Fundamental Research Corp.
Investment Analysis for Intelligent Investors

December 16, 2022

Capital Direct I Income Trust

Robust Outlook for 2023 Amid Higher Rates

Estimated Yield (2023): 7.0%
Rating*: 2-
Risk*: 3

Sector / Industry: Mortgage Investment Entities

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Highlights

- **2022 (9M) yield was 6.3% (beating our estimate by 12bps)** vs 6.1% in 2021 (full-year).
- At the end of Q3-2022, Capital Direct had $354M in mortgage receivables, up 6% YTD, surpassing our 2022 year-end estimate of $338M.
- The company remains focused on single family residential properties. **We believe the portfolio's risk profile has decreased,** amid lower Loan-to-Values (LTV), improved geographical diversification, and lower debt use.
- After raising rates in seven consecutive meetings, the Bank of Canada (BoC) has signaled a potential pause in rate hikes. **Although rates are likely to remain high in H1-2023, we believe slower GDP growth and higher unemployment will prompt the BoC to start cutting rates in the second half.** The IMF recently lowered their 2023 GDP growth forecast for Canada from 1.8% to 1.5%. A recent survey by IG Wealth Management indicated that more than 50% of Canadians are worried about being able to make mortgage payments if rates continue to rise.
- We believe **alternative lenders, such as Capital Direct, should be able to grow their loan portfolios,** amid lower repayments and new loan requests from borrowers unable to qualify with traditional lenders.
- Residential real estate prices in Toronto and Vancouver are down 18% from their peaks earlier this year. Consensus estimates indicate that prices could fall another 5% over the next 12 months, before climbing back. **We believe Capital Direct's low LTV (52%) puts them in a comfortable position.**
- For conservatism, we are modelling a 100% increase in the allowance for loan losses in the next 12 months, for all the alternative lenders under our coverage. Banks and conventional lenders had raised their allowance by 100%-200% during past recessions.
- **Due to higher lending rates, we are projecting a yield of 7.0% in 2023, up from our estimate of 6.5% in 2022.** We believe low-duration funds, such as Mortgage Investment Entities (MIE), 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	Capital Direct I Income Trust
Securities Offered	Classes A, C, and F Trust Units
Unit Price	$10
Minimum Subscription	$5,000
Hurdle Rate	N/A
Distribution to Investors	80% of net income on a quarterly basis
Redemption	Class A - a fee of 5% of NAV in year 1, decreasing by 1% every year; no fee after year 5 / Class C & Class F - a fee of 2% within 6 months and no fee after that
Management Fee	2.0% p.a. of NAV on Classes A and C units / 1.0% p.a. of NAV on Class F units
Auditor	Johnsen Archer LLP

Financial Summary	2019	2020	2021	2022E	2023E
Mortgage Investments (net)	$200,483,054	$259,760,322	$334,981,715	$373,125,000	$398,000,000
Debt as a % of Mortgage Outstanding	11%	24%	29%	23%	25%
Revenues	$21,100,094	$22,192,821	$25,402,829	$32,025,949	$37,362,397
Net Income	$15,372,537	$16,193,008	$17,564,199	$20,883,206	$24,946,626
Net Asset Value	$10.00	$10.00	$10.00	$10.00	$10.00
Investors' Returns (% of Invested Capital)	7.62%	6.87%	6.60%	6.50%	6.98%

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

Capital Direct has lower first mortgages, average mortgage size, and LTV

Yield is lower as well as management is paid a performance fee (20% of net income) in addition to management fees; most comparable MIC do not charge performance-based fees

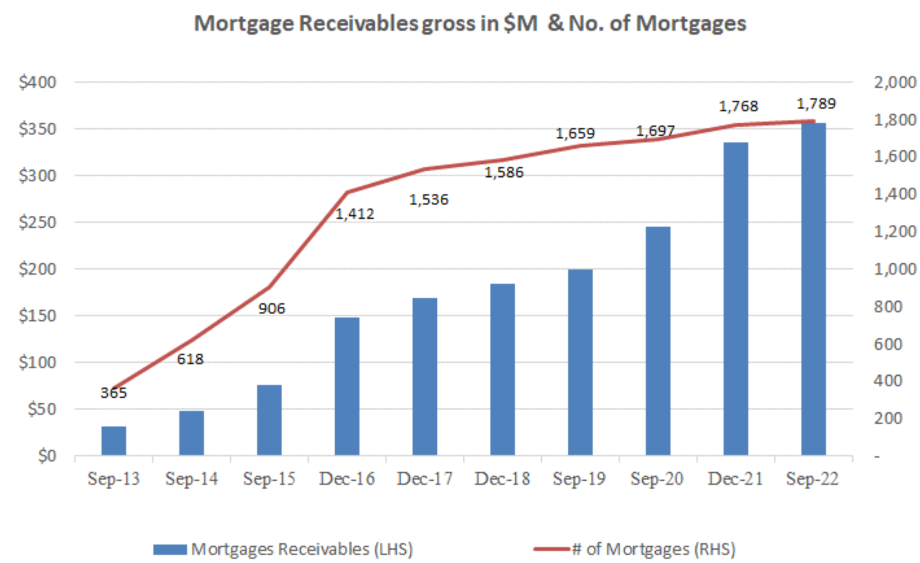
The following table shows how Capital Direct's portfolio compares to that of other similar MIEs (with AUM of over $100M) focused on single-family residential units.

	Capital Direct	Average
First Mortgage	59%	84%
B.C.	52%	41%
ON	39%	44%
AB	7%	6%
Others	3%	9%
LTV	52%	58%
Yield	6.6%	7.0%
Debt to Capital	24%	25%
Average Loan Size	$204,319	$557,231
Delinquent/Foreclosures	N/A	2.6%
Provision	0.4%	0.6%

Source: FRC / Various

Portfolio Update

Gross mortgage receivables were up 6% YTD, to $354M

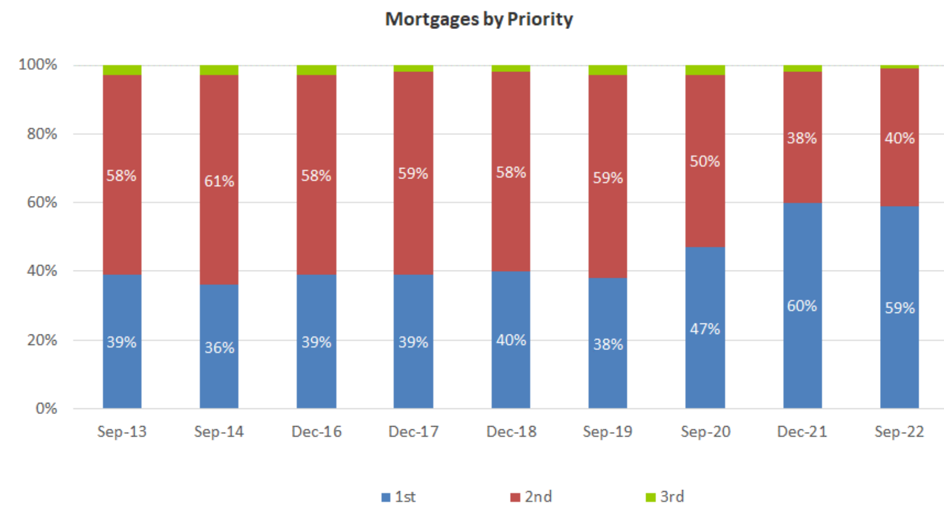


Source: Company / FRC

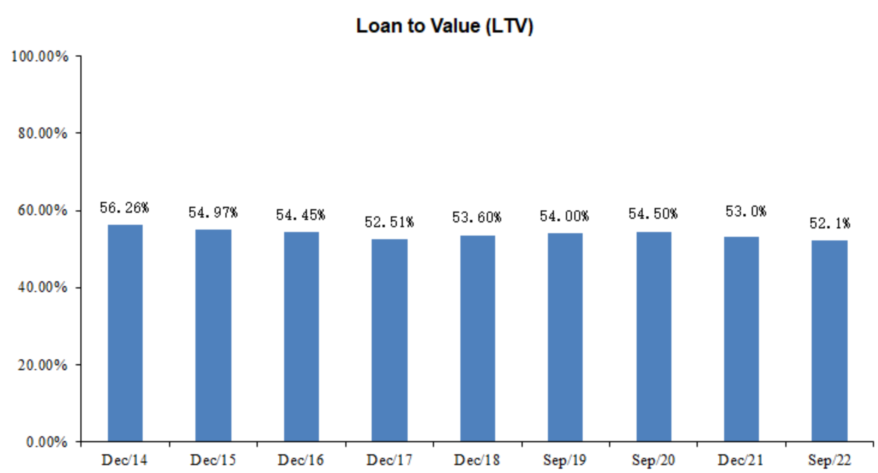
Debt to capital decreased, implying lower risk; we believe MICs of comparable size have debt to capital of 20%-40%

Balance Sheet	2018	2019	2020	2021	Q3-2022
Assets					
Cash	$8,052,977	$14,405,424	$10,020,064	$13,541,298	$7,759,996
Accounts Receivable	$2,524,347	$4,004,506	$5,100,374	$3,429,247	$2,270,393
Interest Rate Swap					$1,434,680
Assets held for sale		$834,499			
Mortgage Investments (net)	$182,156,694	$200,483,054	$259,760,322	$334,981,715	$353,574,548
Total Assets	**$192,734,018**	**$219,727,483**	**$274,880,760**	**$351,952,260**	**$365,039,617**
Liabilities					
Loan Payable	$35,524,445	$22,355,427	$62,380,903	$98,320,737	$85,322,106
Accounts Payable & Accured Liabilities	$7,927,563	$13,726,639	$7,791,655	$12,267,106	$5,161,937
Total Liabilities	**$43,452,008**	**$36,082,066**	**$70,172,558**	**$110,587,843**	**$90,484,043**
Net Asset	$149,282,010	$183,645,417	$204,708,202	$241,364,417	$274,555,574
SE + Liabilities	**$192,734,018**	**$219,727,483**	**$274,880,760**	**$351,952,260**	**$365,039,617**
Debt to Capital	19%	11%	23%	29%	24%
Debt as a % of Mortgage Outstanding	20%	11%	24%	29%	24%
Interest Coverage Ratio	9.3	10.9	16.8	8.1	5.5

Exposure to first mortgages was down slightly

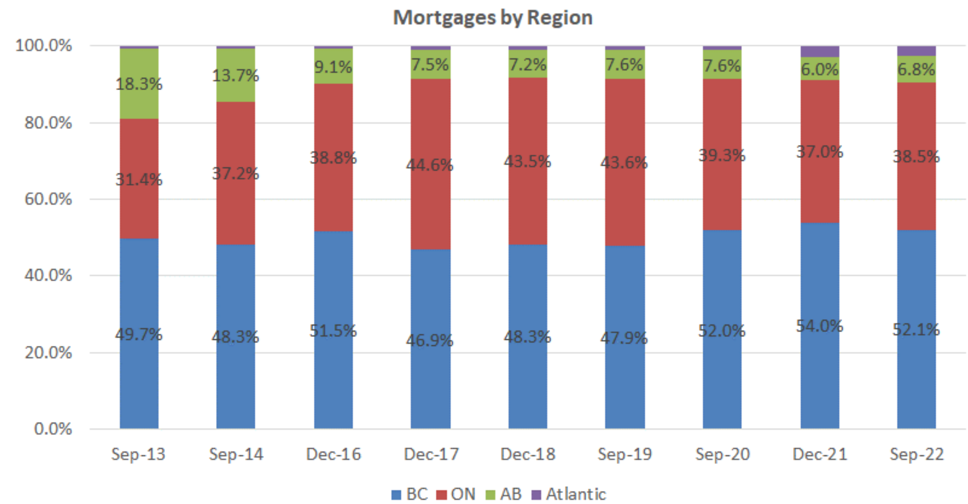


LTV was down as well

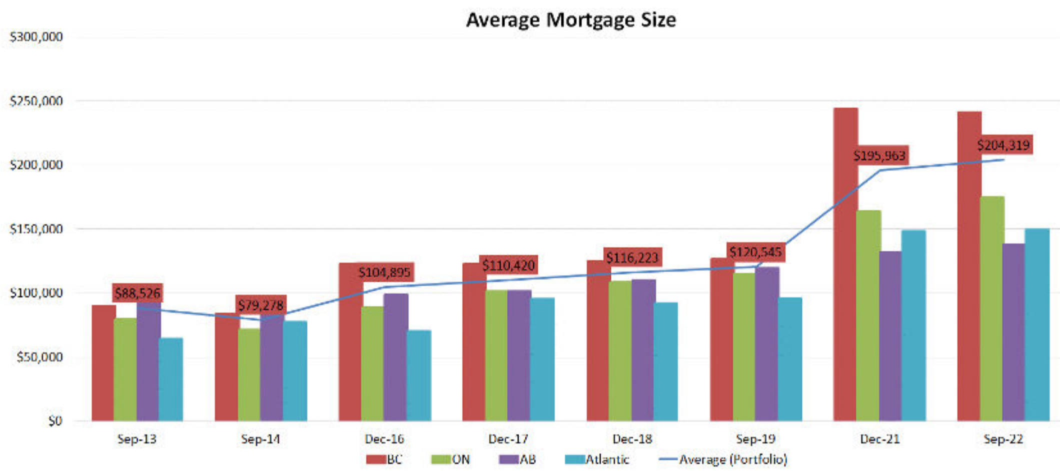


Source: Company / FRC

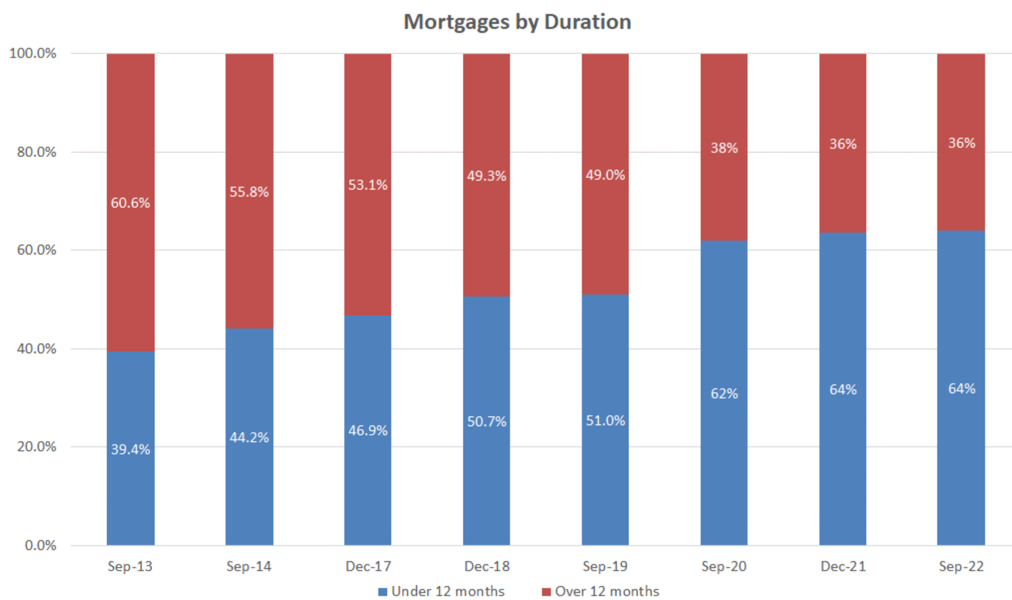
Increased exposure to ON, while reducing B.C., implying enhanced geographical diversification



The average mortgage size increased 2%YTD



Duration remained flat



Source: Company / FRC

Minimal realized losses

For conservatism, we are modeling a 100% increase in the allowance for loan losses in the next 12 months

	2019	2020	2021	2022 (9M)
Actual Losses	$452,974	$666,711	$312,001	$49,472
Actual Losses (% of mortgage receivable)	0.24%	0.29%	0.10%	0.01%
Distributions	$12,687,277	$13,340,835	$14,717,145	$12,905,858
Reinvested	$7,575,654	$8,571,974	$9,734,434	$8,187,063
Reinvested (as a % of Distributions)	60%	64%	66%	63%
Redemptions	$19,721,850	$20,027,958	$17,699,880	$22,375,874
Redemption (% of invested capital)	12%	10%	8%	9%
Loan loss reported	$221,274	$494,703	$669,271	$179,869
Loan loss allowance (year/quarter ended)	$970,970	$798,962	$1,156,232	$1,286,629
% of Receivable	0.48%	0.31%	0.35%	0.36%

Source: Company / FRC

In summary, we believe the portfolio's risk profile has decreased slightly (two red vs three green signals)

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

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

Source: FRC

2022 (9M) revenue was up 25% YoY, beating our estimate by 6%, due to higher lending rates and mortgage originations

Net income was up 22% YoY, beating our estimate by 4%

2022 (9M) yield was 6.3% vs 6.1% in 2021 (full year); we are raising our 2022 yield forecast from 6.4% to 6.5%

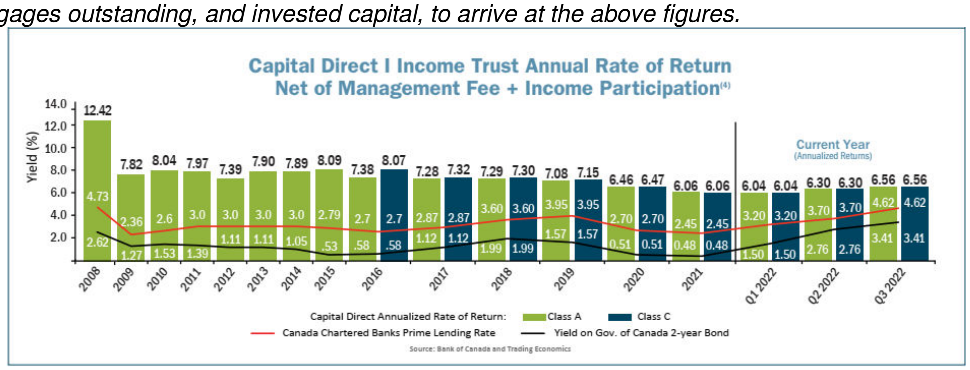
Financials

Income Statement	2019	2020	2021	2021 (9M)	2022 (9M)	YoY
Revenues						
Interest Income	$19,334,213	$20,608,320	$23,392,286	$16,236,383	$19,574,355	21%
Other Income	$1,765,881	$1,584,501	$2,010,543	$2,533,064	$3,909,384	54%
Total Revenue	**$21,100,094**	**$22,192,821**	**$25,402,829**	**$18,769,447**	**$23,483,739**	**25%**
Expenses						
G&A	$506,435	$593,682	$596,181	$484,691	$475,320	$0
Bank Charges	$376,095	$416,125	$467,888	$348,093	$364,057	5%
Interest on Loan Payable	$1,584,010	$1,044,810	$2,464,585	$1,627,650	$3,523,460	116%
Loss on Assets Held for Sale	$374,005	$351,247				
Management Fees	$2,665,738	$3,099,246	$3,640,705	$2,621,288	$3,098,915	18%
Loan Loss Provision	$221,274	$494,703	$669,271	$706,336	$179,869	-75%
Total Operating Expenses	**$5,727,557**	**$5,999,813**	**$7,838,630**	**$5,788,058**	**$7,641,621**	**32%**
Net Income	**$15,372,537**	**$16,193,008**	**$17,564,199**	**$12,981,389**	**$15,842,118**	**22%**
Net Asset Value	$10.00	$10.00	$10.00	$10.00	$10.00	**0%**
Units Outstanding	18,364,542	20,469,383	24,136,442	24,050,714	27,455,557	14%
Distributions						
Investors	12,687,277	13,340,835	14,717,145	$10,821,755	$12,905,858	19%
Management	2,685,260	2,852,173	2,847,054	$2,159,631	$2,936,258	36%
Investors' Share	82.5%	82.4%	83.8%	83.4%	81.5%	

% of Mortgage Receivable	2019	2020	2021	2022 (9M)*
Interest Income	10.11%	8.96%	7.87%	7.58%
Other Income	0.92%	0.69%	0.68%	1.51%
Interest Income + Others	**11.03%**	**9.64%**	**8.54%**	**9.09%**
Less:				
Management Fee	-1.39%	-1.35%	-1.22%	-1.20%
G&A Expenses	-0.46%	-0.44%	-0.36%	-0.33%
Loan Loss Provision and Others	-0.31%	-0.37%	-0.23%	-0.07%
Interest	-0.83%	-0.45%	-0.83%	-1.36%
Net	8.03%	7.04%	5.91%	6.14%
Investors' Returns (% of Invested Capital)	**7.62%**	**6.87%**	**6.60%**	**6.67%**

** annualized*

Note that the above figures may be slightly different from the figures reported by Capital Direct 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: Company

Units Outstanding and Ownership

27M units outstanding at the end of Q3, up 14% YTD

Units Outstanding	30-Dec-21	30-Sep-22	% of Total
Class A	8,548,104	8,649,070	31.5%
Class C	6,133,316	8,321,365	30.3%
Class F	9,455,022	10,485,123	38.2%
Total	**24,136,442**	**27,455,558**	**100.0%**

Source: Company

- Class A - offered to investors directly
- Class F - offered to funds managed by portfolio managers, and other fee-based investment advisors.
- Class C - offered to investors who purchase units through dealers (IIROC and Exempt Market Dealers).

FRC Projections and Rating

We are projecting a yield of 7.0% in 2023

Our forecasts are conservative as we are assuming a 100% increase in the allowance for loan losses over the next 12 months

Our estimate for the 2023 yield varies between 6.2% and 7.4%, using various YoY increases in the allowance for loan losses

Financial Summary	2019	2020	2021	2022E	2023E
Mortgage Investments (net)	$200,483,054	$259,760,322	$334,981,715	$373,125,000	$398,000,000
Debt as a % of Mortgage Outstanding	11%	24%	29%	23%	25%
Revenues	$21,100,094	$22,192,821	$25,402,829	$32,025,949	$37,362,397
Net Income	$15,372,537	$16,193,008	$17,564,199	$20,883,206	$24,946,626
Net Asset Value	$10.00	$10.00	$10.00	$10.00	$10.00
Investors' Returns (% of Invested Capital)	7.62%	6.87%	6.60%	6.50%	6.98%

Allowance for Losses (X% Increase)	2023 Yield (FRC Est.)
0%	7.39%
50%	7.19%
100%	6.98%
200%	6.58%
300%	6.17%

Source: Company/FRC

We are maintaining our overall rating of 2-, and risk rating of 3. We believe low-duration funds, such as MICs, offer attractive opportunities in a rising interest rate environment. We were pleased with the company's ability to grow its portfolio, without materially comprising its lending mandate and key operating metrics. We expect **yields to increase from 6.5% this year, to 7.0% in 2023.**

FRC Rating	
Expected Yield (2023E)	7.0%
Rating	2-
Risk	3

Risks

- Loans are short term and need to be sourced and replaced quickly
- Timely deployment of capital is crucial
- Lower housing prices will result in higher LTVs
- **Unit holders' principal is not guaranteed**
- Unit holders are not guaranteed minimum distributions
- The fund has the ability to use leverage, increasing exposure to negative events
- Second mortgages carry higher risk.
- **Default rates can rise during recession**

APPENDIX

Income Statement	2019	2020	2021	2022E	2023E
Revenues					
Interest Income	$19,334,213	$20,608,320	$23,392,286	$27,340,000	$34,353,619
Other Income	$1,765,881	$1,584,501	$2,010,543	$4,685,949	$3,008,778
Total Revenue	**$21,100,094**	**$22,192,821**	**$25,402,829**	**$32,025,949**	**$37,362,397**
Expenses					
G&A	$506,435	$593,682	$596,181	$633,760	$665,448
Bank Charges	$376,095	$416,125	$467,888	$485,409	$509,680
Interest on Loan Payable	$1,584,010	$1,044,810	$2,464,585	$5,112,154	$5,157,645
Loss on Assets Held for Sale	$374,005	$351,247			
Management Fees	$2,665,738	$3,099,246	$3,640,705	$4,244,706	$4,622,465
Loan Loss Provision	$221,274	$494,703	$669,271	$666,713	$1,460,533
Total Operating Expenses	**$5,727,557**	**$5,999,813**	**$7,838,630**	**$11,142,743**	**$12,415,771**
Net Income	**$15,372,537**	**$16,193,008**	**$17,564,199**	**$20,883,206**	**$24,946,626**
Net Asset Value	$10.00	$10.00	$10.00	$10.00	$10.00
Units Outstanding	18,364,542	20,469,383	24,136,442	27,950,771	29,194,521

Balance Sheet	2019	2020	2021	2022E	2023E
Assets					
Cash	$14,405,424	$10,020,064	$13,541,298	$0	$0
Accounts Receivable	$4,004,506	$5,100,374	$3,429,247	$3,772,172	$4,715,215
Interest Rate Swap					
Mortgage Investments (net)	$200,483,054	$259,760,322	$334,981,715	$373,125,000	$398,000,000
Total Assets	**$219,727,483**	**$274,880,760**	**$351,952,260**	**$376,897,172**	**$402,715,214**
Liabilities					
Debt	$22,355,427	$62,380,903	$98,320,737	$87,575,785	$99,974,959
Accounts Payable & Accured Liabilities	$13,726,639	$7,791,655	$12,267,106	$9,813,685	$10,795,053
Total Liabilities	**$36,082,066**	**$70,172,558**	**$110,587,843**	**$97,389,470**	**$110,770,012**
Net Asset	$183,645,417	$204,708,202	$241,364,417	$279,507,702	$291,945,202
SE + Liabilities	**$219,727,483**	**$274,880,760**	**$351,952,260**	**$376,897,172**	**$402,715,214**
Debt to Capital	11%	23%	29%	24%	26%
Debt as a % of Mortgage Outstanding	11%	24%	29%	23%	25%
Interest Coverage Ratio	10.9	16.8	8.1	5.2	5.9

Cash Flow Statement	2022E	2023E
Operating Activities		
Net Income	$20,883,206	$24,946,626
Loan Loss Provision		
	$20,883,206	$24,946,626
Chnges in non-cash Working Capital		
Accounts Receivable	-$342,925	-$943,043
Accounts Payable and Accured Liabilities	-$2,453,421	$981,368
Cash from Operating Activities	**$18,086,860**	**$24,984,951**
Investing Activities		
Net Puchase of Mortgage Investments	-$38,143,285	-$24,875,000
Cash from Investing Activities	**-$38,143,285**	**-$24,875,000**
Financing Activities		
Repayment of Loan Payable		
Distribution to unitholders (net of reinvestments)	-$16,915,397	-$19,957,301
Distribution to Manager	-$3,967,809	-$4,989,325
Cash Received on Subscription		
Redemption	$38,143,285	$12,437,500
Advances from Related Parties		
Loan Payable	-$10,744,952	$12,399,174
Cash from Financing Activities	**$6,515,127**	**-$109,952**

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	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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