

Terra Firma Capital Corp. (TII-V)

Great Leadership Addition – Gearing Up for the Next Level

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- Earlier this month, Terra Firma announced that **Mr. Glenn Watchorn joined the company as President and Chief Operating Officer**, effective November 10, 2014.
- In our view, Mr. Watchorn is a very seasoned executive with decades of experience in real estate investments. We believe his addition to Terra Firma's executive team greatly adds to its bench strength and **could help meaningfully accelerate the company's existing growth trajectory**.
- We recently hosted several marketing meetings which helped introduce Mr. Watchorn to the Street in his new role. We came away from these meetings with an even higher level of confidence regarding the company's outlook and growth prospects.
- Our operational forecasts are unchanged. We expect Terra Firma to report Q3/FY14 results on or about November 25, 2014. We are forecasting Q3/FY14 EPS (f.d.) \$0.02 and an ending loan and mortgage portfolio of \$70.4MM.
- **While Terra Firma's shares closed at an all-time high on Friday, in our view, the company's shares have not kept pace with their earnings. Accordingly, we believe current levels represent a good opportunity for investors to acquire shares before the company takes its operations to 'the next level'.**
- **We maintain our Buy rating and \$1.15 target price.**

Highlights from Marketing Meetings

Buy (Unch) \$1.15 (Unch)

Previous Close	\$0.70
12-month Target Price	\$1.15
Potential Return	64%
52 Week Price Range	\$0.32-\$0.73

Estimates

YE: Dec 31	FY13A	FY14E	FY15E
Revenue (\$MM)	\$8.9	\$12.8	\$21.8
Net Income (\$MM)	\$1.7	\$2.7	\$6.0
FD EPS ¹	\$0.05	\$0.07	\$0.11

Valuation

	FY13A	FY14E	FY15E
P/E	14.1x	10.5x	6.3x
P/B	1.5x	1.2x	0.9x
ROE	12.6%	15.4%	21.2%

Stock Data (MM) - Pro Forma for the Financing

Shares Outstanding	
Basic	41.6
FD	57.3
Market Cap	
Basic	\$29.1
FD	\$40.1
Net Debt	-\$1.1
Enterprise Value	\$28.0

About the Company

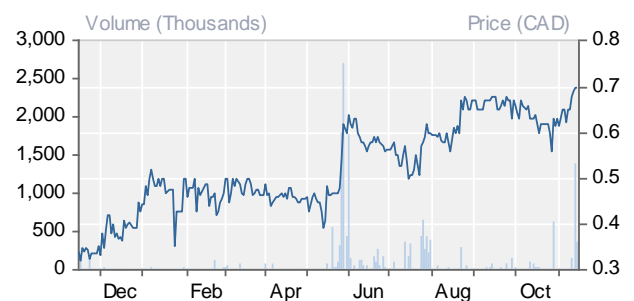
Terra Firma provides customized real estate financing solutions aiming to achieve equity-like returns in a debt-like structure. The company offers a full spectrum of solutions to developers and owners and is headquartered in Toronto, Canada.

<http://www.tfcc.ca/>

¹ Incorporates interest savings & dilution effects of convertible debentures.

All figures in C\$ unless otherwise indicated.

Stock Performance



Background on Glenn Watchorn

Exhibit 1. Mr. Watchorn's Previous Roles

Time Frame	Company	Title	Details
2002 - 2014	Tricon Capital Group Inc. (TCN-T, not covered)	Co-Chief Operating Officer	Mr. Watchorn was responsible for investment strategy and for the sourcing, underwriting and management of investments in the U.S. and Canada. Founded in 1988 (IPO in March 2010), Tricon is one of North America's leading residential real estate investment companies with approximately \$2.2 billion of assets under management and a portfolio of over 4,000 U.S. single-family rental homes. Tricon provides financing to local operators or developers in select markets in the United States and Canada, with a primary focus on for-sale housing in growing markets. Since inception, Tricon has invested in approximately 160 transactions for development projects valued at more than \$14 billion.
1997 - 2002	Intracorp Developments Ltd.	VP Corporate	Mr. Watchorn was responsible for the financial structuring of acquisitions and for raising equity and debt to finance residential and commercial projects. Intracorp is a real estate development company that manages and develops residential and commercial projects throughout Canada.
1991 - 1997	Graywood Developments Ltd.	Development Manager & Financial Analyst	Mr. Watchorn was actively involved in the acquisition, financing, planning and development of the company's projects. Graywood Developments is a private investment management company based in Toronto that specializes in the development of real estate properties in Canada, the United States and selected markets outside North America.

Source: Company reports, Beacon Securities.

- Mr. Watchorn's experience encompasses both the "buy" side (identifying and successfully executing on specific investments / managing assets), as well as the "sell" side (raising money) for real estate investments.
- During his tenure at Tricon Capital Group Inc. (TCN-T), Mr. Watchorn personally oversaw debt or equity transactions, with an aggregate value of approximately \$1 billion.
- **Tricon had a significantly smaller balance sheet than Terra Firma** (and was a private company) **when Mr. Watchorn joined it in 2002**. As Co-COO he played an instrumental role in growing the company to its current \$740MM market cap.
- Mr. Watchorn has worked on projects with a significantly larger size/scale than Terra Firma currently performs. Additionally, we believe he joins Terra Firma with significant contacts and strong relationships with developers/investors (both Canada and the U.S.) and can fairly easily tap into these networks – which would ordinarily be very difficult and require significant amounts of time for the company to develop from scratch.

Thoughts Regarding U.S. Expansion

- While he lived in Toronto, Mr. Watchorn worked almost exclusively in the U.S. for approximately the first seven years of his tenure at Tricon. Mr. Watchorn expanded Tricon's existing operation in Phoenix and over the course of his tenure expanded the company's reach to new U.S. markets including: Miami; Dallas; Atlanta; Houston; and San Francisco, as well as Calgary and Vancouver in western Canada. We believe Mr. Watchorn's experience in these geographic areas perfectly complements and can help diversify Terra Firma's existing

base – which is currently primarily in and around the Greater Toronto Area. That said, we note that Dov Meyer, Terra Firma's CEO, also has extensive experience outside of Canada, most notably as CIO of IPC US REIT and various positions with the Paul Reichmann Group of Companies.

- Mr. Watchorn's view (which is consistent with ours) calls for the upswing in U.S. housing to continue going forward and that, with the market now well past its bottom, this is a good time to make investments. We note that consensus forecasts per Bloomberg are calling for U.S. housing starts to increase 16% in 2015 to 1.161MM, followed by another 13% increase in 2016 to 1.314MM (for perspective they were 2.068MM in 2005). Further, he believes **there is less competition to provide financing in several key U.S. markets compared to Toronto** (as many key players in the U.S. went under during the crisis) – **leading to the potential to earn higher yields/spreads.**

Company's Principles to Remain Unchanged

- Management is currently working on completing its business plan, although it has already identified some key markets for expansion.
- We expect that, in essence, **Terra Firma's goal of earning equity-like returns in a debt-like structure will remain** – with the company's operations simply being on a larger scale and in newer markets.
- We expect that the company will never abandon its syndication model. That said, Terra Firma is considering adding a fund structure, where it would act as a manager for limited partnership funds, at some point down the road. This would help the company scale up (as it would no longer have to syndicate each deal separately), and provide a steady stream of income (a percentage of committed funds) as well as the potential for performance fees if the company exceeded certain hurdle rates. However, spreads under this model would likely be lower than for syndicated loans.
- We expect that over time, the size of deals in which Terra Firma participates will increase, which will provide some efficiencies through scale, as the amount of time (and certain expenses) to work on a deal are often the same regardless of its size.

Update on Current Operations

- The company's current operations appear to be continuing their recent positive momentum, with investors referring more investors and borrowers bringing more borrowers to the firm.
- Management also indicated that they are currently working on a number of deals that are "quite large".

Share Purchase Agreement by Glenn Watchorn

- On November 4, 2014, in connection with his joining the firm, Terra Firma announced an intention to complete a **1MM common share purchase by Mr. Watchorn at \$0.63 per share, for gross proceeds of \$630K.**
- We believe this further demonstrates the confidence Mr. Watchorn has in Terra Firma. This development is in line with other key insiders which have established significant ownership stakes in the company via cash purchases.
- We have updated our model for this transaction; however, it results in only negligible changes to both our EPS (f.d.) and book value forecasts.

Q3/FY14 Preview

- We expect Terra Firma to report Q3/FY14 results on or about November 25, 2014. Our forecasts for the quarter are unchanged. We expect y/y revenue growth of 46% to \$3.2MM and EPS (f.d.) of \$0.02. We expect the company to record some one-time revenue in the quarter in the neighbourhood of \$200-250k resulting from a US\$12MM prepayment for a loan related to student housing in the U.S. – which is not included in the aforementioned \$3.2MM figure.
- We are forecasting Terra Firma to end Q3/FY14 with \$70.4MM in loan and mortgage investments (up 15% sequentially) and to reach \$99.4MM by the end of the year (up 41% sequentially), as the \$5.4MM net proceeds from the company's recent financing essentially go 'right out the door' and are deployed in productive loan and mortgage investments.

Exhibit 2. Q3/FY14 Preview

Quarter Ended	Q3/FY14E	Q3/FY13	Q2/FY14	% Change	
	Sep-14	Sep-13	Jun-14	Y/Y	Q/Q
Revenue (000's)					
Interest and fees earned	\$3,121	\$2,064	\$2,842	51%	10%
Rental income	\$47	\$113	\$47	-59%	-1%
Total Revenue	\$3,168	\$2,177	\$2,889	46%	10%
Expected net revenue from prepayment	\$250				
Expenses (000's)					
Interest	\$1,654	\$1,062	\$1,452	56%	14%
Salary and benefits	\$350	\$279	\$257	26%	36%
All other expenses	\$254	\$267	\$225	-5%	13%
Total Expenses	\$2,258	\$1,607	\$1,933	41%	17%
Income before income taxes	\$1,159	\$570	\$956	103%	21%
Income taxes	\$301	\$147	\$322	105%	-6%
Net income (000's)	\$858	\$423	\$786	103%	9%
EPS (f.d.)	\$0.02	\$0.01	\$0.02	72%	6%
Other Items, Ending Balance (000's)					
Cash and cash equivalents	\$4,513	\$2,316	\$5,285	95%	-15%
Loan and mortgage investments	\$70,366	\$45,124	\$61,266	56%	15%
Total investment portfolio	\$75,430	\$53,697	\$66,330	40%	14%

Note: Q2/FY14 net income includes \$152K from discontinued operations.

Source: Beacon Securities estimates.

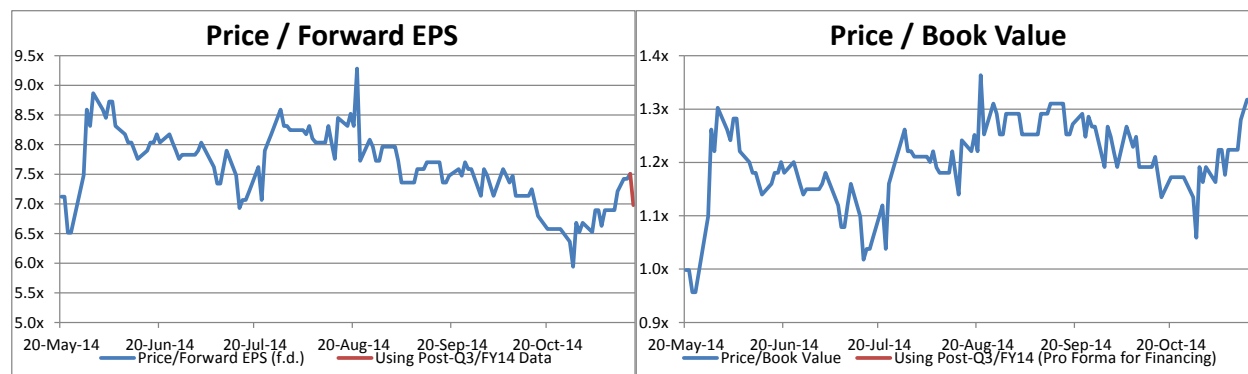
Despite Setting an All-Time High, We Believe the Company's Shares Are Currently Undervalued

- Terra Firma's shares are currently trading at a Price/Forward EPS (f.d) multiple of 7.5x (for the period ended June 30, 2015). After rolling our forecasts forward post-Q3/FY14, the valuation multiple falls to 7.0x – well below its growth oriented real estate / lending peers.
- We note that just to return to the average Price/Forward EPS multiple since we launched coverage on May 20, 2014, of 7.6x on our post-Q3/FY14 estimates would require a share price of \$0.76. However, we believe the company's shares should currently be trading above this six-month average for the following six reasons:
 - 1) The average Price/Forward EPS multiple includes the first few days/weeks after we launched coverage, where we would

argue the company was essentially unknown in the investor community.

- 2) The average Price/Forward EPS multiple **includes some days** (some as recent as last month) where the shares were trading **essentially equal to or below book value** – which we would argue was irrational and unsustainable.
 - 3) Our growth forecasts were previously contingent upon the company raising equity. **With its financing having closed a month ago, we believe a potential obstacle to achieving our forward earnings estimates has been removed.** Per our calculations we do not believe the company will have to raise more equity to achieve our earnings forecasts through the end of FY16 – although, to be prudent, we have modelled one smaller follow-up raise (\$2MM in Q2/FY15).
 - 4) The company now has a **history of exceeding our expectations.** Most notably, it has reported EPS (f.d.) a penny above our forecasts in each of the past two quarters. Given this track record and our belief that there is some meaningful conservatism embedded in our model, we believe the company could exceed our earnings estimates again in the near-term and/or longer-term.
 - 5) **We expect momentum to accelerate** ahead (in our existing model):
 - a. Y/Y Earnings Momentum – the difference between our **forward EPS expectations and trailing EPS (f.d.) has never been wider.**
 - b. Sequential Loan and Mortgage Momentum – The company's loan and mortgage investments grew 2% sequentially in Q1/FY14 and 9% in Q2/FY14. We are forecasting **15% sequential growth in Q3/FY14, followed by 41% in Q4/FY14.**
 - 6) We believe the **addition of Mr. Watchorn can help accelerate the company's growth.** However, with the company still finalizing its expansion plan (and expected to report Q3/FY14 results next week), we have not made any changes to our operational forecasts since his appointment was announced.
- Terra Firma's shares are currently trading at a **Price/Book multiple of just 1.27x** our post-Q3/FY14 estimate (pro forma for its financing), and 1.21x our FY14 ending book value forecast. These multiples are considerably below the company's growth oriented real estate / lending peers (Exhibit 6).

Exhibit 3. Valuation History Since Initiating Coverage



Source: Beacon Securities estimates.

Maintaining Buy and \$1.15 Target Price

Our target price is derived by applying a 9.0 multiple (unchanged) to the company's EPS (f.d.) for the 12 months ending Q2/FY16.

Exhibit 4. Calculation of Target Price

Four Quarter EPS Estimate (f.d., ending June 2016, MM)	\$0.13
Target Valuation Multiple	9.0x
Target Price (Rounded)	\$1.15
Implied Return	64%

Source: Beacon Securities estimates.

Exhibit 5. Expected Changes in Key Metrics Over the Next 12 Months

	Valuation Metrics			Operational Metrics		Total Investment Portfolio (MM)
	Price/Forward EPS	Price/Trailing EPS	Price/Book Value	Forward EPS (F.D.)	Book Value	
Current	7.5x	10.2x	1.3x	\$0.09	\$0.53	\$66.3
Target	9.1x	12.3x	1.8x	\$0.13	\$0.65	\$120.3
Implied Increase	21%	21%	33%	36%	24%	81%

Current represents the last reported quarter (book value adjusted for the company's recent financing).

Target incorporates our share price and balance sheet expectations as at the quarter ending Q2/FY15.

Source: Company reports, Beacon Securities estimates.

Exhibit 6. Market Comparables

Terra Firma Comparables													
Company	Ticker	Last Price	Market Cap. (MM)	EV (MM)	BVPS	EPS (F.D.)				Sales (MM)			
						Current	2013A	2014E	2015E	2016E	2013A	2014E	2015E
Terra Firma Capital Corporation	TFC-CAN	\$0.70	\$29	\$28	\$0.53	\$0.05	\$0.07	\$0.11	\$0.14	\$8.9	\$12.8	\$21.8	\$26.7
Mortgage Investment Corporations													
Firm Capital Mortgage Investment Corporation	FC-CAN	\$12.85	\$233	\$379	\$10.31	\$0.97	\$0.97	\$1.01	\$1.00	\$28.5	\$25.6	\$27.6	na
Timbercreek Mortgage Investment Corporation	TMC-CAN	\$8.84	\$327	\$415	\$8.99	\$0.79	\$0.67	\$0.77	na	\$44.1	\$32.0	\$37.2	na
MCAN Mortgage Corporation	MKP-CAN	\$14.60	\$298	\$934	\$10.62	\$1.54	\$1.19	\$1.36	na	\$74.2	\$51.0	\$56.1	na
Atrium Mortgage Investment Corp.	AI-CAN	\$11.85	\$251	\$412	\$10.17	\$0.85	\$0.92	\$0.95	na	\$23.8	\$33.2	\$39.7	na
Group Average			\$277	\$535									
Other Growth Oriented Real Estate / Lending Comps													
Tricon Capital Group Inc.	TCN-CAN	\$8.21	\$740	\$874	\$5.83	\$0.45	\$0.40	\$0.38	\$0.34	\$91.2	\$84.1	\$92.5	\$93.8
Home Capital Group Inc.	HCG-CAN	\$50.05	\$3,478	\$7,194	\$19.57	\$3.68	\$4.12	\$4.68	\$5.47	\$497.0	\$581.7	\$648.8	\$751.7
Equitable Group Inc.	EQB-CAN	\$67.99	\$1,043	\$5,281	\$38.16	\$5.82	\$6.65	\$7.38	\$8.38	\$507.1	\$213.5	\$241.3	\$281.7
easyhome Ltd.	EH-CAN	\$21.73	\$289	\$382	\$11.04	\$1.15	\$1.25	\$1.89	\$2.65	\$218.8	\$256.8	\$304.4	\$363.0
Callidus Capital Corp	CBL-CAN	\$22.52	\$1,096	\$1,227	\$8.13	Na	\$0.84	\$1.75	\$2.15	\$59.4	\$102.8	\$183.2	\$215.3
Group Average			\$1,329	\$2,992									

Terra Firma Comparables														
Company	Price/Earnings						P/BVPS	ROE (LTM)	Dividend Yield	EPS Growth				
	LTM	NTM	2013A	2014E	2015E	2016E				2013A	2014E	2015E	2016E	
Terra Firma Capital Corporation	10.2x	7.5x	14.1x	10.5x	6.3x	5.0x	1.3x	17.7%	-	25%	34%	67%	27%	
Mortgage Investment Corporations														
Firm Capital Mortgage Investment Corporation	13.2x	12.9x	13.2x	13.2x	12.8x	na	1.2x	9.7%	7.3%	-3%	0%	4%	na	
Timbercreek Mortgage Investment Corporation	7.2x	11.9x	11.2x	13.1x	11.4x	na	1.0x	9.1%	8.6%	2%	-15%	15%	na	
MCAN Mortgage Corporation	10.2x	10.5x	9.5x	12.2x	10.7x	na	1.4x	16.6%	7.9%	26%	-23%	14%	na	
Atrium Mortgage Investment Corp.	13.0x	12.8x	13.9x	12.9x	12.5x	na	1.2x	8.8%	7.2%	-1%	8%	3%	na	
Group Average			12.1x	12.5x	12.0x	12.9x	11.9x	-	1.2x	11.0%	7.7%	6%	-7%	9%
Other Growth Oriented Real Estate / Lending Comps														
Tricon Capital Group Inc.	9.3x	24.4x	18.2x	20.5x	21.6x	na	1.4x	8.0%	2.9%	125%	-11%	-5%	na	
Home Capital Group Inc.	12.3x	11.1x	13.6x	12.1x	10.7x	na	2.6x	23.5%	1.1%	15%	12%	14%	na	
Equitable Group Inc.	10.8x	9.5x	11.7x	10.2x	9.2x	na	1.8x	17.3%	0.9%	19%	14%	11%	na	
easyhome Ltd.	17.4x	13.2x	18.9x	17.4x	11.5x	na	2.0x	13.5%	1.6%	32%	8%	52%	na	
Callidus Capital Corp	-	13.7x	-	26.8x	12.8x	10.5x	2.8x	Na	0.0%	Na	Na	109%	22%	
Group Average			12.5x	14.4x	15.6x	17.4x	13.2x	10.5x	2.1x	15.6%	1.3%	48%	6%	36%

Source: Company reports, Factset, Beacon Securities estimates.

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As at October 31, 2014		
#Stocks	Distribution	
BUY	35	79.5%
Speculative Buy	5	11.4%
HOLD	3	6.8%
SELL	0	0.0%
Under Review	1	2.3%
Total	44	100.0%

BUY	Total 12-month return expected to be > 15%
Speculative Buy	Potential 12-month return is high (>15%) but given elevated risk, investment could result in a material loss
HOLD	Total 12-month return is expected to be between 0% and 15%
SELL	Total 12-month return is expected to be negative
Under Review	Currently undergoing a change of analyst coverage

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