803	$11,194,987	$12,240,090	$10,257,696	$6,080,966	$7,268,932
Prepaid Expense	$16,200	$16,200	$16,200	$16,200	$30,427	$57,944
Mortgage Investments (net)	$189,980,578	$180,967,671	$173,315,185	$160,810,418	$183,318,440	$216,933,310
	$200,823,369	**$192,344,235**	**$186,286,656**	**$172,300,744**	**$203,550,533**	**$225,819,522**
Liabilities						
LOC	$16,659,627	$13,880,000	$11,330,000	-	-	$23,210,000
Payable	$621,514	$508,161	$324,490	$611,993	$748,350	$768,642
Prepaid Mortgage Payments	$316,111	$168,609	$101,614	$47,279	$83,777	$121,450
	$17,597,252	$14,556,770	$11,756,104	$659,272	$832,127	$24,100,092
Net Asset	$183,226,117	$177,787,465	$174,530,552	$171,641,472	$202,718,406	$201,719,430
SE + Liabilities	**$200,823,369**	**$192,344,235**	**$186,286,656**	**$172,300,744**	**$203,550,533**	**$225,819,522**
Debt to Capital	8.3%	7.2%	6.1%	0.0%	0.0%	10.3%
Debt as a % of Mortgage Outstanding	8.8%	7.7%	6.5%	0.0%	0.0%	10.7%
Interest Coverage Ratio	154.5	17.0	78.4	105.3	13085.6	25.8

Source: Company / FRC

In summary, we believe the portfolio's risk profile has increased due higher impaired mortgages

That said, we believe Frontenac maintains a relatively low-risk portfolio, due to its focus on first mortgages, and low debt-levels

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

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

Source: FRC

Key Updates

Management and board own 0.8% of outstanding shares

The MIC has a fully independent board

Started allowing redemptions once a quarter (previously once a year)

In addition, the MIC has retained MNP to provide monthly audited reports, reviewing the fund's NAV, and fair value of its mortgages; we view this as a risk-mitigating feature, and note that most MICs prepare audited reports annually, and not monthly

Management	Position	Shares Held	% of Total (MIC)
Matthew Robinson	CEO	27,150	0.400%
Dan Komorowski	CFO	2,482	0.037%
Gord Ross	Chief Sales Officer	4,868	0.072%
Agostino Tuzi	VP Pillar Financial	-	-
Amber Kehoe	CCO	165	0.002%
Debra Smith	Head of Culture and Talent	3,872	0.057%
Board of Directors			
Jody Becker	Board Chair	1,139	0.017%
Robert Barnes	Director	13,161	0.194%
Eric Dinelle	Director	2,212	0.033%
Ryan Seeds	Audit Committee Chair	1,223	0.018%
Meghan Davis	Director	271	0.004%
Allison Martin	Director	167	0.002%
Alex de Korte	Governance & Nominating Committee Chair	542	0.008%
Ryan Wykes	Director	7	0.000%
Total		**57,260**	**0.84%**

Source: Company

Financials

2022 revenue grew 25% YoY, while net income was up 18% on higher rates and mortgage receivables

Revenue beat our estimate by 15%; net income beat by 11%

Income Statement	2017	2018	2019	2020	2021	2022	YoY
Revenues							
Interest Income	$16,178,501	$18,134,892	$15,810,099	$15,086,513	$15,671,183	$19,571,337	
	$16,178,501	**$18,134,892**	**$15,810,099**	**$15,086,513**	**$15,671,183**	**$19,571,337**	**25%**
Expenses							
G&A	$730,422	$747,488	$618,686	$910,688	$886,073	$1,020,011	
Management Fees	$4,229,612	$4,608,592	$4,117,383	$3,880,095	$4,133,054	$4,657,149	
Loan Loss Provision	$2,817,427	$738,184	$1,292,201	$1,071,835	$249,018	$1,148,185	
Interest on Loan Payable	$54,372	$707,639	$124,846	$87,574	$795	$494,532	
	$7,831,833	**$6,801,903**	**$6,153,116**	**$5,950,192**	**$5,268,940**	**$7,319,877**	**39%**
Net Income	**$8,346,668**	**$11,332,989**	**$9,656,983**	**$9,136,321**	**$10,402,243**	**$12,251,460**	**18%**
Dividends	$9,362,668	$10,207,989	$9,656,983	$9,136,319	$10,402,243	$12,251,460	**18%**
Net Asset Value	$29.83	$30.00	$30.00	$30.00	$30.00	$30.00	**0%**
Shares Outstanding	6,141,401	5,926,249	5,817,686	5,721,384	6,757,281	6,723,982	**0%**

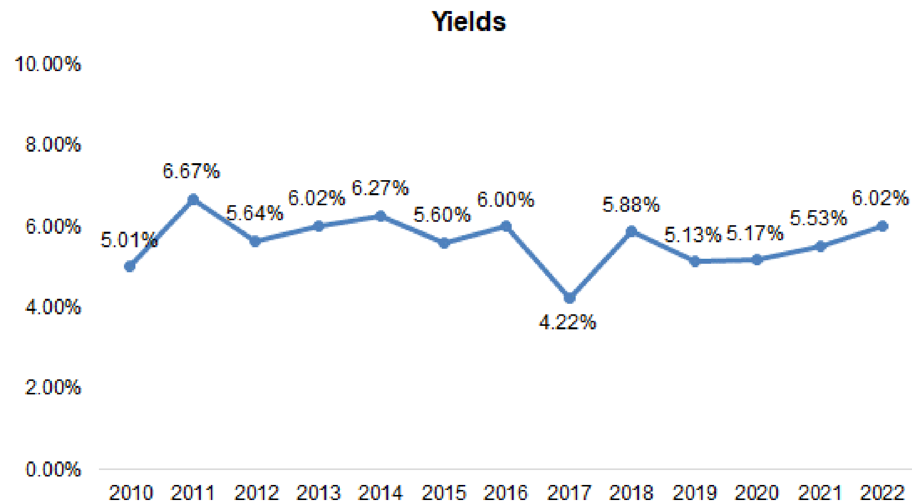
Source: Company / FRC

Net income as a percentage of invested capital increased by 50 bps

% of Mortgage Receivable	2017	2018	2019	2020	2021	2022
Interest Income	8.85%	9.78%	8.93%	9.03%	9.11%	9.78%
Interest Income + Others	**8.85%**	**9.78%**	**8.93%**	**9.03%**	**9.11%**	**9.78%**
Less:						
Management Fee	-2.31%	-2.48%	-2.32%	-2.32%	-2.40%	-2.33%
G&A Expenses	-0.40%	-0.40%	-0.35%	-0.55%	-0.51%	-0.51%
Loan Loss Provisions	-1.54%	-0.40%	-0.73%	-0.64%	-0.14%	-0.57%
Interest	-0.03%	-0.38%	-0.07%	-0.05%	0.00%	-0.25%
Net	**4.56%**	**6.11%**	**5.45%**	**5.47%**	**6.05%**	**6.12%**
Investors' Returns (% of Invested Capital)	**4.98%**	**5.64%**	**5.48%**	**5.28%**	**5.56%**	**6.06%**

Note that the above figures may be slightly different from the figures reported by Frontenac 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.

The yield increased to 6.02% in 2022, up from 5.53% in 2021



Source: Company / FRC

FRC Projections and Rating

Our forecasts are conservative as we are assuming loan loss allowances to double over the next 24 months

Key Financials /YE: Dec 31st	2022	2023E (Introducing)	2024E (Introducing)
Mortgage Receivables	$216,933,310	$230,000,000	$250,000,000
Revenue	$19,571,337	$22,905,332	$24,000,000
Net Profit	$12,251,460	$14,232,897	$15,382,924
Dividend Yield	6.0%	6.6%	6.5%

Source: FRC

Our estimate for the 2023 yield varies between 6.1% and 7.2%, using various increases in loan loss allowances

% Increase in Loan Loss Allowances	FY2023 Yield
0.0%	7.15%
50.0%	6.90%
100.0%	6.64%
150.0%	6.39%
200.0%	6.14%

Source: FRC

We are reiterating our overall rating of 2-, and risk rating of 2. We believe Frontenac's most appealing feature is that its portfolio has a relatively low-risk profile, driven by a high percentage of low-LTV/first mortgages, and limited use of debt. **We are expecting the yield to increase by 60 bps this year**. Key sector risks include a softer mortgage origination market, and higher default rates.

FRC Rating	
Expected Yield (2023)	6.64%
Rating	2-
Risk	2

Risks

We believe the MIC is exposed to the following key risks (not exhaustive):

- Concentration risk - 100% of its mortgages are in ON
- **Lower housing prices will result in higher LTVs**
- A downturn in the real estate sector may impact the company's deal flow
- Shareholders' principal and distributions are not guaranteed
- Reinvestment
- **Default rates can rise during recession**

APPENDIX

Income Statement	2021	2022	2023E	2024E
Revenues				
Interest Income	$15,671,183	$19,571,337	$22,905,332	$24,000,000
	$15,671,183	**$19,571,337**	**$22,905,332**	**$24,000,000**
Expenses				
G&A	$886,073	$1,020,011	$1,138,975	$1,223,243
Management Fees	$4,133,054	$4,657,149	$5,300,985	$5,693,182
Loan Loss Provision	$249,018	$1,148,185	$1,088,150	$1,088,150
Interest on Loan Payable	$795	$494,532	$1,144,325	$612,500
	$5,268,940	**$7,319,877**	**$8,672,435**	**$8,617,076**
Net Income	**$10,402,243**	**$12,251,460**	**$14,232,897**	**$15,382,924**
Dividends	$10,402,243	$12,251,460	$14,232,897	$15,382,924
Net Asset Value	$30.00	$30.00	$30.00	$30.00
Shares Outstanding	6,757,281	6,723,982	7,557,315	8,223,982

Balance Sheet	2021	2022	2023E	2024E
Assets				
Cash	$14,114,425	$122,558	$452,190	$538,828
Due from Administrator in Trust	$6,275	$1,436,778	$1,508,617	$1,584,048
Interest Receivable	$6,080,966	$7,268,932	$7,632,379	$8,013,998
Prepaid Expense	$30,427	$57,944	$60,841	$63,883
Mortgage Investments (net)	$183,318,440	$216,933,310	$230,000,000	$250,000,000
	$203,550,533	**$225,819,522**	**$239,654,027**	**$260,200,756**
Liabilities				
LOC	-	$23,210,000	$12,000,000	$12,500,000
Payable	$748,350	$768,642	$807,074	$847,428
Prepaid Mortgage Payments	$83,777	$121,450	$127,523	$133,899
	$832,127	$24,100,092	$12,934,597	$13,481,326
Net Asset	$202,718,406	$201,719,430	$226,719,430	$246,719,430
SE + Liabilities	**$203,550,533**	**$225,819,522**	**$239,654,027**	**$260,200,756**
Debt to Capital	0.0%	10.3%	5.0%	4.8%
Debt as a % of Mortgage Outstanding	0.0%	10.7%	5.2%	5.0%
Interest Coverage Ratio	13085.6	25.8	13.4	26.1

Cash Flow Statement	2022	2023E	2024E
Operating Activities			
Net Income	$12,251,460	$14,232,897	$15,382,924
Loan Loss Provision	$1,148,185		
	$13,399,645	$14,232,897	$15,382,924
Changes in non-cash Working Capital			
Accounts Receivable	-	-$363,447	-$381,619
Accounts Payable and Accured Liabilities	$198,464	$44,505	$46,730
Interest Payable	-$1,187,966	-	-
Due from Administrator in Trust	-$1,430,503	-$71,839	-$75,431
Prepaid Expenses	-$27,517	-$2,897	-$3,042
	-$2,447,522	-$393,678	-$413,362
Cash from Operating Activities	**$10,952,123**	**$13,839,219**	**$14,969,562**
Investing Activities			
Net Puchase of Mortgage Investments	-$34,725,382	-$13,066,690	-$20,000,000
Cash from Investing Activities	**-$34,725,382**	**-$13,066,690**	**-$20,000,000**
Financing Activities			
Debt	$23,210,000	-$11,210,000	$500,000
Distribution	-	-$14,232,897	-$15,382,924
Equity	-$7,228,996	-	-
Cash Received on Subscription	-	$25,000,000	$20,000,000
Redemption	-	-	-
Dividends	-$6,199,612	-	-
Cash from Financing Activities	**$9,781,392**	**-$442,897**	**$5,117,076**

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			
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Rating - 2	31%	Risk - 2	10%
Rating - 3	46%	Risk - 3	39%
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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