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Analyst

Fundamental Research Corp.
Investment Analysis for Intelligent Investors

July 26, 2016

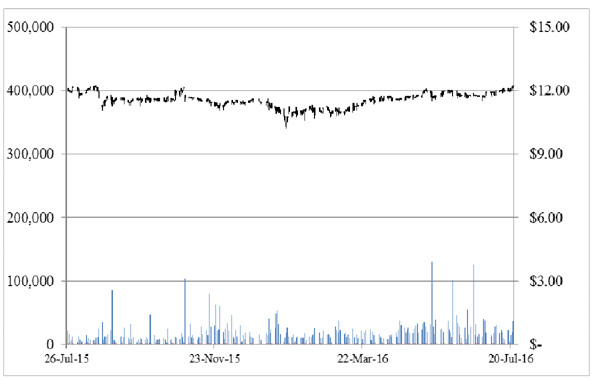
Atrium Mortgage Investment Corporation (TSX: AI) – Portfolio surpasses $500M

Sector/Industry: Mortgage Investment Corporation **www.atriummic.com**

Market Data (as of July 25, 2016)

Current Price	**C$12.25**
Fair Value	**C$12.90**
Rating*	**BUY**
Risk*	**2**
52 Week Range	C$10.22 - C$12.31
Shares O/S	26.97 million
Market Cap	C$330.43 million
Yield (forward)	7.8%
P/E (forward)	12.8x
P/B	1.2x
YoY change in share price	4.4%
YoY TSX	14.6%

**See back of report for rating and risk definitions*



Highlights

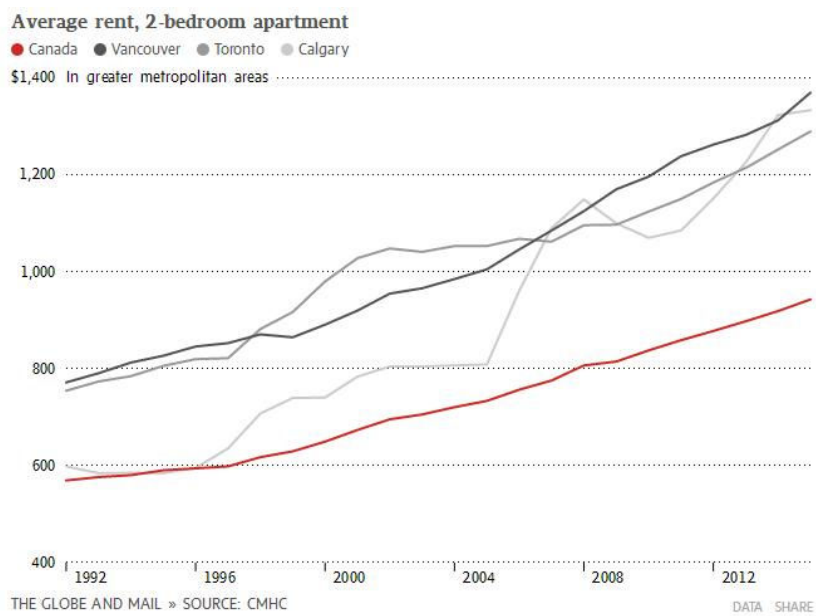
- Q2-2016 (quarter ended June 30, 2016) was another record quarter, with revenues up by 11% YOY to $10.69 million, and net income also up by 11% YOY to $6.43 million (EPS: $0.24).
- In Q2-2016, Atrium ("company", "Atrium", "AI") advanced $102 million mortgages (another record). At the end of Q2, the portfolio size was up 12% YTD from $452 million to $505 million.
- Continues to reduce exposure to Alberta, down from 12.7% of the total portfolio at the end of Q1, to 9.9% at the end of Q2.
- Portfolio remains healthy with first mortgages accounting for 80.2% of the portfolio at the end of Q2. The loan-to-value ("LTV") was 63.9% versus the historical average of 65%.
- AI's share price is up 6.1% from $11.55 to $12.25 per share since our previous update report in April 2016.
- The Vancouver and Toronto real estate markets remain strong. The B.C. government is adopting measures to curb foreign investment, which we believe is likely to result in a modest correction in prices. B.C. accounted for 16.7% of Atrium's portfolio at the end of Q2.
- We are raising our fair value estimate from $12.80 to $12.90 per share.

Key Financials (FYE - Dec 31) (C$)	**2014**	**2015**	**2016(F)**	**2017(F)**
Mortgage Receivables(net)	$ 432,757,000	$ 448,099,000	$ 499,351,238	$ 524,743,512
Cash	$ -	$ -	$ 0	$ 0
Revenues	$ 34,956,000	$ 40,206,000	$ 42,190,406	$ 46,125,000
Net Income	$ 21,037,000	$ 23,337,000	$ 25,718,480	$ 28,143,276
EPS	$ 0.91	$ 0.94	$ 0.96	$ 1.01
Dividends per Share	$ 0.89	$ 0.93	$ 0.96	$ 1.01

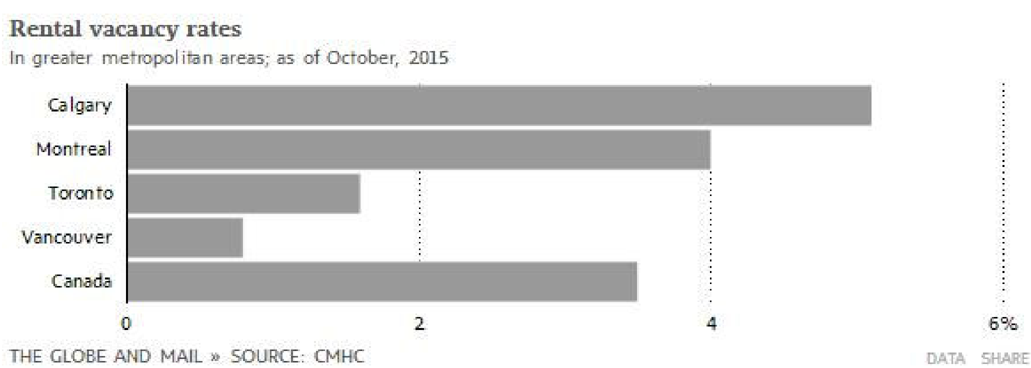
Vancouver Rental Market Remaining Strong and Tight

In our previous report, we discussed how the low interest rate environment and the weak C$, coupled with a persistent lack of inventory for single, semi and townhouses is keeping the Greater Toronto Area ("GTA") real estate market healthy. These same factors have also driving the Vancouver real estate market. Atrium has been gradually increasing its exposure to BC. At the end of June 30, 2016, the company had $84 million in loans, or 16.7% of the total portfolio, in BC.

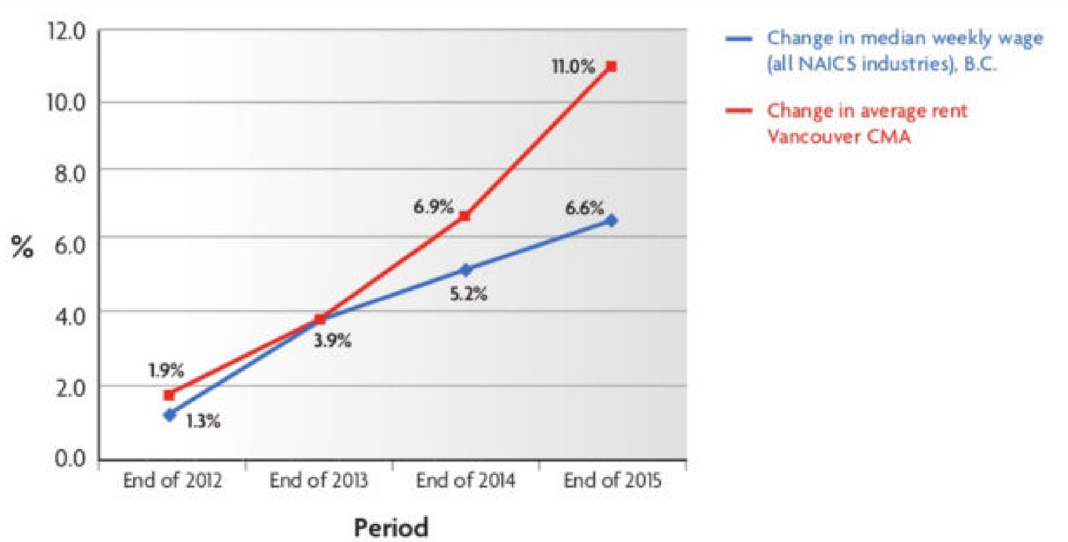
The strong housing prices and limited supply are also driving the rental market in Vancouver. The following chart shows the increase in rental rates in the city since 1992. At the end of 2015, the average rent for a 2-bedroom unit in Metro Vancouver was $1,368, well above the national average of $942.



The vacancy rate of rental units in the city are at historic lows. The following chart shows Vancouver's extremely low vacancies compared to other cities as of October 2015. **The current vacancy rate, as per the City of Vancouver, is approximately 0.6%.**



A recent report by Vancity Credit Union suggests that from 2011 to 2015, although the average rent increased by 11.4% in Metro Vancouver, weekly median wages only grew by 6.6% in B.C.

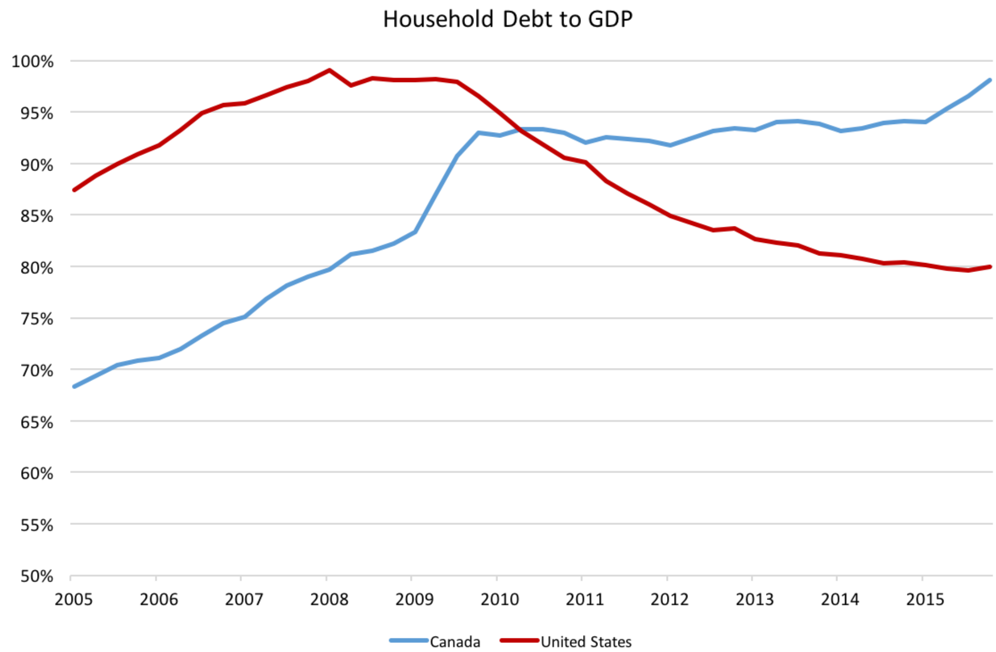


Source: Vancity Credit Union / CBC News

Rising rent is making Vancouver increasingly unaffordable, especially for younger and lower income households. Although the supply of purpose built rental units and condominiums have been increasing, they have not been able to meet demand so far. **We believe one of the key challenges of Vancouver is that over 80% of the existing rental units are more than 35 years old, and 26% are more than 55 years old. A lot of these older buildings are low rise buildings and do not maximize density. Another factor is that real estate developers are currently more focused on building condominium projects (instead of purpose built rental projects), which are a better option to quickly capitalize on the record housing prices in the city.**

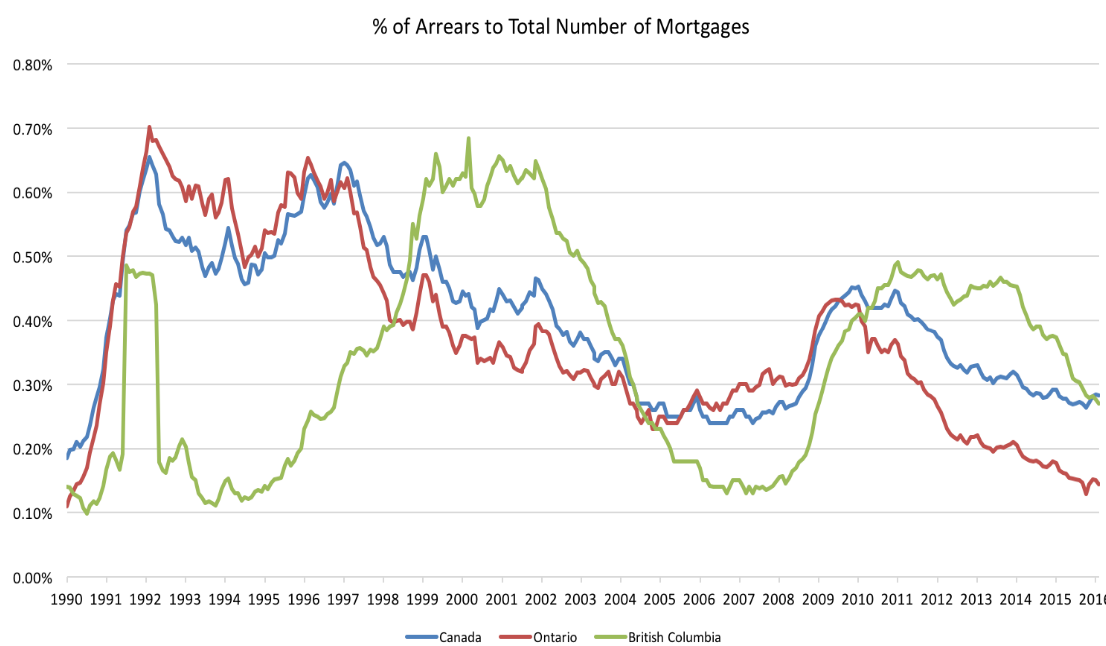
Vancouver's real estate market is highly influenced by foreign investment. The Bank of Canada estimates that Chinese investment accounts for $12.7 billion in real estate sales in Vancouver, representing 33% of the total sales. **Yesterday, the B.C. government introduced legislation to add a 15% property transfer tax on foreign nationals buying real estate in Metro Vancouver – a move, we believe, that is likely to curb foreign investment and eventually lead to a price correction. However, B.C. only accounts for 16.7% of the portfolio and the LTV is at 58%. Therefore, prices would have to fall over 40% for Atrium to realize losses. Moreover, AI has assigned a loan loss provision of $4.9 million.**

A potential area for concern surrounds Canada's rising levels of debt. As shown in the chart below, Canada's household debt to Gross Domestic Product ("GDP") has now approached the levels seen in the U.S. during the 2008-2009 recession.



Source: Federal Reserve Economic Data (FRED)

Despite rising levels of debt, mortgage arrears have been declining in recent years, as shown in the chart below. As of March 2016, approximately 0.27% of mortgages in BC were in arrears versus the national rate of 0.28%. The historic average (from 1990 to March 2016) of B.C. is 0.34%.



Source: Canadian Bankers Association

Vancouver's detached housing market is reasonably healthy in the near-term (due to low supply), and we do not expect a major correction. Immigration and foreign investment is expected to continue due to the city's global appeal, Canada's economic stability, and the weakness in the C$. However, we are **taking a more cautious approach to B.C. considering the government's new legislation and will monitor housing prices closely.**

Record Originations in Q2

In Q2-2016, Atrium advanced $102 million mortgages (up from $94 million in Q2-2015 and $60 million in Q1-2016). At the end of Q2, the portfolio size was up 12% YTD from $452 million to $505 million. Approximately $75 million of the mortgages originated in the quarter were new mortgages. 88% of the new loans were in Ontario (mostly GTA), and the rest were in British Columbia ("BC"). No new loans were funded in Alberta ("AB").

Q2s are historically a strong quarter for the company. In 2015, originations had dropped from $94 million in Q2 to $59 million in Q3. In a conference call, management indicated that Q2 was an exceptional quarter and that it is unlikely that they will be able to repeat such performance in Q3.

The portfolio's exposure to Alberta dropped again QOQ from $59 million (12.7% of the total) to $50 million (9.9% of the total). Management expects to bring their AB exposure down to approximately $40 million by the end of the year.

	June 30, 2016				
Location of underlying property	Number of mortgages	Outstanding amount	Percentage outstanding	Weighted average loan to value	Weighted average interest rate
(outstanding amounts in 000s)					
Greater Toronto Area	155	$ 349,005	69.1%	65.3%	8.54%
Non-GTA Ontario	14	9,855	1.9%	65.4%	9.25%
Saskatchewan	1	11,989	2.4%	71.1%	8.50%
Alberta	18	49,796	9.9%	62.5%	9.10%
British Columbia	11	84,340	16.7%	58.0%	8.48%
	199	$ 504,985	100.0%	63.9%	8.60%

	March 31, 2016				
Location of underlying property	Number of mortgages	Outstanding amount	Percentage outstanding	Weighted average loan to value	Weighted average interest rate
(outstanding amounts in 000s)					
Greater Toronto Area	155	$ 305,000	65.7%	63.6%	8.50%
Non-GTA Ontario	14	8,222	1.8%	66.8%	9.17%
Saskatchewan	1	11,444	2.5%	71.1%	8.50%
Alberta	21	58,822	12.7%	59.9%	9.04%
British Columbia	13	80,516	17.3%	60.4%	8.88%
	204	$ 464,004	100.0%	62.8%	8.64%

Source: Company

Management has raised their year-end target to be in the $475 million to $500 million range, versus their previous guidance of $475 million. **We are maintaining our year-end estimate at $500 million.**

FRC Fundamental Research Corp.

The percentage of first mortgages at the end of Q2 was 80.2% versus 82.8% at the end of Q1, and 77.8% at the end of 2015.

Type of mortgage	June 30, 2016 Number of mortgages	Outstanding amount	Percentage outstanding	Weighted average interest rate
(outstanding amounts in 000s)				
First mortgages				
Conventional	138	$ 382,735	75.8%	8.3%
Non-Conventional	7	18,300	3.6%	8.5%
Other	17	3,890	0.8%	7.4%
	162	404,925	80.2%	8.3%
Second and third mortgages				
Conventional	28	75,914	15.0%	9.5%
Non-conventional	9	24,146	4.8%	10.8%
	37	100,060	19.8%	9.8%
	199	$ 504,985	100.0%	8.6%

Source: Company

Exposure by property type

The following table shows the outstanding loans by category. The growth in the portfolio primarily came from an increase in low-rise residential mortgages.

Mortgage category	June 30, 2016 Number	Outstanding amount	% of Portfolio	December 31, 2015 Number	Outstanding amount	% of Portfolio
(outstanding amounts in 000s)						
Low-rise residential	30	$ 136,939	27.1%	23	$ 110,034	24.3%
House and apartment	102	88,076	17.4%	110	84,755	18.8%
Construction	8	53,493	10.6%	9	44,701	9.9%
High-rise residential	7	46,324	9.2%	9	42,245	9.4%
Mid-rise residential	5	11,663	2.3%	7	14,662	3.2%
Condominium corporation	17	3,890	0.8%	18	4,111	0.9%
Residential portfolio	169	340,385	67.4%	176	300,508	66.5%
Commercial/mixed use	30	164,600	32.6%	31	151,083	33.5%
Mortgage portfolio	199	504,985	100.0%	207	451,591	100.0%
Accrued interest receivable		2,091			1,960	
Mortgage discount		(393)			(440)	
Mortgage origination fees		(809)			(712)	
Provision for mortgage losses		(4,900)			(4,300)	
Mortgages receivable		$ 500,974			$ 448,099	

Source: Company

Other key parameters

The following highlights the other key portfolio parameters:

The **weighted average interest rate,** excluding lender fees, of the portfolio, was 8.6% at the end of Q2 (8.66% at the end of 2015).

The **weighted average term to maturity** was at 13.2 months at the end of Q2 versus 11.1 months at the end of 2015.

The **LTV** was 63.9% compared to 64.7% at the end of 2015.

The company reported a **loan loss provision** of $0.32 million in the quarter, bringing the total provision to $4.90 million, or 1% of the portfolio. At the end of Q2, eight loans (totaling approximately $26 million) were in default, four in ON, and four in AB. Subsequent to the quarter-end, one of the loans in ON has been converted to good standing, and the other three loans are loans to Toronto based developer Urbancorp, who recently filed for bankruptcy protection from its creditors. Launched in 1993, Urbancorp is a well-known developer in Toronto and have been very active in recent years. The loans to Urbancorp total $16.48 million. All three mortgages are first mortgages with low loan-to-value ("LTV") ratios. **All three of these properties are currently listed for sale, and the company stated that they expect to fully recover all amounts due from Urbancorp and its related parties.**

Property	Mortgage Balance ($, 000s)	Mortgage Rank	Appraised Value ($, 000s)	LTV
Bayview Ave, Toronto	$8,934	First	$15,900	56.2%
Mallow Rd, Toronto	$3,792	First	$16,900	22.4%
Patricia Ave, Toronto	$3,756	First	$15,500	24.2%
	$16,482		**$48,300**	

With regard to the loans in AB, management expects to "lose a small amount of money on these loans, which is fully provided for in the loan loss reserve."

Revenues up 11% YOY - new record

Revenues grew by 11% YOY to $10.69 million in Q2-2016. Net income also increased by 11% YOY to $6.43 million (EPS: $0.24) – marking another record quarter.

Interest income (including lender fees) as a percentage of mortgage receivables: As shown in the table below, the interest income as a percentage of mortgage receivables decreased YOY from 9.31% to 8.90% p.a. **However, dividends as a percentage of the book value increased from 8.23% to 9.78% p.a. due to the use of leverage.**

% of Mortgage Receivables (net) - annualized	Q2-2015	Q2-2016	2015 (6M)	2016 (6M)
Interest Income + Origination	9.31%	8.90%	8.79%	8.77%
Less:				
Management Fee	0.97%	0.93%	0.91%	0.92%
Loan Loss Provision	0.24%	0.27%	0.28%	0.26%
G&A Expenses	0.16%	0.17%	0.16%	0.16%
Interest Expenses	2.23%	2.11%	2.11%	2.06%
Share Based Payments	0.07%	0.07%	0.08%	0.07%
Net	**5.63%**	**5.35%**	**5.25%**	**5.29%**
Dividends as a Percentage of Book Value	8.23%	9.78%	8.25%	9.09%

**The calculations in the above table are approximates as we used the average of beginning and end of period* *mortgage receivables outstanding.*

We are maintaining our revenue forecast for 2016 at $42.19 million, and for 2017 at $46.13 million. We are slightly adjusting our 2016 net income forecast from $25.56 million (EPS: $0.95) to $25.72 million (EPS: $0.96), while maintaining our 2017 estimate at $28.14 million (EPS: $1.01).

The 2016 regular dividend is $0.86 per share. **Our forecast for 2016, and 2017, are total dividends of $0.96 per share, and $1.01 per share, respectively.**

The table below shows a summary of the balance sheet.

	2014	2015	Q1-2016	Q2-2016
Mortgages receivable, net	$432,757,000	$448,099,000	$460,244,000	$500,974,000
Cash				
LT debt	$100,328,000	$101,230,000	$100,844,000	$101,705,000
Debt	$180,294,000	$167,796,000	$181,209,000	$220,527,000
Equity	$248,204,000	$274,984,000	$276,280,000	$277,685,000
Total Capital	$428,498,000	$442,780,000	$457,489,000	$498,212,000
Debt to Capital	42.1%	37.9%	39.6%	44.3%
Debt to Asset	41.7%	37.4%	39.4%	44.0%
EBIT/ Interest expense	3.8	3.4	3.6	3.5

- *Our calculations are slightly different from the company's calculations.*

The company had a debt to capital of 44% at the end of Q2, up from 40% at the end of Q1.

Options and Warrants

The company has no options or warrants outstanding.

Rating

We are maintaining our BUY rating and raising our fair value estimate from $12.80 to $12.90 per share.

Name	Ticker	P/E	Dividend Yield
Firm Capital MIC	FC	14.3	7.2%
Timbercreek Financial	TF	12.8	
TREZ Capital MIC	TZZ	15.0	8.3%
Average		**14.0**	**7.7%**
Atrium MIC	AI	**13.0**	**7.6%**
Atrium MIC (2016 forward)	AI	**12.8**	**7.8%**
Fair Value of AI (based on 2016 est.)		**$13.4**	**$12.4**
Average		**$12.89**	

Risks

The following, we believe, are the key risks of the company at this time:

- Diversification risks - approximately 71% of Atrium's mortgages are secured by properties in Ontario.
- Like all mortgages, AI mortgages are exposed to credit risks, and interest rate risks.
- Interest rate risks are minimal as most of the mortgages are short-term with fixed rates.
- A downturn in the real estate sector may impact the company's deal flow.
- Timely deployment of capital is critical.
- Investments in mortgages are typically affected by macroeconomic conditions, and local real estate markets.
- Competition is high in the mortgage lending business.
- Like most MICs, the company uses leverage to fund mortgages. Leverage, if not maintained below optimum levels, can have negative impact.
- The B.C. government is adopting measures to curb foreign investment, which we believe is likely to result in a modest correction in prices.

Appendix

Income Statement YE - December 31	2014	2015	2016(F)	2017(F)
Revenue				
Mortgage interest and other fees	$34,956,000	$40,206,000	$42,190,406	$46,125,000
Total Revenues	**$34,956,000**	**$40,206,000**	**$42,190,406**	**$46,125,000**
Expenses				
G&A	766,000	862,000	948,099	1,025,000
Mortgage servicing and management fees	3,553,000	4,173,000	4,480,067	4,843,449
Share based payments	248,000	325,000	349,810	378,183
Interest + Bank Charges	2,908,000	2,724,000	3,181,268	4,889,242
Interest on convertible debenture	4,627,000	6,873,000	6,863,919	6,589,362
Loan loss provision	1,817,000	1,912,000	648,763	256,488
Total Expenses	**13,919,000**	**16,869,000**	**16,471,926**	**17,981,724**
Net Income	**$21,037,000**	**$23,337,000**	**$25,718,480**	**$28,143,276**
EPS	$0.91	$0.94	$0.96	$1.01

Balance Sheet	2014	2015	2016(F)	2017(F)
YE - December 31				
Assets				
Cash	-		$0	$0
Mortgages receivable, net	$432,757,000	$448,099,000	$499,351,238	$524,743,512
Prepaid Expenses	$38,000	$54,000	$259,425	$283,619
Total Asset	**$432,795,000**	**$448,153,000**	**$499,610,663**	**$525,027,132**
Liabilities				
Credit facility	$79,966,000	$66,566,000	$117,372,034	$122,915,773
Account payable and accrued liabilities	$523,000	$677,000	$986,406	$1,076,819
Due to related party	$395,000	$402,000	$402,000	$402,000
Dividend payable	$3,379,000	$4,294,000	$4,286,413	$4,690,546
Convertible debenture	$100,328,000	$101,230,000	$101,230,000	$101,230,000
Total Liabilities	**$184,591,000**	**$173,169,000**	**$224,276,853**	**$230,315,138**
Share capital	$245,794,000	$272,698,000	$272,698,000	$291,698,000
Contributed surplus	$1,085,000	$970,000	$1,319,810	$1,697,993
Equity component of convertible debenture	$1,062,000	$1,062,000	$1,062,000	$1,062,000
Retained Earnings	$263,000	$254,000	$254,000	$254,000
Total Shareholders Equity	**$248,204,000**	**$274,984,000**	**$275,333,810**	**$294,711,993**
Total Shareholders Equity+Liabilities	**$432,795,000**	**$448,153,000**	**$499,610,663**	**$525,027,132**

Cash Flow Statement YE - December 31	2014	2015	2016(F)	2017(F)
Operating Activities				
Net Income	$21,037,000	$23,337,000	$25,718,480	$28,143,276
Add (subtract) non cash item				
Total	$17,693,000	$25,369,000	$26,717,052	$28,777,947
Net changes in non-cash operating items				
Prepaid expenses	-$7,000	-$16,000	-$205,425	-$24,194
Accrued interest receivable	-$615,000	$217,000	-	-
Accounts payable and accrued liabilities	$63,000	$154,000	$301,820	$494,546
Additions to mortgage discount	$248,000	$133,000	-	-
Additions to mortgage origination fee	$1,264,000	$1,046,000	-	-
Others	$1,093,000	-$43,000		
Cash From Operating Activities	$19,739,000	$26,860,000	$26,813,447	$29,248,299
Investing Activities				
Mortgage investments	-$278,319,000	-$266,522,000		
Repayment of mortgages	$130,983,000	$249,552,000		
Interest capitalized to mortgages				
Mortgage investments(net)	-$147,336,000	-$16,970,000	-$51,901,000	-$25,648,763
Cash used Investing Activities	-$147,336,000	-$16,970,000	-$51,901,000	-$25,648,763
Financing Activities				
Credit facility	$43,572,000	-$13,930,000	$50,806,034	$5,543,740
Increase/decrease in amounts due to related party	$213,000	$7,000	-	-
Issuance of share capital	$36,708,000	$27,672,000		$20,000,000
Share capital issue costs	-$1,609,000	-$1,208,000	-	-$1,000,000
Cash dividends paid during the year	-$19,931,000	-$22,431,000	-$25,718,480	-$28,143,276
Proceeds from issuance of convertible debentures	$72,051,000			
Convertible debenture issue costs	-$3,407,000		-	-
Cash used in Financing Activities	$127,597,000	-$9,890,000	$25,087,554	-$3,599,537
Net Increase(Decrease) in Cash	$0	$0	$0	$0

Fundamental Research Corp. Equity Rating Scale:
Buy – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk
Hold – Annual expected rate of return is between 5% and 12%
Sell – Annual expected rate of return is below 5% or the expected return is not commensurate with risk
Suspended or Rating N/A— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

Fundamental Research Corp. Risk Rating Scale:
1 (Low Risk) - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

2 (Below Average Risk) - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company's capital structure is conservative with little to modest use of debt.

3 (Average Risk) - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

4 (Speculative) - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

5 (Highly Speculative) - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues, and may rely on external funding. These stocks are considered highly speculative.

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