

# FIRST NATIONAL

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FINANCIAL CORPORATION



## **Report to Shareholders**

**Period Ended September 30, 2022**

# FIRST NATIONAL

FINANCIAL CORPORATION



## **Fellow Shareholders:**

First National's third quarter 2022 results were generated during a period of market adjustment brought on by the Bank of Canada's decision to rapidly increase interest rates to quell inflation. The result of a 300-basis point increase in short-term interest rates between March and September 2022 led to a reduction in housing affordability for Canadians, a decline in market activity and a reduction in total mortgage origination for our Company, which stood at \$9.1 billion in the third quarter, 18% lower than a year ago.

Despite a more competitive and higher cost operating environment, First National profitably originated \$6.9 billion of new mortgages in the quarter and renewed \$2.3 billion. As a result, Mortgages under administration ("MUA") grew 6% to record \$129.3 billion, up 6% from \$122.3 billion at September 30, 2021 and net income was \$40.1 million (\$0.66 per share), compared to \$47.6 million (\$0.78 per share) a year ago. The common share payout ratio in the third quarter was 89%. First National also paid \$0.8 million of dividends on its preferred shares.

## **Common Share Dividend Increase**

Our Board of Directors announced an increase in the regular monthly dividend effective with the payment to be made December 15, 2022, to shareholders of record at the close of business November 30, 2022. At that time, the monthly dividend will rise to an annualized rate of \$2.40 per common share from the current annualized rate of \$2.35 per common share. We are pleased to say this is the 15<sup>th</sup> increase in the dividend since our IPO in 2006.

## **Looking Forward**

We encourage you to review the full text of our MD&A to gain a better appreciation for the drivers of our recent results, management's responses to this period of market adjustment and our outlook. In the short term, we estimate that year-over-year origination will moderate in line with housing activity across Canada. For commercial originations, we expect a solid fourth quarter but weaker mortgage commitments going into 2023.

Against this backdrop, we will manage First National with a long-term mindset. This means continuing to focus on providing responsive, differentiated services to Canadian borrowers and independent mortgage brokers, and stressing fundamentals including the enhancement of business processes and efficiencies to ensure First National performs for all stakeholders.

Yours sincerely,

Stephen Smith  
Executive Chairman

Jason Ellis  
President and Chief Executive Officer

## MANAGEMENT'S DISCUSSION AND ANALYSIS

*The following management's discussion and analysis ("MD&A") of financial condition and results of operations is prepared as of October 25, 2022. This discussion should be read in conjunction with the unaudited interim condensed consolidated financial statements and accompanying notes of First National Financial Corporation (the "Company" or "Corporation" or "First National") as at and for the three months (the "period") and nine months ended September 30, 2022. The unaudited condensed consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS").*

*This MD&A contains forward-looking information. Please see "Forward-Looking Information" for a discussion of the risks, uncertainties and assumptions relating to these statements. The selected financial information and discussion below also refer to certain measures to assist in assessing financial performance. These other measures, such as "Pre-FMV Income" and "After-tax Pre-FMV Dividend Payout Ratio", should not be construed as alternatives to net income or loss or other comparable measures determined in accordance with IFRS as an indicator of performance or as a measure of liquidity and cash flow. These measures do not have standard meanings prescribed by IFRS and therefore may not be comparable to similar measures presented by other issuers.*

*Unless otherwise noted, tabular amounts are in thousands of Canadian dollars.*

*Additional information relating to the Company is available in First National Financial Corporation's profile on the System for Electronic Data Analysis and Retrieval ("SEDAR") website at [www.sedar.com](http://www.sedar.com).*

### **General Description of the Company**

First National Financial Corporation is the parent company of First National Financial LP ("FNFLP"), a Canadian-based originator, underwriter and servicer of predominantly prime residential (single-family and multi-unit) and commercial mortgages. With more than \$129 billion in mortgages under administration ("MUA"), First National is one of Canada's largest non-bank originators and underwriters of mortgages and is among the top three in market share in the mortgage broker distribution channel.

## Third Quarter 2022 Results Summary

Management is satisfied with First National's performance in the third quarter of 2022. With slowing housing activity across Canada, the Company's single-family origination was 23% lower year over year but about 10% ahead of pre-pandemic levels. Commercial segment originations decreased 4% on continued strength in insured mortgage products. Total combined new origination was lower by 18% year over year. Mortgages Under Administration (MUA), the source of most of the Company's earnings, continued to grow and reached another record high. Operating profitability was lower as mortgage origination fell while headcount growth and inflation meant employee costs increased. The rapid pace of interest rate increases also negatively affected the Company's securitization margins.

The following summarizes the performance of the Company's significant metrics:

- MUA grew to \$129.3 billion at September 30, 2022 from \$122.3 billion at September 30, 2021, an increase of 6%; the growth from June 30, 2022, when MUA was \$127.3 billion, was 6% on an annualized basis.
- Total new single-family mortgage origination was \$4.7 billion in the third quarter of 2022 compared to \$6.1 billion in 2021, a decrease of 23%. The Company attributes this to a slowing real estate market together with a more competitive marketplace. Commercial segment origination of \$2.2 billion was 4% lower than the \$2.3 billion originated in the comparative 2021 quarter. Total new origination decreased by 18% in the 2022 third quarter compared to 2021.
- The Company took advantage of available opportunities in the quarter to renew \$1.9 billion of single-family mortgages (\$1.7 billion a year ago). For the commercial segment, renewals were lower by 40% (\$362 million compared to \$604 million a year ago).
- Revenue for the third quarter of 2022 increased by 11% to \$392.4 million from \$353.7 million in the third quarter of 2021. This change was the result of higher interest rates. The last 12-month period featured a rapidly rising interest rate environment with bond yields and mortgage rates increasing as monetary policy tightened to counteract inflation risks. These changes led to higher interest earned on securitized mortgages, higher interest revenue earned on mortgages accumulated for securitization and higher interest earned on mortgage investments. These increases in revenue were partially offset by lower placement fees as residential origination volumes were lower by about 23% comparing the two quarters.
- Income before income taxes was \$54.6 million in 2022 compared to \$65.1 million in the third quarter of 2021. The decrease reflected the effect of changing capital market conditions in both quarters. Excluding gains and losses related to financial instruments, the Company's earnings before income taxes and gains and losses on financial instruments ("Pre-FMV Income" <sup>(1)</sup>) for 2022 decreased by 26% to \$48.2 million from \$64.9 million in 2021. This change was largely the result of a 23% drop in new residential origination and a competitive market for volume. As mortgage rates rose over the past six months, housing transactions have slowed across the country. With the ensuing competition with other lenders in a smaller market, the Company increased broker incentives to drive referrals. Together with tight funding spreads for securitized floating rate mortgages and employee head count designed to underwrite higher volumes, profitability was lower.

The Company's Board of Directors announced an increase to the regular monthly dividend to \$2.40 per common share from \$2.35 on an annualized basis effective with the dividend payable on December 15, 2022.

(1) This non-IFRS measure adjusts income before income taxes by eliminating the impact of changes in fair value by adding back losses on the valuation of financial instruments (except those on mortgage investments) and deducting gains on the valuation of financial instruments. See Key Performance Indicators section in this MD&A.

## Selected Quarterly Information

### Quarterly Results of First National Financial Corporation

(\$000s, except per share amounts)

	Revenue	Net Income for the Period	Pre-FMV Income for the Period <sup>(1)</sup>	Net Income per Common Share	Total Assets
<b>2022</b>					
Third quarter	\$392,413	\$40,145	\$48,219	\$0.66	\$42,392,225
Second quarter	\$416,774	\$61,281	\$55,864	\$1.01	\$42,927,449
First quarter	\$350,321	\$53,637	\$45,187	\$0.88	\$42,386,708
<b>2021</b>					
Fourth quarter	\$339,292	\$41,971	\$57,045	\$0.69	\$42,274,158
Third quarter	\$353,704	\$47,614	\$64,867	\$0.78	\$40,763,169
Second quarter	\$365,118	\$52,401	\$71,218	\$0.86	\$41,727,249
First quarter	\$336,492	\$52,575	\$64,146	\$0.87	\$40,586,601
<b>2020</b>					
Fourth quarter	\$387,303	\$69,123	\$94,937	\$1.13	\$39,488,527

### Reconciliation of Quarterly Determination of Pre-FMV Income

(\$000s, except per share amounts)

	Income before income tax for the Period	Add/ deduct Realized and unrealized losses (gains)	Deduct (losses), add gains related to mortgage and loan investments	Pre-FMV Income for the Period <sup>(1)</sup>
<b>2022</b>				
Third quarter	\$54,645	(\$5,846)	(\$580)	\$48,219
Second quarter	\$83,081	(\$27,217)	\$—	\$55,864
First quarter	\$73,087	(\$27,900)	\$—	\$45,187
<b>2021</b>				
Fourth quarter	\$57,111	\$71	(\$137)	\$57,045
Third quarter	\$65,134	\$383	(\$650)	\$64,867
Second quarter	\$70,101	\$1,217	(\$100)	\$71,218
First quarter	\$71,475	(\$7,486)	\$157	\$64,146
<b>2020</b>				
Fourth quarter	\$94,273	(\$260)	\$924	\$94,937

(1) This non-IFRS measure adjusts income before income taxes by eliminating the impact of changes in fair value by adding back losses on the valuation of financial instruments (except those on mortgage investments) and deducting gains on the valuation of financial instruments. See Key Performance Indicators section in this MD&A.

With First National's large portfolio of mortgages pledged under securitization, quarterly revenue is driven primarily by the gross interest earned on mortgages pledged under securitization. The gross interest on the mortgage portfolio is dependent both on the size of the portfolio of mortgages pledged under securitization, as well as mortgage rates. Recently MUA has increased, and revenue followed. Net income is partially dependent on conditions in bond markets, which affect the value of gains and losses on financial instruments arising from the Company's interest rate hedging program. Accordingly, the movement of this measurement between quarters is related to factors external to the Company's core business. By removing this volatility and analyzing Pre-FMV Income, management believes a more appropriate measurement of the Company's performance can be assessed.

In the past eight quarters, the Company experienced a volatile economic environment. 2020 began slowly and volumes were not particularly strong. COVID-19-related financial turmoil at the end of 2020's first quarter created large losses on financial instruments; however in the final three quarters of 2020, the Company benefited from both its business model, which does not rely on face-to-face interactions and historically wide mortgage spreads. These spreads were the result of the aftermath of the COVID-19-related financial crisis that began at the end of the 2020 first quarter and were the basis for growth in Pre-FMV Income in the last three quarters of 2020. In 2021, net income remained steady as financial markets stabilized, and the Company earned income from higher origination volumes and wider spreads locked in its securitization portfolio. Competition accelerated in mid 2021 on signs of an improving economy and a risk-on environment, such that over the final six months of 2021, spreads returned to pre-pandemic levels. Spread tightening reduced profitability for the Company in the third and fourth quarters of 2021 compared to the periods of exceptional profitability in 2020. To start 2022, the economic outlook was positive and there was a surplus of liquidity for investment in financial assets. However, late in the first quarter, inflation risk became evident as wages and prices increased and companies competed for employees. The Bank of Canada moved quickly in an attempt to stem this escalation and short-term interest rates rose by about 300 basis points between March and September 2022. While spreads remained relatively narrow, the Company faced the headwinds of a slowing housing market, strong competition for employees as well as for customers such that the Company earned comparatively lower normalized income.

## **Outstanding Securities of the Corporation**

At September 30, 2022, and October 25, 2022, the Corporation had 59,967,429 common shares; 2,984,835 Class A preference shares, Series 1; 1,015,165 Class A preference shares, Series 2; 200,000 November 2024 senior unsecured notes; and 200,000 November 2025 senior unsecured notes outstanding.

## Selected Annual Financial Information and Reconciliation to Pre-FMV Income<sup>(1)</sup>

(\$000s, except per share amounts)

	2021	2020	2019
<b>For the Year Ended December 31,</b> Income Statement Highlights			
Revenue	1,394,606	1,380,294	1,326,523
Interest expense – securitized mortgages	(630,279)	(708,162)	(739,071)
Brokerage fees	(201,786)	(159,018)	(102,596)
Salaries, interest and other operating expenses	(298,720)	(254,385)	(243,143)
Add (deduct): realized and unrealized losses (gains) on financial instruments	(5,815)	67,355	9,655
Deduct: unrealized losses regarding mortgage investments	(730)	(3,076)	(4,300)
Pre-FMV Income <sup>(1)</sup>	257,276	323,008	247,068
Add (deduct): realized and unrealized gains (losses) on financial instruments excluding those on mortgage investments	6,545	(64,279)	(5,355)
Provision for income taxes	(69,260)	(68,500)	(64,500)
Net income	194,561	190,229	177,213
Common share dividends declared	210,885	148,419	144,421
<b>Per Share Highlights</b>			
Net income per common share	3.20	3.12	2.90
Dividends per common share	3.52	2.47	2.41
<b>At Year End</b> Balance Sheet Highlights			
Total assets	42,274,158	39,488,527	37,685,593
Total long-term financial liabilities	398,888	398,554	374,025

Notes:

- (1) Pre-FMV Income is not a recognized earnings measure under IFRS and does not have a standardized meaning prescribed by IFRS. Therefore, Pre-FMV Income may not be comparable to similar measures presented by other issuers. Investors are cautioned that Pre-FMV Income should not be construed as an alternative to net income or loss determined in accordance with IFRS as an indicator of the Company's performance or as an alternative to cash flows from operating, investing and financing activities as a measure of liquidity and cash flows. The figures for 2019 have been restated to conform to the 2021 and 2020 presentation.

## Vision and Strategy

The Company provides mortgage financing solutions to the residential and commercial mortgage markets in Canada. By offering a full range of mortgage products, with a focus on customer service and superior technology, the Company believes that it is a leading non-bank mortgage lender. The Company intends to continue leveraging these strengths to lead the non-bank mortgage lending industry in Canada, while appropriately managing risk. The Company's strategy is built on four cornerstones: providing a full range of mortgage solutions for Canadian single-family and commercial customers; growing assets under administration; employing technology to enhance business processes and service to mortgage brokers and borrowers; and maintaining a conservative risk profile. An important element of the Company's strategy is its direct relationship with the mortgage borrower. The Company is considered by most of its borrowers as the mortgage lender. This is a critical distinction. It allows the Company to communicate with each borrower directly throughout the term of the related mortgage. Through this relationship, the Company can negotiate new transactions and pursue marketing initiatives. Management believes this strategy will provide long-term profitability and sustainable brand recognition for the Company.

## Key Performance Drivers

The Company's success is driven by the following factors:

- Growth in the portfolio of mortgages under administration;
- Growth in the origination of mortgages;
- Raising capital for operations; and
- Employing innovative securitization transactions to minimize funding costs.

## Growth in Portfolio of Mortgages under Administration

Management considers the growth in MUA to be a key element of the Company's performance. The portfolio grows in two ways: through mortgages originated by the Company and through third-party mortgage servicing contracts. Mortgage originations not only drive revenues from placement and interest from securitized mortgages, but perhaps more importantly, create longer-term value from servicing rights, renewals and growth in the customer base for marketing initiatives. As at September 30, 2022, MUA totalled \$129.3 billion, up from \$122.3 billion at September 30, 2021, an increase of 6%. The growth of MUA in the third quarter of 2022, was also 6% on an annualized basis.

## Growth in Origination of Mortgages

### *Direct Origination by the Company*

The origination of mortgages not only drives the growth of MUA as described above, but leverages the Company's origination platform, which has a large fixed-cost component. As more mortgages are originated, the marginal costs of underwriting decrease. Increased origination satisfies demand from its institutional customers and produces volume for the Company's own securitization programs. In the third quarter of 2022, the Company's single-family origination decreased by 23% compared to the third quarter of 2021. The Company believes this is the result of slowing real estate markets following the unsustainable growth experienced during the pandemic when interest rates were at historical lows. Now with rising interest rates, housing affordability has diminished. By historical standards, the commercial segment had a strong third quarter. Total commercial volumes were \$2.2 billion compared to \$2.3 billion in 2021, a reduction of 4%. Together, overall new origination in the third quarter of 2022 decreased 18% year over year.

### *Third-Party Mortgage Underwriting and Fulfilment Processing Services*

In 2015, the Company launched its third-party underwriting and fulfilment processing services business with a large Canadian schedule I bank ("Bank"). This business is designed to adjudicate mortgages originated by the Bank through the single-family residential mortgage broker channel. First National employs a customized software solution based on its industry-leading MERLIN technology to accept mortgage applications from the Bank in the mortgage broker channel and underwrite these mortgages in accordance with the Bank's underwriting guidelines. The Bank funds all the mortgages underwritten under the agreement and retains full responsibility for mortgage servicing and the client relationship. Management considers the agreement a way to leverage the capabilities and strengths of First National in the mortgage broker channel and add some diversity to the Company's service offerings. In late 2019, the Company entered into a similar agreement with another Canadian bank.

## *Excalibur Mortgage Products*

The Company originates alternative single-family (“Excalibur”) mortgage products. Alternative lending describes single-family residential mortgages that are originated using broader underwriting criteria than those applied in originating prime mortgages. These mortgages generally have higher interest rates than prime mortgages. First National’s relationships with mortgage brokers and its underwriting systems allow for cost effective origination of significant volumes. The product is originated primarily for placement with institutional investors, but beginning in April 2019, the Company finalized an agreement with a bank-sponsored securitization conduit to fund a portion of the Excalibur origination. In early 2020, an agreement was reached with another bank-sponsored conduit to provide additional funding for this product. Excalibur was rolled out gradually, beginning in Ontario. Currently the program originates the majority of its mortgages in Ontario with small but growing volumes in Western Canada.

## **Raising Capital for Operations**

### *Bank Credit Facility*

The Company has a \$1.5 billion revolving line of credit with a syndicate of banks. This facility enables the Company to fund the large amounts of mortgages accumulated for securitization. In second quarter of 2022, the Company extended the term of the facility by another year to March 2027. The facility bears interest at floating rates. The Company has elected to undertake this debt for a number of reasons: (1) the facility provides the amount of debt required to fund mortgages originated for securitization purposes; (2) the debt is revolving and can be used and repaid as the Company requires, providing more flexibility than senior unsecured notes, which are fully drawn during their term; (3) the five-year remaining term gives the Company a committed facility for the medium term; and (4) the cost of borrowing reflects the Company’s BBB issuer rating.

### *Note Issuance*

In November 2020, the Company issued 200,000 2.961% Series 3 senior unsecured notes for a five-year term pursuant to a private placement under an offering memorandum. These notes add to the Company’s 2019 issuance of 200,000 3.582% Series 2 senior unsecured notes. The net proceeds of both offerings, after broker commissions, were invested in FNFLP. On settlement, the proceeds were used to pay down a portion of the indebtedness under the bank credit facility. The Company’s medium-term debt capital now stands at approximately \$400 million.

### *Preferred Share Issuance*

Effective April 1, 2021, pursuant to the original prospectus, the Company reset the annual dividend rate on the outstanding Class A Series 1 preference shares to 2.895% for a five-year term to March 31, 2026. After the exercise of shareholder conversion rights in March 2021, there were 2,984,835 Class A Series 1 shares outstanding and 1,015,165 Class A Series 2 outstanding. The Series 2 shares bear a floating rate dividend calculated quarterly based on the 90-day T-Bill rate. Both the Series 1 and Series 2 shares pay quarterly dividends, subject to Board of Directors approval, and are redeemable at the discretion of the Company such that after each five-year term ending on March 31, the Company can choose to extend the shares for another five-year term at a fixed spread (2.07%) over the relevant index (five-year Government of Canada bond yield for any Series 1 shares or the 90-day T-Bill rate for any Series 2 shares). While investors in these shares have an option on each five-year anniversary to convert their Series 1 preference shares into Series 2 preference shares (and vice versa), there is no provision of redemption rights to these shareholders. As such, the Company considers these shares to represent a permanent source of capital.

## Employing Securitization Transactions to Minimize Funding Costs

### *Approval as Both an Issuer of NHA-MBS and Seller to the Canada Mortgage Bonds Program*

In December 2007, the Company was approved by Canada Mortgage and Housing Corporation (“CMHC”) as an issuer of NHA-MBS and as a seller into the Canada Mortgage Bonds (“CMB”) program. Issuer status provides the Company with direct and independent access to reliable and low-cost funding. Insured mortgage spreads can be illustrated by comparing insured posted five-year fixed single-family mortgage rates to a similar-term Government of Canada bond as listed in the table below.

Period	Average Five-Year Insured Mortgage Spread for the Period
2006	1.12%
2007	1.50%
2008	2.68%
2009–2016	1.77%
2017–2019	1.38%
2020	1.76%
2021	1.17%
First quarter 2022	1.38%
Second quarter 2022	1.98%
Third quarter 2022	1.51%

Generally, when this spread is wider, the Company can earn higher returns from its securitization activities, although funding spreads also affect profitability. Between 2009 and 2019, liquidity issues at financial institutions created by the 2008 financial crisis diminished and the competition for mortgages increased such that spreads tightened in the 10-year period as shown above, falling to a low of 1.10% in 2018. In early 2020, fears of a global pandemic led to a dramatic and sudden decrease in bond yields as central banks cut overnight rates significantly. Credit spreads widened and the capital markets ceased to function normally. Later in 2020, as financial systems began to normalize, mortgage coupons remained elevated as other credit spreads, including those on NHA-MBS, narrowed. The resulting spreads had positive impacts on 2020 results and increased the profitability inherent in the Company’s securitization portfolio. In 2021, spreads narrowed, returning to 2018 levels at first and then closing to levels not seen since before the 2008 financial crisis as competition increased. In 2022, spreads widened with increasing pace in response to Bank of Canada announcements. The spreads in the second and third quarter of 2022 remained elevated due to the current economic uncertainty. If such spreads persist, it will be favorable to the Company in future quarters. In the third quarter of 2022, the Company originated and renewed for securitization purposes approximately \$3.4 billion of single-family and multi-unit residential mortgages.

The Company is subject to various regulations put in place by CMHC to control the amount of NHA-MBS that a single issuer can create. These rules include the amount of CMHC guarantees that is a requirement to issue a pool. Currently there is a tiered NHA-MBS guarantee fee pricing structure, such that any guarantees issued to one issuer over \$9.0 billion of issuance have a higher price. The tiered limit of \$9.0 billion remains unchanged for 2022. In July 2022, CMHC announced new rules for “aggregators”. Generally, aggregators are NHA MBS issuers that buy mortgages from other lenders who originate directly. These rules commence in 2023 and may have an impact on the Company’s ability to place mortgages with some institutions.

### *Canada Mortgage Bonds Program*

The CMB program is an initiative where Canada Housing Trust (“CHT”) issues securities to investors in the form of semi-annual interest-yielding five- and 10-year bonds. As a seller into the CMB, the Company is able to make direct sales into the program. The ability to sell into the CMB has given the Company access to lower costs of funds on both single-family and multi-family mortgage securitizations. Because of the effectiveness of the CMB, many institutions have indicated their desire to participate. As a result, CHT has created guidelines

through CMHC that limit the amount that can be sold by each seller into the CMB each quarter. The Company is subject to these limitations.

## Key Performance Indicators

The principal indicators used to measure the Company's performance are:

- Earnings before income taxes and losses and gains on financial instruments, with the exception of any losses related to mortgage investments ("Pre-FMV Income"<sup>(1)</sup>); and
- Dividend payout ratio.

Beginning in 2012, the Company used Pre-FMV EBITDA as a key performance measure. This non-IFRS measure was used to adjust the Company's earnings by excluding gains and losses related to the fair value of financial instruments and adding back depreciation and amortization. The addbacks of amortization ended in 2016 when IPO-related intangible assets were fully amortized. Accordingly, effective January 1, 2020, the Company elected to simplify the non-IFRS measure it presents to adjust only for fair value-related gains and losses. This measure is reported as "Pre-FMV Income." Measures prior to 2020 were restated in accordance with this revised calculation. Pre-FMV Income is not recognized under IFRS. However, management believes that Pre-FMV Income is a useful measure that provides investors with an indication of income normalized for capital-market fluctuations. Pre-FMV Income should not be construed as an alternative to net income determined in accordance with IFRS or to cash flows from operating, investing and financing activities. The Company's method of calculating Pre-FMV Income may differ from other issuers and, accordingly, Pre-FMV Income may not be comparable to measures used by other issuers.

	Quarter Ended		Nine months ended	
	September 30, 2022	September 30, 2021	September 30, 2022	September 30, 2021
<b>For the Period</b>			(\$000s)	
Revenue	392,413	353,704	1,159,508	1,055,313
Income before income taxes	54,645	65,134	210,813	206,710
Pre-FMV Income <sup>(1)</sup>	48,219	64,867	149,270	200,231
<b>At Period End</b>				
Total assets	42,392,225	40,763,169	42,392,225	40,763,169
Mortgages under administration	129,321,654	122,311,392	129,321,654	122,311,392

- (1) This non-IFRS measure adjusts income before income taxes by eliminating the impact of changes in fair value by adding back losses on the valuation of financial instruments (except those on mortgage investments) and deducting gains on the valuation of financial instruments.

Since going public in 2006, First National has been considered a high-yielding, dividend-paying company. With a large MUA that generates continuing income and cash flow and a business model that is designed to make efficient use of capital, the Company has been able to pay distributions to its shareholders that represent a relatively large ratio of its earnings. The Company calculates the dividend payout ratio as dividends declared on common shares over net income attributable to common shareholders. This measure is useful to shareholders, as it indicates the percentage of earnings paid out as dividends. Similar to the performance measurement for earnings, the Company also calculates the dividend payout ratio on a basis using after-tax Pre-FMV Income.

## Determination of Common Share Dividend Payout Ratio

	Quarter Ended		Nine months ended	
	September 30, 2022	September 30, 2021	September 30, 2022	September 30, 2021
<b>For the Period</b>	(\$000s)			
Net income attributable to common shareholders	39,378	46,935	152,908	150,579
Total dividends paid or declared on common shares	35,231	35,231	105,693	100,695
Total common share dividend payout ratio	89%	75%	69%	67%
After-tax Pre-FMV dividend payout ratio <sup>(1)</sup>	101%	75%	98%	69%

Note:

- (1) This non-IFRS measure adjusts the net income used in the calculation of the “Regular common share dividend payout ratio” to after tax Pre-FMV income so as to eliminate the impact of changes in fair value by adding back losses on the valuation of financial instruments (except those on mortgage investments) and deducting gains on the valuation of financial instruments. The Company uses its aggregate effective tax rate to tax affect the impact of the valuation of financial instruments on this ratio.

For the quarter ended September 30, 2022, the common share payout ratio was 89% compared to 75% for the quarter ended September 30, 2021. Gains and losses are recorded in the period in which the prices on Government of Canada bonds change; however, the offsetting economic impact is generally reflected in narrower or wider spreads in the future once the mortgages have been pledged for securitization. Accordingly, management does not consider such gains and losses to affect its dividend payment policy in the short term. If the gains and losses on financial instruments in the two quarters are excluded from the above calculations, the dividend payout ratio for the 2022 quarter would have been 101% compared to 75% in the comparative 2021 quarter.

The Company also paid \$0.8 million of dividends on its preferred shares in the third quarter of 2022 (\$0.7 million in 2021).

## Revenues and Funding Sources

### *Mortgage Origination*

The Company derives a significant amount of its revenue from mortgage origination activities. Most mortgages originated are funded either by placement with institutional investors or through securitization conduits, in each case with retained servicing. In general, originations are allocated from one funding source to another depending on different criteria, including type of mortgage and securitization limits, with an overall consideration related to maintaining diversified funding sources. The Company retains servicing rights on virtually all the mortgages it originates, which provide the Company with servicing fees to complement revenue earned through originations. For the quarter ended September 30, 2022, new origination volume decreased to \$6.9 billion from \$8.4 billion, or about 18% compared to the 2021 quarter.

## *Securitization*

The Company securitizes a portion of its origination through various vehicles, including NHA-MBS, CMB and asset-backed commercial paper (“ABCP”). Although legally these transactions represent sales of mortgages, for accounting purposes they do not meet the requirements for sale recognition and instead are accounted for as secured financings. These mortgages remain as mortgage assets of the Company for the full term and are funded with securitization-related debt. Of the Company’s \$9.1 billion of new originations and renewals in third quarter of 2022, \$3.4 billion was originated for its own securitization programs.

## *Placement Fees and Gain on Deferred Placement Fees*

The Company recognizes revenue at the time that a mortgage is placed with an institutional investor. Cash amounts received in excess of the mortgage principal at the time of placement are recognized in revenue as “placement fees”. The present value of additional amounts expected to be received over the remaining life of the mortgage sold (excluding normal market-based servicing fees) is recorded as a “deferred placement fee”. A deferred placement fee arises when mortgages with spreads in excess of a base spread are placed. Normally the Company would earn an upfront cash placement fee, but investors prefer paying the Company over time, as they earn net interest margin on such transactions. Upon the recognition of a deferred placement fee, the Company establishes a “deferred placement fee receivable” that is amortized as the fees are received by the Company. Of the Company’s \$9.1 billion of new originations and renewals in third quarter of 2022, \$5.5 billion was placed with institutional investors.

For all institutional placements, the Company earns placement fees. Revenues based on these originations are equal to either (1) the present value of the excess spread, or (2) an origination fee based on the outstanding principal amount of the mortgage. This revenue is received in cash at the time of placement. In addition, under certain circumstances, additional revenue from institutional placements may be recognized as “gain on deferred placement fees” as described above.

## *Mortgage Servicing and Administration*

The Company services virtually all mortgages generated through its mortgage origination activities on behalf of a wide range of institutional investors. Mortgage servicing and administration is a key component of the Company’s overall business strategy and a significant source of continuing income and cash flow. In addition to pure servicing revenues, fees related to mortgage administration are earned by the Company throughout the mortgage term. Another aspect of servicing is the administration of funds held in trust, including borrowers’ property tax escrows, reserve escrows and mortgage payments. As acknowledged in the Company’s agreements, any interest earned on these funds accrues to the Company as partial compensation for administration services provided. The Company has negotiated favourable interest rates on these funds with the chartered banks that maintain the deposit accounts, which has resulted in significant additional servicing revenue.

In addition to the interest income earned on securitized mortgages and deferred placement fees receivable, the Company also earns interest income on mortgage-related assets, including mortgages accumulated for sale or securitization, mortgage and loan investments and purchased mortgage servicing rights.

The Company provides underwriting and fulfilment processing services to two mortgage originators using the mortgage broker distribution channel. The Company earns a fee based on the dollar value of funded mortgages. These fees are recognized at the time a mortgage funds and are included in “Mortgage servicing income” in the consolidated statement of income.

## Results of Operations

The following table shows the volume of mortgages originated by First National and mortgages under administration for the periods indicated:

	Quarter Ended		Nine months Ended	
	September 30, 2022	September 30, 2021	September 30, 2022	September 30, 2021
	(\$ millions)			
<b>Mortgage Originations by Segment</b>				
New single-family residential	4,717	6,137	15,885	18,196
New multi-unit and commercial	2,170	2,264	7,357	6,702
Sub-total	6,887	8,401	23,242	24,898
Single-family residential renewals	1,861	1,731	4,932	4,815
Multi-unit and commercial renewals	362	604	1,474	1,756
Total origination and renewals	9,110	10,736	29,648	31,469
<b>Mortgage Originations by Funding Source</b>				
Institutional investors	5,464	7,749	19,315	20,950
NHA-MBS/CMB/ABCP securitization	3,360	2,643	9,339	9,448
Internal Company resources	286	344	994	1,071
Total	9,110	10,736	29,648	31,469
<b>Mortgages under Administration</b>				
Single-family residential	87,571	84,664	87,571	84,664
Multi-unit residential and commercial	41,751	37,647	41,751	37,647
Total	129,322	122,311	129,322	122,311

Total new mortgage origination volumes decreased in the third quarter of 2022 compared to 2021 by 18%. This reflected a 23% decrease in single-family volumes and a 4% decrease in commercial segment volumes year over year. Management believes the decrease in the single-family segment was due to a slowing housing market, the result of higher mortgage rates. The Company's MERLIN technology continues to support its mortgage origination platform so as to underwrite efficiently across the country. In the commercial segment, where the Company's expertise in underwriting multi-unit mortgages is a fundamental competency, third quarter volumes reflected demand for insured loans, offset by lower conventional mortgage activity as higher interest rates began to slow the market. When combined with renewals, total production inclusive of both business segments decreased by 15% to \$9.1 billion in the third quarter of 2022 from \$10.7 billion in the third quarter of 2021. Origination for direct securitization into NHA-MBS, CMB and ABCP programs remained a large part of the Company's strategy, with volume of almost \$3.4 billion in the third quarter of 2022.

### *Net Interest – Securitized Mortgages*

Comparing the quarter ended September 30, 2022, to the quarter ended September 30, 2021, "net interest – securitized mortgages" (NIM) increased by about 8% to \$43.2 million from \$40.1 million. The portfolio of mortgages pledged under securitization grew 2% from about \$35.4 billion at September 30, 2021 to \$36.1 billion at September 30, 2022. This reflected growth of about 23% in the multi-residential program portfolio partially offset by a reduction of 20% in single-family programs. Accordingly, commercial segment earnings were up by about \$2.7 million. Residential segment growth of \$0.4 million was affected negatively by the rapid rise of short-term interest rates. As rates rise, there is a temporary compression between the Company's prime lending rate and its short-term CDOR-based funding costs. The Company estimates that residential segment NIM was lower year over year by about \$3.6 million due to mid quarter interest rate hikes. The Company adjusts its floating mortgage rates for its borrowers in the month subsequent to changes in short term interest rates. This was offset somewhat by a tempering of prepayment speeds. In the third quarter of

2021 prepayment speed was higher than expected. With higher interest rates, prepayment has returned to traditional levels. In the third quarter of 2021, prepayment fees received by the Company were offset by indemnities owed to NHA MBS bondholders. There were virtually no indemnities to pay in the 2022 quarter as bondholders could reinvest proceeds from prepayment at higher risk-free yields. Accordingly, in 2022 prepayment fees could be used to offset the cost of accelerated amortization of capitalized origination costs.

### *Placement Fees*

Placement fee revenue decreased by 31% to \$58.5 million from \$85.0 million in the comparative year. The decrease was the result of a 29% decrease in origination volumes sold to institutional investors. Generally, per unit fees were marginally higher than in the comparable quarter as product mix changed between investors and spreads in the commercial insured segment went wider. Single family renewals were steady increasing by 8% from the 2021 third quarter. Placement fees from the portion placed with investors were consistent between the third quarters and supported aggregate placement fee revenue.

### *Gains on Deferred Placement Fees*

Gains on deferred placement fees revenue increased 31% to \$4.6 million from \$3.5 million. These gains related primarily to multi-unit residential mortgages originated and sold to institutional investors. Volumes for these transactions increased by 50% from the 2021 quarter as the Company's insured origination grew. However, spreads on these mortgages were narrower in 2022 compared to 2021.

### *Mortgage Servicing Income*

Mortgage servicing income increased 8% to \$55.4 million from \$51.4 million. This increase was attributable to growing interest earned on funds held in escrow as a result of higher overnight interest rates. Administration revenue on MUA grew marginally and third-party underwriting fees were lower on a decline in volumes processed in the 2022 quarter.

### *Mortgage Investment Income*

Mortgage investment income increased 85% to \$30.0 million from \$16.2 million. The increase was due primarily to the interest rate environment. Interest rates rose steadily in the third quarter of 2022 as the market predicted a cycle of rate hiking by the Bank of Canada to address the risks of inflation. The impact is such that 5-year bond yields increased by about 225 basis points between September 30, 2021 and September 30, 2022. This directly affected mortgage rates offered by the Company such that it earned more interest income on its mortgage and loan investment portfolio and mortgages accumulated for securitization.

### *Realized and Unrealized Gains (Losses) on Financial Instruments*

This financial statement line item consists of three primary components: (1) gains and losses related to the Company's economic hedging of single-family commitments, (2) gains and losses related to holding a portfolio of mortgage and loan investments at fair value, and (3) gains and losses on interest rate swaps used to mitigate interest rate risk on its CMB activity. With the adoption of IFRS 9 in 2018, a significant portion of the Company's interest rate management program qualifies as "hedging" for accounting purposes. The Company has elected to document hedging relationships for virtually all of the multi-residential commitments and mortgages it originates for its own securitization programs. It has also done the same for funded single-family mortgages and the swaps used in its ABCP programs. This decision has reduced the volatility of gains and losses on financial instruments otherwise recorded in the Company's regular earnings, as gains and losses on hedged items are generally deferred and amortized into income over the term of the related mortgages. The Company has not documented a hedging relationship for its interest mitigation program for its single-family mortgage commitments. The Company believes, given the optional nature of these commitments, it is difficult to establish a valid hedging relationship. For financial reporting purposes, this means that there will still be gains and losses on financial instruments, but these should be limited to those on the bonds sold short

used to mitigate such risk. The following table summarizes these gains and losses by category in the periods indicated:

Summary of Realized and Unrealized Gains (Losses) on Financial Instruments	Quarter Ended		Nine Months Ended	
	September 30, 2022	September 30, 2021	September 30, 2022	September 30, 2021
	(\$000s)			
Gains on short bonds used for the economic hedging program	8,622	653	75,285	12,242
Gains (losses) on mortgages held at fair value	(580)	(650)	(580)	(593)
Losses on interest rate swaps	(2,196)	(386)	(13,745)	(5,763)
Net gains (losses) on financial instruments	5,846	(383)	60,963	5,886

The third quarters of both 2022 and 2021 featured inflationary environments in which the market forecasted rising interest rates as central banks focused on tighter monetary policies. This resulted in increases in both short- and longer-term interest rates. The rate of increase in 2021 was slower than in 2022 as the Bank of Canada raised its key overnight rate by 3.00% between March 3 and September 30, 2022. These changes and the tone of the Bank's announcements meant that 5- and 10-year term government of Canada bond yields changed by about 25 basis points between the end of June and September. Accordingly, the impact on the Company's short-bond position used to mitigate interest rate risk on single-family commitments was larger in 2022 (\$8.6 million of gains compared to \$0.7 million of gains in the 2021 quarter).

#### *Brokerage Fees Expense*

Brokerage fees expense decreased 26% to \$40.6 million from \$54.9 million. This decrease reflected lower origination volumes of single-family mortgages for institutional investors, which decreased by about 37% year over year. The decrease was offset by higher per-unit fees as the Company increased incentives in the 2022 quarter to enhance volumes in a competitive market. These incentives increased per-unit broker fees by about 10%. Brokerage fees expense was also negatively affected by the under absorption of the higher per unit fees upon securitization. Effectively the additional fees paid for securitized mortgages have been expensed.

#### *Salaries and Benefits Expense*

Salaries and benefits expense increased 5% to \$46.8 million from \$44.7 million. Salaries were higher as overall headcount increased by 13% (1,729 employees at September 30, 2022 compared to 1,532 at September 30, 2021). Headcount growth is primarily in the residential underwriting departments. Commercial underwriting compensation was lower in the quarter by about \$4.0 million due to the lower levels of origination for that segment in the quarter. Management salaries were paid to the two senior executives (co-founders) who together control about 71% of the Company's common shares. The current period expense is a result of the compensation arrangement executed on the closing of the initial public offering ("IPO") in 2006.

#### *Interest Expense*

Interest expense increased 114% to \$38.7 million from \$18.1 million. As discussed in the "Liquidity and Capital Resources" section of this analysis, the Company warehouses a portion of the mortgages it originates prior to settlement with the investor or funding with a securitization vehicle. The Company used its \$1.5 billion syndicated bank line together with repurchase agreements to fund mortgages during this period. The overall interest expense increased from the 2021 quarter due to higher prevailing interest rates on the Company's floating rate debt as short-term rates increased significantly with monetary tightening from central banks to address inflation. Interest expense also includes the cost of carry related to the Company's economic hedging program where costs increased by \$1.3 million year over year.

### *Other Operating Expenses*

Other operating expenses increased by 30% to \$16.9 million from \$13.0 million, primarily due to occupancy related costs and depreciation of computer equipment. The costs to occupy its new Toronto headquarters including the amortization of new leaseholds are higher than incurred in the previous head office. Other expenses that decreased in the pandemic due to limitations on travel and discretionary spending also increased as pandemic travel restrictions lifted.

### *Income before Income Taxes and Pre-FMV Income*

Income before income taxes decreased 16% to \$54.6 million from \$65.1 million in the third quarter of 2021. This decrease was partially the result of changing capital markets. The Company's results include gains and losses on account of financial instruments used to economically hedge residential mortgage commitments. As described previously in this MD&A, the Company recorded \$6.4 million of gains on financial instruments (excluding losses related to mortgage and loan investments) in the third quarter of 2022. Comparatively, in the third quarter of 2021, the Company recorded \$0.3 million of gains on financial instruments (excluding the losses related to mortgage and loan investments). The change in these values accounted for a \$6.1 million increase in comparative income before income taxes. Pre-FMV Income, which excludes these changes, decreased by 26% to \$48.2 million from \$64.9 million. This change was largely the result of a 25% drop in new residential origination and a competitive market for volume. As mortgage rates rose over the past six months, housing transactions slowed across the country. As lenders competed in a smaller market, the Company increased broker incentives to increase referrals. Together with tight funding spreads for securitized floating rate mortgages and employee head count designed to underwrite higher volumes, profitability was lower. During the pandemic, the Company increased originations by a factor of about 30%. At the same time the volumes that it processed in its third-party underwriting department also increased significantly. The Company's employees worked extra hours to address the additional volume. This workload was not sustainable with existing staffing levels and the Company increased headcount to underwrite the large volumes being originated. Higher headcount together with a competitive environment for skilled underwriters in an inflationary environment resulted in \$5.1 million of higher salary costs year over year.

### *Income Tax Expense*

The provision for taxes decreased by 17% to \$14.5 million from \$17.5 million. The provision decreased proportionately with net income before income taxes.

### *Other Comprehensive Income*

For the commercial segment, the Company hedges the interest rate risk associated with insured multi-residential mortgages. This hedging begins on commitment and ends when the Company either securitizes the mortgages or places the mortgage with an institutional investor. As the Company determined that these cash flow hedges were effective, the Company recorded \$19.2 million of pre-tax net losses on such hedges in OCI in the third quarter of 2022. In the quarter, the Company amortized a portion of the gains and losses in accumulated OCI into regular earnings; this was \$2.2 million. The remaining OCI amount will be amortized into net income in future periods.

## Operating Segment Review

The Company aggregates its business from two segments for financial reporting purposes: (i) Residential (which includes single-family residential mortgages), and (ii) Commercial (which includes multi-unit residential and commercial mortgages), as summarized below:

<b>Operating Business Segments</b>				
<b>For the Period Ended</b>	<b>Residential</b>		<b>Commercial</b>	
	<b>(\$000s except percent amounts)</b>			
	<b>September 30, 2022</b>	<b>September 30, 2021</b>	<b>September 30, 2022</b>	<b>September 30, 2021</b>
Originations and renewals	6,577,876	7,867,877	2,531,667	2,867,402
<i>Percentage change</i>	<i>(16%)</i>		<i>(12%)</i>	
Revenue	277,090	263,104	115,323	90,600
<i>Percentage change</i>	<i>5%</i>		<i>27%</i>	
Income before income taxes	30,096	49,893	24,549	15,241
<i>Percentage change</i>	<i>(40%)</i>		<i>61%</i>	
<b>As at</b>	<b>September 30, 2022</b>	<b>December 31, 2021</b>	<b>September 30, 2022</b>	<b>December 31, 2021</b>
Identifiable assets	28,222,553	28,813,695	14,139,896	13,430,687
Mortgages under administration	87,570,667	84,895,778	41,750,986	39,011,848

### Residential Segment

Overall residential origination volumes including renewals decreased by 16% between the third quarters of 2022 and 2021 while residential revenues increased by 5%. Revenue benefitted from the impact of financial instruments. Excluding the impact of these revenues, adjusted revenue increased by 3%. Revenue was affected in 2022 by lower origination which translated into lower placement fees. Higher interest earned on the securitized portfolio and mortgages accumulated for securitization offset the decrease in placement fees. Net income before tax was also affected by fair value-related revenues. Without the impact of these revenues, net income before tax decreased to \$23.7 million in the 2022 quarter from \$49.6 million in 2021, or by 52%. This is the outcome of lower revenues on placement activity, higher per-unit broker fees combined with higher headcount which created a comparatively more expensive operating environment. Identifiable assets decreased from December 31, 2021, as the Company's pledged mortgages under securitization decreased with high rates of prepayment. This was offset with increased mortgages accumulated for securitization.

### Commercial Segment

2022 third quarter commercial revenues were higher compared to 2021 largely because of an increase in the securitized portfolio. In the last twelve months, the Company elected to securitize a larger percentage of its commercial segment mortgage origination, specifically 10-year term insured mortgages in 2022 and 2021. This increased the commercial segment portfolio by about \$2.3 billion or 23% since September 2021 and produced an increase in revenues on securitization of \$18 million. Income before income taxes increased by 61% year over year. The increase is due to placing a greater portion of mortgages with institutional investors in the quarter such that placement fees were higher and the Company continued to earn revenue from the portfolio of mortgages securitized in prior periods. Higher interest revenue earned on mortgage investments and escrow deposits were also favorable to income. Identifiable assets increased from those at December 31, 2021 as the Company increased securitized mortgages by about \$1.6 billion.

## Liquidity and Capital Resources

The Company's fundamental liquidity strategy has been to invest in prime Canadian mortgages. Management's belief has always been that these mortgages are considered "AAA" by investors and should always be well bid and highly liquid. This strategy proved effective during the turmoil experienced in 2007 through 2009, and once again in the 2020 pandemic, when capital markets were disrupted and the demand for high-quality assets increased. As the Company's results in those years demonstrated, First National was able to attract investors to purchase its mortgage origination at profitable margins. Originating prime mortgages also allows the Company to securitize in the capital markets; however, this activity requires significant cash resources to purchase and hold mortgages prior to arranging for term debt through the securitization markets. For this purpose, the Company uses the combination of unsecured notes and the Company's revolving bank credit facility. This aggregate indebtedness is typically used to fund: (1) mortgages accumulated for sale or securitization, (2) the origination costs associated with securitization, and (3) mortgage and loan investments. The Company has a credit facility with a syndicate of financial institutions for total credit of \$1.5 billion. This facility was extended in April 2022 for a five-year term maturing in March 2027. At September 30, 2022, the Company had entered into repurchase transactions with financial institutions to borrow \$1.8 billion related to \$1.9 billion of mortgages held in "mortgages accumulated for sale or securitization" on the balance sheet.

At September 30, 2022, outstanding bank indebtedness was \$1,113.3 million (December 31, 2021 - \$965.4 million). This debt was used to fund \$976.0 million (December 31, 2021 - \$951.3 million) of mortgages accumulated for sale or securitization. At September 30, 2022, the Company's other interest-yielding assets included: (1) deferred placement fees receivable of \$63.4 million (December 31, 2021 - \$64.4 million) and (2) mortgage and loan investments of \$187.9 million (December 31, 2021 - \$192.3 million). The portion of bank indebtedness and the senior unsecured notes that fund assets other than mortgages accumulated for sale or securitization is considered by the Company a proxy for true leverage. This leverage has increased between December 31, 2021, and September 30, 2022, and now stands at \$536.4 million (December 31, 2021 - \$413.0 million). This represents a debt-to-equity ratio of approximately 0.77:1. This ratio is higher than the ratio of 0.72:1 at December 31, 2021. In general, the increase was the result of the investment of \$101 million in cash collateral and subordinate notes for the Company's Alt-A securitization program. The Company believes the ratio is appropriate given the nature of the assets which the debt is funding.

Since being approved as an issuer of NHA-MBS, the Company has funded the difference between the mortgages it uses to create NHA-MBS and the debt obligations it assumes upon issuance. In recent years, this requirement has generally been limited to mortgages in arrears where First National does not receive payments from the borrower but is obliged to pay the interest and amortizing principal on the NHA-MBS debt. However, due to 2020 related national unemployment pursuant to the COVID-19 pandemic, this funding requirement increased as borrowers requested mortgage payment deferrals. In such situations, the Company determined to grant mortgage payment deferrals. Qualifying borrowers received three months of payment deferral. In cases of extended hardship, the Company provided a second three-month deferral after the initial deferral period ended. During this deferral period, a portion of such mortgages ceased to amortize and interest otherwise payable was capitalized to the principal of the mortgage. The three mortgage default insurers approved these steps, permitting the deferrals to occur without any impact on subsequent claims under the mortgage insurance policies. In turn, First National has been required to make "timely payments" on the NHA-MBS securities. This means that despite not receiving payments from borrowers on the mortgages that support the NHA-MBS, the Company has been required to pay the interest and amortizing principal on the debt. In effect, the Company de-leveraged its balance sheet by paying off the debt while the related mortgages did not as amortize as quickly. At September 30, 2022, the Company estimates that it had reduced its NHA MBS debt by approximately \$28 million (December 31, 2021 - \$46 million) because of the impact of deferred payments. This has been funded by the Company's available cash resources.

The Company funds a portion of its mortgage originations for institutional placement on the same day as the advance of the related mortgage. The remaining originations are funded by the Company on behalf of institutional investors or pending securitization by the Company. On specified days, the Company aggregates all mortgages warehoused to date for an institutional investor and transacts a settlement with that institutional investor. A similar process occurs prior to arranging for funding through securitization. The

Company uses a portion of the committed credit facility with the banking syndicate to fund the mortgages during this warehouse period. The credit facility is designed to be able to fund the highest balance of warehoused mortgages in a month and is normally only partially drawn.

The Company also invests in short-term mortgages, usually for six- to 18-month terms, to bridge existing borrowers in the interim period before long-term financing. The banking syndicate has provided credit facilities to partially fund these investments. As these investments return cash, it will be used to pay down this bank indebtedness. The syndicate has also provided credit to finance a portion of the Company's deferred placement fees receivable and the origination costs associated with securitization, as well as other miscellaneous longer-term financing needs.

A portion of the Company's capital has been employed to support its ABCP and NHA-MBS programs, primarily to provide credit enhancements as required by rating agencies. The most significant portion of cash collateral is the investment made on behalf of the Company's ABCP programs. As at September 30, 2022, the investment in cash collateral was \$133.9 million (December 31, 2021 - \$105.1 million).

The Company's Board of Directors has elected to pay dividends, when declared, on a monthly basis on the outstanding common shares and on a quarterly basis on the outstanding preference shares. For purposes of the enhanced dividend tax credit rules contained in the *Income Tax Act* (Canada) and any corresponding provincial and territorial tax legislation, all dividends (and deemed dividends) paid by the Company to Canadian residents on both common and preference shares after June 30, 2010, are designated as "eligible dividends". Unless stated otherwise, all dividends (and deemed dividends) paid by the Company hereafter are designated as "eligible dividends" for the purposes of such rules.

## **Financial Instruments and Risk Management**

The Company records mortgages accumulated for sale and mortgage and loan investments as financial assets measured at "fair value through profit or loss" such that changes in market value are recorded in the consolidated statement of income. The mortgages accumulated for sale are held for very short periods, and any change in value due to changing interest rates is the obligation of the ultimate institutional investor. Accordingly, the Company believes there will be little, if any, effect on its income related to the change in fair value of these mortgages. The majority of mortgages in mortgage and loan investments are uninsured commercial segment bridge loans. These are primarily floating rate loans that have mortgage terms of 18 months or less. As the mortgages do not conform to conventional mortgage lending, there are few active quoted markets available to determine the fair value of these assets. The Company estimates fair value based upon: benchmark interest rates, credit spreads for similar products, creditworthiness and status of the borrower, valuation of the underlying real property, payment history, and other conditions specific to the rationale for the loan. Any favourable or unfavourable amounts will be recorded in the statement of income each quarter.

The Company believes its hedging policies are suitably designed such that the interest rate risk of holding mortgages prior to securitization is mitigated. The Company designates hedging relationships such that the results of any effective hedging does not affect the Company's statement of income. See previous discussion in this MD&A under "Realized and Unrealized Gains (Losses) on Financial Instruments". As at September 30, 2022, the Company had \$1.4 billion of notional forward bond positions related to its single-family programs. For multi-unit residential and commercial mortgages, the Company assumes all mortgages committed will fund, and hedges each mortgage individually. This includes mortgages committed for the CMB program as well as mortgages to be sold to the Company's other securitization vehicles. As at September 30, 2022, the Company had entered into \$0.4 billion of notional value forward bond sales for this segment. The Company is also a party to three interest rate swaps that economically hedge the interest rate exposure related to certain CMB transactions in which the Company has replacement obligations. As at September 30, 2022, the aggregate value of these swaps, maturing between December 2023 and September 2026, was a \$13.1 million liability. During the third quarter of 2022, the fair value of these swaps decreased by \$2.2 million.

As described above, the Company employs various strategies to reduce interest rate risk. In the normal course of business, the Company also takes on credit spread risk. This is the risk that the credit spread at which a mortgage is originated changes between the date of commitment of that mortgage and the ultimate date of placement or securitization. If credit spreads widen during this holding period, this is unfavourable for the Company. It means that the Company cannot fund the mortgages originated with a funding source as effectively as originally intended. Despite entering into effective interest rate hedges, the Company's exposure to credit spreads will remain. This risk is inherent in the Company's business model and the Company believes it cannot be economically hedged. As at September 30, 2022, the Company had various exposures to changing credit spreads. In particular, in mortgages accumulated for sale or securitization, there were approximately \$2.7 billion of mortgages that were susceptible to some degree of changing credit spreads.

## **Capital Expenditures**

A significant portion of First National's business model is the origination and placement or securitization of financial assets. Generally, placement activities do not require any capital investment. Securitization transactions may require the investment of significant amounts of the Company's own capital. This capital is provided in the form of cash collateral, credit enhancements, and the upfront funding of broker fees and other origination costs. These are described more fully in the "Liquidity and Capital Resources" section above. The business requires capital expenditures on technology (both software and hardware), leasehold improvements, and office furniture. During the quarter ended September 30, 2022, the Company purchased new computer equipment and software and made leasehold improvements. In the long term, the Company expects capital expenditures on fixed assets will be approximately \$10 million annually. 2021 expenditures were much higher as the Toronto office moved to its new premises and invested in new leasehold improvements.

## **Summary of Contractual Obligations**

The Company's long-term obligations include leases of premises with terms up to 15 years for its offices across Canada, and its obligations for the ongoing servicing of mortgages sold to securitization conduits and mortgages related to purchased servicing rights. The Company sells its mortgages to securitization conduits on a fully serviced basis and is responsible for the collection of the principal and interest payments on behalf of the conduits, including the management and collection of mortgages in arrears.

## Critical Accounting Policies and Estimates

The Company prepares its financial statements in accordance with IFRS, which requires management to make estimates, judgments and assumptions that management believes are reasonable based upon the information available. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Management bases its estimates on historical experience and other assumptions that it believes to be reasonable under the circumstances. Management also evaluates its estimates on an ongoing basis. The significant accounting policies of First National are described in Note 2 to the Company's annual consolidated financial statements as at December 31, 2021. The policies that First National believes are the most critical to aid in fully understanding and evaluating its reported financial results include the determination of the gains on deferred placement fees and the impact of fair value accounting on financial instruments.

The Company uses estimates in valuing its gain or loss on the sale of its mortgages placed with institutions earning a deferred placement fee. Under IFRS, valuing a gain on deferred placement fees requires the use of estimates to determine the fair value of the retained interest in the mortgages. These retained interests are reflected on the Company's balance sheet as deferred placement fees receivable. The key assumptions used in the valuation of gains on deferred placement fees are prepayment rates and the discount rate used to present value future expected cash flows. The annual rate of unscheduled principal payments is determined by reviewing portfolio prepayment experience on a monthly basis. The Company assumes there is virtually no prepayment on multi-unit residential fixed-rate mortgages.

On a quarterly basis, the Company reviews the estimates used to ensure their appropriateness and monitors the performance statistics of the relevant mortgage portfolios to adjust and improve these estimates. The estimates used reflect the expected performance of the mortgage portfolio over the lives of the mortgages. The method of determining the assumptions underlying the estimates used for the quarter ended September 30, 2022, are consistent with those used for the year ended December 31, 2021 and quarters ended June 30 and March 31, 2022.

The Company elects to treat certain of its financial assets and liabilities, including mortgages accumulated for sale, mortgage and loan investments and bonds sold short, at fair value through profit or loss. Essentially, this policy requires the Company to record changes in the fair value of these instruments in the current period's earnings. A portion of the bonds sold short are designated as an effective hedge, and accordingly, a portion of the change in the short bonds' fair value may be recorded in Other Comprehensive Income or deferred against hedge assets. This accounting has reduced the volatility in earnings as changes in the value on short bonds have been matched to the recognition of the change in value of the hedged mortgages. The Company's assets and liabilities are such that the Company must use valuation techniques based on assumptions that are not fully supported by observable market prices or rates in most cases. Much like the valuation of deferred placement fees receivable described above, the Company's method of determining the fair value of the assets listed above are subject to Company estimates. The most significant would be implicit in the valuation of mortgage and loan investments. These are generally non-homogeneous mortgages where it is difficult to find independent valuation comparatives. The Company uses information in its underwriting files, regional real estate information and other internal measures to determine the fair value of these assets.

As a mortgage lender, the Company invests in uninsured mortgages. When it funds these mortgages through securitization debt, it continues to be liable for any credit losses. The key inputs in the measurement of any expected credit loss ("ECL") include probability of default, loss given default and forecast of future economic conditions, which involves significant judgment. Upon application of IFRS 9 with respect to impairment, there has been no impact on the Company's earnings. Because of the high proportion of government-insured mortgages in its securitized portfolio and the low historical loss rates on the uninsured mortgages on which the Company lends, \$0.6 million of credit losses were recorded in the third quarter of 2022.

## **Disclosure Controls and Internal Controls over Financial Reporting**

The Company's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company in reports filed under Canadian securities laws is recorded, processed, summarized and reported within the time periods specified under those laws, and include controls and procedures that are designed to ensure that information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with reporting standards; however, because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements on a timely basis.

No changes were made in the Company's internal controls over financial reporting during the quarter ended September 30, 2022, that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

## **ESG**

The Company issued its initial Public Accountability Statement in the fall of 2021. This report explores First National's approach to sustainability and provides environmental, social and governance disclosure that has been reviewed and approved by our Board of Directors. It complements our Management Information Circular, Annual Information Form, Management Discussion and Analysis and Annual Report, all of which offer more information about the financial position, priorities, responsibilities and commitments of the consolidated operations of First National.

## **Risks and Uncertainties Affecting the Business**

The business, financial condition and results of operations of the Company are subject to a number of risks and uncertainties and are affected by a number of factors outside the control of management of the Company. In addition to the risks addressed elsewhere in this discussion and the financial statements, these risks include: ability to sustain performance and growth, reliance on sources of funding, concentration of institutional investors including third-party servicing customers, reliance on independent mortgage brokers, changes in interest rates, repurchase obligations and breach of representations and warranties on mortgage sales, risk of servicer termination including the impact of trigger events on cash collateral and retained interests, reliance on multi-unit residential and commercial mortgages, general economic conditions, legislation and government regulation (including regulations imposed by the Department of Finance and CMHC and the policies set by and for mortgage default insurance companies), potential for losses on uninsured mortgages, competition, reliance on mortgage insurers, reliance on key personnel and the ability to attract and retain employees and executives, conduct and compensation of independent mortgage brokers, failure or unavailability of computer and data processing systems and software, insufficient insurance coverage, change in or loss of ratings, impact of natural disasters and other events, unfavourable litigation, and environmental liability. In addition, there are risks associated with the structure of the Company, including: those related to the dependence on FNFLP, leverage and restrictive covenants, dividends that are not guaranteed and could fluctuate with the Company's performance, restrictions on potential growth, the market price of the Company's shares, statutory remedies, control of the Company, and contractual restrictions. The Company is subject to Canadian federal and provincial income and commodity tax laws and pays such taxes as it determines are compliant with such legislation. Among the risks of all potential tax matters, there is a risk that tax legislation changes are detrimental to the Company or that Canadian tax authorities interpret tax legislation differently than the Company's filing positions. Risk and risk exposure are managed through a combination of insurance, a system of internal controls and sound operating practices. The Company's key business model is to originate primarily prime mortgages and find funding through various channels to earn ongoing servicing or spread income. For the single-family residential segment, the Company relies on independent mortgage brokers for origination and several large institutional investors for sources of funding, one of which accounts for about 20% of the Companies total revenues. These relationships are critical to the Company's success. In October 2019, the sale transaction involving an institution for which the Company administers a large portfolio of third-party originated mortgages was completed. The new owners of the institution may decide not to renew the existing contract with First National or to exercise termination clauses within the agreement. In the event of non-renewal or termination, the Company's MUA will decrease. For a more complete discussion of the risks affecting the Company, reference should be made to the Company's Annual Information Form.

The COVID-19 crisis was the cause of unemployment across the country and widespread economic hardship. During the duration of this crisis, the probability of the risks listed above having a negative impact on the Company increased. Although the virus has not been entirely eradicated, the Company no longer views this as a crisis. Recent rate hikes by the Bank of Canada have raised short term rates by about 300 basis points in the past six months. In that same period mortgage rates for 5-year term mortgage have increased by approximately 300 basis points and bank prime lending rates have risen by 300 basis points with the latest change occurring in early September. These are significant changes that have taken place over a short period of time. Higher borrowing rates will directly affect consumers across the country. Management believes these changes may impact the Company negatively in future periods. Related losses could be material.

## **Forward-Looking Information**

Forward-looking information is included in this MD&A. In some cases, forward-looking information can be identified by the use of terms such as “may”, “will”, “should”, “expect”, “plan”, “anticipate”, “believe”, “intend”, “estimate”, “predict”, “potential”, “continue” or other similar expressions concerning matters that are not historical facts. Forward-looking information may relate to management’s future outlook and anticipated events or results, and may include statements or information regarding the future financial position, business strategy and strategic goals, product development activities, projected costs and capital expenditures, financial results, risk management strategies, hedging activities, geographic expansion, licensing plans, taxes and other plans and objectives of or involving the Company. Particularly, information regarding growth objectives, any increase in mortgages under administration, future use of securitization vehicles, industry trends and future revenues is forward-looking information. Forward-looking information is based on certain factors and assumptions regarding, among other things, interest rate changes and responses to such changes, the demand for institutionally placed and securitized mortgages, the status of the applicable regulatory regime, and the use of mortgage brokers for single-family residential mortgages. This forward-looking information should not be read as providing guarantees of future performance or results, and will not necessarily be an accurate indication of whether or not, or the times by which, those results will be achieved. While management considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect. Forward-looking information is subject to certain factors, including risks and uncertainties, which could cause actual results to differ materially from what management currently expects. These factors include reliance on sources of funding, concentration of institutional investors, reliance on independent mortgage brokers, and changes in interest rates as outlined in the “Risk and Uncertainties Affecting the Business” section. In evaluating this information, the reader should specifically consider various factors, including the risks outlined in the “Risk and Uncertainties Affecting the Business” section, that may cause actual events or results to differ materially from any forward-looking information. The forward-looking information contained in this discussion represents management’s expectations as of October 25, 2022, and is subject to change after such date. However, management and the Company disclaim any intention or obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

## Outlook

The third quarter saw the continuation of trends established at the beginning of 2022: a competitive marketplace and reduced origination activity. The quarter also featured more increases in Bank of Canada's ("BoC") overnight rate as it addressed risks associated with inflation. Between July 1, 2022 and September 30, 2022, the overnight rate increased by another 100 basis points. Equally important as the increases were the BoC's statements indicating the likelihood of more interest rate hikes to come. The Company believes these increases have contributed to significantly higher mortgage rates and reduced the affordability of housing across the country. Despite this uncertain business environment, the Company successfully grew MUA and continued to build its portfolio of mortgages pledged under securitization. First National will benefit from this growth in the future: earning income from mortgage administration, net securitization margin and increased renewal opportunities.

In the short term, the expectation for the remainder of 2022 is for lower origination as higher mortgage rates further reduce housing affordability and dampen activity across the country. Management recognizes that home purchasing activity through the second half of 2020 and all of 2021 was unsustainable and that while drivers such as higher immigration might support the market, a continued moderation in housing activity is possible. Although, management is confident that First National will remain competitive and a leader in the marketplace, it estimates that year-over-year origination will moderate in line with housing activity across Canada. Management anticipates commercial origination will also slow as the market digests changing property valuations given the new underlying financial environment. At this time, the Company foresees a solid fourth quarter for commercial originations but weaker commitments going into 2023.

During the pandemic, the value of First National's business model has been demonstrated. By designing systems that do not rely on face-to-face interactions, the Company's business practices have resonated with mortgage brokers and borrowers alike. The economic effects of COVID-19 are expected to slowly diminish although the duration and impact of the pandemic is unknown at this time, as is the long-term efficacy of the government and central bank interventions. It is still not possible to reliably estimate the length and severity of these developments and the impact on the financial results and condition of the Company and its operating subsidiaries in future periods.

First National is well prepared to execute its business plan. The Company expects to enjoy the value of its continued goodwill with broker partners earned over the last 30+ years and reinforced during the pandemic. With diverse relationships over an array of institutional investors and solid securitization markets, the Company has access to consistent and reliable sources of funding.

The Company is confident that its strong relationships with mortgage brokers and diverse funding sources will continue to set First National apart from its competition. The Company will continue to generate income and cash flow from its \$36 billion portfolio of mortgages pledged under securitization and \$90 billion servicing portfolio and focus on the value inherent in its significant single-family renewal book.

Interim condensed consolidated financial statements

**First National Financial Corporation**

[Unaudited]

Third quarter 2022

# First National Financial Corporation

## Interim condensed consolidated statements of financial position

[Unaudited – in thousands of Canadian dollars]

As at

	September 30, 2022	December 31, 2021
	\$	\$
<b>Assets</b>		
Restricted cash <i>[note 3]</i>	668,252	815,807
Cash held as collateral for securitization <i>[note 3]</i>	133,949	105,108
Accounts receivable and sundry	160,612	97,602
Mortgages accumulated for sale or securitization <i>[note 5]</i>	2,873,701	2,757,640
Mortgages pledged under securitization <i>[note 3]</i>	36,117,242	35,435,455
Deferred placement fees receivable <i>[note 4]</i>	63,387	64,370
Mortgage and loan investments <i>[note 6]</i>	187,862	192,340
Securities purchased under resale agreements	2,051,285	2,677,972
Other assets <i>[note 7]</i>	115,847	119,129
Income taxes recoverable	20,088	8,735
<b>Total assets</b>	<b>42,392,225</b>	<b>42,274,158</b>
<b>Liabilities and equity</b>		
<b>Liabilities</b>		
Bank indebtedness <i>[note 9]</i>	1,113,298	965,420
Obligations related to securities and mortgages sold under repurchase agreements	1,831,459	1,768,029
Accounts payable and accrued liabilities	265,886	222,369
Securities sold short	2,044,713	2,677,689
Debt related to securitized mortgages <i>[note 10]</i>	35,893,418	35,576,353
Senior unsecured notes	399,138	398,888
Deferred income tax liabilities	150,100	88,000
<b>Total liabilities</b>	<b>41,698,012</b>	<b>41,696,748</b>
<b>Equity attributable to shareholders</b>		
Common shares <i>[note 11]</i>	122,671	122,671
Preferred shares <i>[note 11]</i>	97,394	97,394
Retained earnings	412,190	364,974
Accumulated other comprehensive gain (loss)	61,958	(7,629)
<b>Total equity</b>	<b>694,213</b>	<b>577,410</b>
<b>Total liabilities and equity</b>	<b>42,392,225</b>	<b>42,274,158</b>

See accompanying notes

On behalf of the Board:



Robert Mitchell



Robert Pearce

## First National Financial Corporation

### Interim condensed consolidated statements of income

[Unaudited – in thousands of Canadian dollars]

	Three months ended		Nine months ended	
	September 30,	September 30,	September 30,	September 30,
	2022	2021	2022	2021
	\$	\$	\$	\$
<b>Revenue</b>				
Interest revenue – securitized mortgages	238,065	198,018	632,892	598,036
Interest expense – securitized mortgages	(194,805)	(157,872)	(509,568)	(479,680)
Net interest – securitized mortgages	43,260	40,146	123,324	118,356
Placement fees	58,471	84,977	216,054	235,613
Gains on deferred placement fees <i>[note 4]</i>	4,615	3,462	10,095	13,063
Mortgage investment income	30,022	16,198	71,311	45,969
Mortgage servicing income	55,394	51,432	168,193	156,747
Realized and unrealized gains (losses) on financial instruments <i>[note 12]</i>	5,846	(383)	60,963	5,886
	197,608	195,832	649,940	575,634
<b>Expenses</b>				
Brokerage fees	40,593	54,867	147,009	153,003
Salaries and benefits	46,809	44,651	148,294	127,472
Interest	38,697	18,148	93,780	48,425
Other operating	16,864	13,032	50,044	40,024
	142,963	130,698	439,127	368,924
<b>Income before income taxes</b>	<b>54,645</b>	65,134	<b>210,813</b>	206,710
Income tax expense	14,500	17,520	55,750	54,120
<b>Net income for the period</b>	<b>40,145</b>	47,614	<b>155,063</b>	152,590
<b>Earnings per share</b>				
Basic <i>[note 11]</i>	0.66	0.78	2.55	2.51

See accompanying notes

**First National Financial Corporation**

**Interim condensed consolidated statements of comprehensive income**

[Unaudited – in thousands of Canadian dollars]

	Three months ended		Nine months ended	
	September 30, 2022	September 30, 2021	September 30, 2022	September 30, 2021
	\$	\$	\$	\$
<b>Net income for the period</b>	<b>40,145</b>	47,614	<b>155,063</b>	152,590
<b>Other comprehensive income (loss) items that may be subsequently reclassified to income</b>				
Net gains (losses) from change in fair value of cash flow hedges	(19,207)	6,770	118,655	30,225
Reclassification of net losses (gains) to income	(2,158)	1,981	(24,018)	798
	(21,365)	8,751	94,637	31,023
Income tax recovery (expense)	5,600	(2,380)	(25,050)	(8,280)
Total other comprehensive income (loss)	(15,765)	6,371	69,587	22,743
<b>Total comprehensive income for the period</b>	<b>24,380</b>	53,985	<b>224,650</b>	175,333

**First National Financial Corporation**

**Interim condensed consolidated statements of changes in equity**

[Unaudited – in thousands of Canadian dollars]

	<b>Common shares</b>	<b>Preferred shares</b>	<b>Retained earnings</b>	<b>Accumulated other comprehensive income</b>	<b>Total equity</b>
	\$	\$	\$	\$	\$
Balance as at January 1, 2022	<b>122,671</b>	<b>97,394</b>	<b>364,974</b>	<b>(7,629)</b>	<b>577,410</b>
Net income	—	—	<b>155,063</b>	—	<b>155,063</b>
Other comprehensive income	—	—	—	<b>69,587</b>	<b>69,587</b>
Dividends paid or declared	—	—	<b>(107,847)</b>	—	<b>(107,847)</b>
<b>Balance as at September 30, 2022</b>	<b>122,671</b>	<b>97,394</b>	<b>412,190</b>	<b>61,958</b>	<b>694,213</b>

	<b>Common shares</b>	<b>Preferred shares</b>	<b>Retained earnings</b>	<b>Accumulated other comprehensive loss</b>	<b>Total equity</b>
	\$	\$	\$	\$	\$
Balance as at January 1, 2021	122,671	97,394	383,993	(33,257)	570,801
Net income	—	—	152,590	—	152,590
Other comprehensive income	—	—	—	22,743	22,743
Dividends paid or declared	—	—	(102,706)	—	(102,706)
<b>Balance as at September 30, 2021</b>	<b>122,671</b>	<b>97,394</b>	<b>433,877</b>	<b>(10,514)</b>	<b>643,428</b>

# First National Financial Corporation

## Interim condensed consolidated statements of cash flows

[Unaudited – in thousands of Canadian dollars]

	Three months ended		Nine months ended	
	September 30, 2022	September 30, 2021	September 30, 2022	September 30, 2021
	\$	\$	\$	\$
<b>Operating activities</b>				
Net income for the period	40,145	47,614	155,063	152,590
Add (deduct) items				
Provision for deferred income taxes	6,400	120	37,050	7,620
Non-cash portion of gains on deferred placement fees	(4,453)	(3,328)	(9,728)	(13,113)
Decrease (increase) in restricted cash	179,111	282,314	147,555	(115,289)
Net investment in mortgages pledged under securitization	(710,476)	(464,689)	(785,095)	(1,282,409)
Net increase in debt related to securitized mortgages	483,843	153,016	420,373	1,316,401
Securities purchased under resale agreements, net	1,125,048	382,533	626,687	7,676
Securities sold short, net	(1,213,196)	(371,811)	(454,989)	54,895
Amortization of deferred placement fees receivable	3,446	3,454	10,711	10,702
Amortization of property, plant and equipment	4,440	2,775	13,320	8,324
Unrealized losses (gains) on financial instruments	55,473	(9,498)	(69,027)	(51,046)
	(30,219)	22,500	91,920	96,351
Net change in non-cash working capital balances related to operations	(167,862)	699,912	(156,254)	134,132
<b>Cash provided by (used in) operating activities</b>	<b>(198,081)</b>	<b>722,412</b>	<b>(64,334)</b>	<b>230,483</b>
<b>Investing activities</b>				
Additions to property, plant and equipment	(4,982)	(8,517)	(10,037)	(22,121)
Investment in cash held as collateral for securitization	(14,266)	(7,438)	(28,841)	(13,737)
Investment in mortgage and loan investments	(341,712)	(347,836)	(1,111,255)	(1,089,279)
Repayment of mortgage and loan investments	466,430	445,847	1,115,153	1,067,102
<b>Cash provided by (used in) investing activities</b>	<b>105,470</b>	<b>82,056</b>	<b>(34,980)</b>	<b>(58,035)</b>
<b>Financing activities</b>				
Dividends paid	(35,941)	(35,910)	(107,764)	(101,436)
Obligations related to securities and mortgages sold under repurchase agreements	17,141	(656,194)	63,430	(296,084)
Repayment of lease liabilities	(1,410)	(974)	(4,230)	(2,922)
<b>Cash used in financing activities</b>	<b>(20,210)</b>	<b>(693,078)</b>	<b>(48,564)</b>	<b>(400,442)</b>
<b>Net decrease (increase) in bank indebtedness, during the period</b>	<b>(112,821)</b>	<b>111,390</b>	<b>(147,878)</b>	<b>(227,994)</b>
Bank indebtedness, beginning of period	(1,000,477)	(1,022,216)	(965,420)	(682,832)
<b>Bank indebtedness, end of period</b>	<b>(1,113,298)</b>	<b>(910,826)</b>	<b>(1,113,298)</b>	<b>(910,826)</b>
<b>Supplemental cash flow information</b>				
Interest received	281,203	231,112	755,300	712,535
Interest paid	197,633	148,522	535,912	466,772
Income taxes paid	5,669	17,707	30,052	59,820

# First National Financial Corporation

## Notes to interim condensed consolidated financial statements

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

September 30, 2022

### 1. General organization and business of First National Financial Corporation

First National Financial Corporation [the “Corporation” or “Company”] is the parent company of First National Financial LP [“FNFLP”], a Canadian-based originator, underwriter and servicer of predominantly prime residential [single family and multi-unit] and commercial mortgages. With over \$129 billion in mortgages under administration as at September 30, 2022, FNFLP is a significant participant in the mortgage broker distribution channel.

The Corporation is incorporated under the laws of the Province of Ontario, Canada and has its registered office and principal place of business located at 16 York Street, Toronto, Ontario. The Corporation’s common and preferred shares are listed on the Toronto Stock Exchange under the symbols FN, FN.PR.A and FN.PR.B, respectively.

### 2. Significant accounting policies

#### Basis of preparation

The interim condensed consolidated financial statements have been prepared in accordance with IAS 34 – *Interim Financial Reporting* under International Financial Reporting Standards, as issued by the International Accounting Standards Board. The interim condensed consolidated financial statements have been prepared using the same accounting policies used in the preparation of the audited annual consolidated financial statements for the year ended December 31, 2021.

The comparative unaudited interim condensed consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2022 unaudited interim condensed consolidated financial statements. Costs related to hedging have been reclassified from Other Operating Expense to Interest Expense for presentation purposes.

These interim condensed consolidated financial statements should be read in conjunction with the audited annual consolidated financial statements and are presented in Canadian dollars with all values rounded to the nearest thousand, except when otherwise indicated. The interim condensed consolidated financial statements were authorized for issue by the Board of Directors on October 25, 2022.

#### Estimates and use of judgement

Management has exercised judgement in the process of applying the Company’s accounting policies. Some of the Company’s accounting policies require subjective, complex judgements and estimates relating to matters that are inherently uncertain. The preparation of these interim condensed consolidated financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the consolidated balance sheet dates and the reported amounts of revenue and expenses during the reporting periods.

## First National Financial Corporation

### Notes to interim condensed consolidated financial statements

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

September 30, 2022

#### 3. Mortgages pledged under securitization

The Company securitizes residential and commercial mortgages in order to raise debt to fund these mortgages. Most of these securitizations consist of the transfer of fixed and floating rate mortgages into securitization programs, such as ABCP, NHA-MBS, and CMB. In these securitizations, the Company transfers the assets to structured entities for cash, and incurs interest-bearing obligations typically matched to the term of the mortgages. These securitizations do not qualify for derecognition, although the structured entities and other securitization vehicles have no recourse to the Company's other assets for failure of the mortgages to make payments when due.

As part of the ABCP transactions, the Company provides cash collateral for credit enhancement purposes as required by the rating agencies. Credit exposure to securitized mortgages is generally limited to this cash collateral. The principal and interest payments on the securitized mortgages are paid to the Company by the structured entities monthly over the term of the mortgages. The full amount of the cash collateral is recorded as an asset and the Company anticipates full recovery of these amounts. NHA-MBS securitizations may also require cash collateral in some circumstances. As at September 30, 2022, the cash held as collateral for securitization was \$133,950 [December 31, 2021 – \$105,108].

The following table compares the carrying amount of mortgages pledged for securitization and the associated debt:

	September 30, 2022		December 31, 2021	
	Carrying amount of securitized mortgages	Carrying amount of associated liabilities	Carrying amount of securitized mortgages	Carrying amount of associated liabilities
	\$	\$	\$	\$
Securitized mortgages	36,023,725	(36,273,562)	35,186,217	(35,659,675)
Capitalized amounts related to hedge accounting	(102,827)	—	50,880	(46,933)
Capitalized origination costs	196,344	—	198,358	—
Debt discounts	—	380,144	—	130,255
	<b>36,117,242</b>	<b>(35,893,418)</b>	35,435,455	(35,576,353)
<b>Add</b>				
Principal portion of payments held in restricted cash	612,892	—	766,118	—
	<b>36,730,134</b>	<b>(35,893,418)</b>	36,201,573	(35,576,353)

The principal portion of payments held in restricted cash represents payments on account of mortgages pledged under securitization which have been received at period end but have not been applied to reduce the associated debt. This cash is applied to pay down the debt in the month subsequent to collection. In order to compare the components of mortgages pledged under securitization-to-securitization debt, this amount is added to the carrying value of mortgages pledged under securitization in the above table.

## First National Financial Corporation

### Notes to interim condensed consolidated financial statements

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

September 30, 2022

Mortgages pledged under securitization have been classified as amortized cost and are carried at par plus adjustment for unamortized origination costs and amount related to hedge accounting.

The changes in capitalized origination costs for the three months ended September 30, 2022 are as follows:

	2022	2021
	\$	\$
<b>Opening balance, June 30</b>	<b>193,247</b>	197,790
Add: new origination costs capitalized in the period	<b>26,268</b>	30,864
Less: amortization in the period	<b>(23,171)</b>	(25,914)
<b>Ending balance, September 30</b>	<b>196,344</b>	202,740

The following table summarizes the mortgages pledged under securitization that are past due:

	September 30, 2022	December 31, 2021
	\$	\$
<b>Arrears days</b>		
31 to 60	<b>548</b>	1,086
61 to 90	<b>48</b>	447
Greater than 90	<b>928</b>	752
	<b>1,524</b>	2,285

All the mortgages listed above are insured, except for three mortgages which are uninsured and have a principal balance of \$939 as at September 30, 2022 [December 31, 2021 – six mortgages, \$1,505]. The Company's exposure to credit loss is limited to uninsured mortgages with principal balances totaling \$4,004,725 [December 31, 2021 – \$3,094,301], before consideration of the value of underlying collateral. Approximately one half of the uninsured mortgages are conventional prime single-family mortgages, with loan to value ratios of 80% or less. The Company has provided an allowance for expected credit losses of \$2,427 as of September 30, 2022 [December 31, 2021 – \$766].

#### 4. Deferred placement fees receivable

The Company enters into transactions with institutional investors to sell primarily fixed rate mortgages in which placement fees are received over time as well as at the time of the mortgage placement. These mortgages are derecognized when substantially all of the risks and rewards of ownership are transferred and the Company has minimal exposure to the variability of future cash flows from these mortgages. The investors have no recourse to the Company's other assets for failure of mortgagors to make payments when due.

## First National Financial Corporation

### Notes to interim condensed consolidated financial statements

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

September 30, 2022

Deferred placement fees receivable is classified as amortized cost and has been calculated initially based on the present value of the anticipated future stream of placement fees. An assumption of no credit losses was used, commensurate with the credit quality of the investors. An assumption of no prepayment for the commercial segment was used, as borrowers cannot refinance for financial advantage without paying the Company a fee commensurate with its investment in the mortgage. The effect of variations, if any, between actual experience and assumptions will be recorded in future statements of income but is expected to be minimal.

	<b>September 30, 2022</b>		
	<b>Residential</b>	<b>Commercial</b>	<b>Total</b>
	\$	\$	\$
Mortgages placed with institutional investors	—	928,404	928,404
Gains on deferred placement fees recognized	—	4,615	4,615
Cash receipts on deferred placement fees received	111	3,998	4,109
	<b>September 30, 2021</b>		
	<b>Residential</b>	<b>Commercial</b>	<b>Total</b>
	\$	\$	\$
Mortgages placed with institutional investors	311,862	619,575	931,437
Gains on deferred placement fees recognized	359	3,103	3,462
Cash receipts on deferred placement fees received	33	4,098	4,131

#### 5. Mortgages accumulated for sale or securitization

Mortgages accumulated for sale or securitization consist of mortgages the Company has originated for its own securitization programs together with mortgages funded in advance of settlement with institutional investors.

Mortgages originated for the Company's own securitization programs are classified as amortized cost and are recorded at par plus adjustment for unamortized origination costs. Mortgages funded for placement with institutional investors are designated as FVTPL and are recorded at fair value. The fair values of mortgages classified as FVTPL approximate their carrying values as the time period between origination and sale is short. The following table summarizes the components of mortgages according to their classification:

	<b>September 30, 2022</b>	<b>December 31, 2021</b>
	\$	\$
Mortgages accumulated for securitization	<b>2,747,434</b>	2,726,697
Mortgages accumulated for sale	<b>126,267</b>	30,943
	<b>2,873,701</b>	2,757,640

## First National Financial Corporation

### Notes to interim condensed consolidated financial statements

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

September 30, 2022

The Company's exposure to credit loss is limited to \$564,755 [December 31, 2021 – \$299,446] of principal balances of uninsured mortgages within mortgages accumulated for sale or securitization, before consideration of the value of underlying collateral. As at September 30, 2022, four of these mortgages are in arrears past 31 days, with a total principal balance of \$527.

#### 6. Mortgage and loan investments

Mortgage and loan investments consist primarily of commercial first and second mortgages held for various terms, the majority of which mature within one year.

Mortgage and loan investments are classified as FVTPL and are recorded on a fair value basis. Any changes in fair value are immediately recognized in income. The Company recorded a loss of \$580 in the quarter ended September 30, 2022 [2021 – \$650].

The portfolio contains \$12,001 [December 31, 2021 – \$12,723] of insured mortgages and \$190,425 [December 31, 2021 – \$179,617] of uninsured mortgage and loan investments as at September 30, 2022. Of the uninsured mortgages, approximately \$14,777 [December 31, 2021 – \$14,874] have principal balance in arrears past 31 days. One of these mortgages is non-performing and the Company has stopped accruing interest. This mortgage has an original principal balance of \$13,605 and a nil carrying value as at September 30, 2022, and December 31, 2021.

#### 7. Other assets

The components of other assets are as follows as at:

	September 30, 2022	December 31, 2021
	\$	\$
Property, plant and equipment, net	36,886	36,968
Right-of-use assets	49,185	52,385
Goodwill	29,776	29,776
	<u>115,847</u>	<u>119,129</u>

The right-of-use assets pertain to five premises leases for the Company's office space. The leases have remaining terms of one to fifteen years. The related lease liability of \$50,653 [December 31, 2021 – \$52,871] is grouped with accounts payable and accrued liabilities on the interim condensed consolidated statements of financial position.

The recoverable amount of the company's goodwill is calculated by reference to the Company's market capitalization, mortgages under administration, origination volume, and profitability. These factors indicate that the Corporation's recoverable amount exceeds the carrying value of its net assets and accordingly, goodwill is not impaired.

## First National Financial Corporation

### Notes to interim condensed consolidated financial statements

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

September 30, 2022

#### 8. Mortgages under administration

As at September 30, 2022, the Company managed mortgages under administration of \$129,321,654 [December 31, 2021 – \$123,907,627], including mortgages held on the Company's interim condensed consolidated statements of financial position. Mortgages under administration are serviced for financial institutions such as banks, insurance companies, pension funds, mutual funds, trust companies, credit unions and securitization vehicles. As at September 30, 2022, the Company administered 319,900 mortgages [December 31, 2021 – 325,399] for 119 institutional investors [December 31, 2021 – 119] with an average remaining term to maturity of 43 months [December 31, 2021 – 43 months].

Mortgages under administration are serviced as follows:

	September 30, 2022	December 31, 2021
	\$	\$
Institutional investors	88,801,066	84,184,863
Mortgages accumulated for sale or securitization and mortgage and loan investments	3,071,842	2,969,617
Mortgages pledged under securitization	36,023,725	35,186,217
CMBS conduits	1,425,021	1,566,930
	<b>129,321,654</b>	<b>123,907,627</b>

The Company's exposure to credit loss is limited to mortgage and loan investments as described in note 6, securitized mortgages as described in note 3 and uninsured mortgages held in mortgages accumulated for securitization as described in note 5.

The Company maintains trust accounts on behalf of the investors it represents. The Company also holds municipal tax funds in escrow for mortgagors. Since the Company does not hold a beneficial interest in these funds, they are not presented on the interim condensed consolidated statements of financial position. The aggregate of these accounts as at September 30, 2022 was \$650,611 [December 31, 2021 – \$806,268].

#### 9. Bank indebtedness

Bank indebtedness includes a revolving credit facility of \$1,500,000 [December 31, 2021 – \$1,500,000] maturing in March 2027. At September 30, 2022, \$1,113,298 [December 31, 2021 – \$965,420] was drawn against which the following have been pledged as collateral:

- [a] a general security agreement over all assets, other than real property, of the Company; and
- [b] a general assignment of all mortgages owned by the Company.

The credit facility bears a variable rate of interest based on prime and bankers' acceptance rates.

## First National Financial Corporation

### Notes to interim condensed consolidated financial statements

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

September 30, 2022

#### 10. Debt related to securitized mortgages

Debt related to securitized mortgages represents the funding for mortgages pledged under the NHA-MBS, CMB and ABCP programs. As at September 30, 2022, debt related to securitized mortgages was \$35,893,418 [December 31, 2021 – \$35,576,353], net of unamortized discount of \$380,144 [December 31, 2021 – \$130,255]. A comparison of the carrying amounts of the pledged mortgages and the related debt is summarized in note 3.

Debt related to securitized mortgages is reduced on a monthly basis when the principal payments received from the mortgages are applied. Debt discounts and premiums are amortized over the term of each debt on an effective yield basis. Debt related to securitization mortgages had a similar contractual maturity profile as the associated mortgages in mortgages pledged under securitization.

#### 11. Shareholders' equity

##### [a] Authorized

Unlimited number of common shares

Unlimited number of cumulative 5-year rate reset preferred shares, Class A Series 1

Unlimited number of cumulative 5-year rate reset preferred shares, Class A Series 2

##### [b] Capital stock activities

	Common shares		Preferred shares	
	#	\$	#	\$
Balance, December 31, 2021 and September 30, 2022	<b>59,967,429</b>	<b>122,671</b>	<b>4,000,000</b>	<b>97,394</b>

##### [c] Earnings per share

	Three months ended		Nine months ended	
	September 30, 2022	September 30, 2021	September 30, 2022	September 30, 2021
	\$	\$	\$	\$
Net income attributable to shareholders	<b>40,145</b>	47,614	<b>155,063</b>	152,590
Less: dividends declared on preferred shares	<b>(767)</b>	(679)	<b>(2,155)</b>	(2,011)
Net earnings attributable to common shareholders	<b>39,378</b>	46,935	<b>152,908</b>	150,579
Number of common shares outstanding	<b>59,967,429</b>	59,967,429	<b>59,967,429</b>	59,967,429
Basic earnings per common share	<b>0.66</b>	0.78	<b>2.55</b>	2.51

## First National Financial Corporation

### Notes to interim condensed consolidated financial statements

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

September 30, 2022

#### 12. Financial instruments and risk management

##### Fair value measurement

The Company uses the following hierarchy for determining and disclosing the fair value of financial instruments recorded at fair value in the interim condensed consolidated statements of financial position:

Level 1 – quoted market price observed in active markets for identical instruments;

Level 2 – quoted market price observed in active markets for similar instruments or other valuation techniques for which all significant inputs are based on observable market data; and

Level 3 – valuation techniques in which one or more significant inputs are unobservable.

##### Valuation methods and assumptions

The Company uses valuation techniques to estimate fair values, including reference to third-party valuation service providers using proprietary pricing models and internal valuation models such as discounted cash flow analysis. The valuation methods and key assumptions used in determining fair values for the financial assets and financial liabilities are as follows:

##### [a] Mortgage and loan investments

Mortgages and loan investments are measured at FVTPL. The fair value of these mortgages is based on non-observable inputs and is measured at management's best estimated of the net realizable value.

##### [b] Deferred placement fees receivable

The fair value of deferred placement fees receivable is determined by internal valuation models using market data inputs, where possible. The fair value is determined by discounting the expected future cash flows related to the placed mortgages at market interest rates. The expected future cash flows are estimated based on certain assumptions which are not supported by observable market data.

##### [c] Securities owned and sold short

The fair values of securities owned and sold short used by the Company to hedge its interest rate exposure are determined by quoted prices on a secondary market.

##### [d] Servicing liability

The fair value of the servicing liability is determined by internal valuation models using market data inputs, where possible. The fair value is determined by discounting the expected future cost related to the servicing of explicit mortgages at market interest rates. The expected future cash flows are estimated based on certain assumptions which are not supported by observable market data.

##### [e] Other financial assets and financial liabilities

The fair value of mortgages accumulated for sale, cash held as collateral for securitization, restricted cash and bank indebtedness correspond to the respective outstanding amounts due to their short-term maturity profiles.

## First National Financial Corporation

### Notes to interim condensed consolidated financial statements

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

September 30, 2022

#### [f] Fair value of financial instruments not carried at fair value

The fair values of these financial instruments are determined by discounting projected cash flows using market industry pricing practices, including the rate of unscheduled prepayment. Discount rates used are determined by comparison to similar term loans made to borrowers with similar credit. This methodology will reflect changes in interest rates which have occurred since the mortgages were originated. These fair values are estimated using valuation techniques in which one or more significant inputs are unobservable [Level 3], and are calculated for disclosure purposes only.

#### Carrying value and fair value of selected financial instruments

The fair value of the financial assets and financial liabilities of the Company approximates its carrying value, except for mortgages pledged under securitization, which has a carrying value of \$36,117,242 [December 31, 2021 – \$35,435,455] and a fair value of \$34,850,957 [December 31, 2021 – \$36,515,923], debt related to securitized mortgages, which has a carrying value of \$35,893,418 [December 31, 2021 – \$35,576,353] and a fair value of \$34,000,953 [December 31, 2021 – \$35,864,253], and senior unsecured notes, which have a carrying value of \$399,138 [December 31, 2021 – \$398,888] and a fair value of \$374,480 [December 31, 2021 – \$409,056]. These fair values are estimated using valuation techniques in which one or more significant inputs are unobservable [Level 3].

The following tables represent the Company's financial instruments measured at fair value on a recurring basis:

	September 30, 2022			
	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
<b>Financial assets</b>				
Mortgages accumulated for sale	—	126,267	—	126,267
Mortgage and loan investments	—	—	187,862	187,862
<b>Total financial assets</b>	<b>—</b>	<b>126,267</b>	<b>187,862</b>	<b>314,129</b>
<b>Financial liabilities</b>				
Securities sold short	—	2,044,713	—	2,044,713
Interest rate swaps	—	13,055	—	13,055
<b>Total financial liabilities</b>	<b>—</b>	<b>2,057,768</b>	<b>—</b>	<b>2,057,768</b>

## First National Financial Corporation

### Notes to interim condensed consolidated financial statements

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

September 30, 2022

	December 31, 2021			
	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
<b>Financial assets</b>				
Mortgages accumulated for sale	—	30,943	—	30,943
Mortgage and loan investments	—	—	192,340	192,340
Interest rate swaps	—	688	—	688
<b>Total financial assets</b>	—	31,631	192,340	223,971
<b>Financial liabilities</b>				
Securities sold short	—	2,677,689	—	2,677,689
<b>Total financial liabilities</b>	—	2,677,689	—	2,677,689

In estimating the fair value of financial assets and financial liabilities using valuation techniques or pricing models, certain assumptions are used including those that are not fully supported by observable market prices or rates [Level 3]. The amount of the change in fair value recognized by the Company in net income that was estimated using a valuation technique based on assumptions that are not fully supported by observable market prices or rates for the three months ended September 30, 2022 was \$580 [2021 – \$650]. Although the Company's management believes that the estimated fair values are appropriate as at the date of the interim condensed consolidated statements of financial position, those fair values may differ if other reasonably possible alternative assumptions are used.

Transfers between levels in the fair value hierarchy are deemed to have occurred at the beginning of the period in which the transfer is made. Transfers between levels can occur as a result of additional or new information regarding valuation inputs and changes in their observability. During the quarter, there were no transfers between levels.

The following table presents changes in the fair values including realized gains of \$50,106 [2021 – losses of \$1,731] of the Company's financial assets and financial liabilities for the three months ended September 30, 2022 and 2021, all of which have been classified as FVTPL:

	Three months ended		Nine months ended	
	September 30		September 30	
	2022	2021	2022	2021
	\$	\$	\$	\$
FVTPL mortgages	(580)	(650)	(580)	(593)
Securities sold short	8,622	653	75,285	12,242
Interest rate swaps	(2,196)	(386)	(13,742)	(5,763)
	5,846	(383)	60,963	5,886

## First National Financial Corporation

### Notes to interim condensed consolidated financial statements

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

September 30, 2022

#### Movement in Level 3 financial instruments measured at fair value

The following tables show the movement in Level 3 financial instruments in the fair value hierarchy for the nine months ended September 30, 2022 and 2021. The Company classifies financial instruments as Level 3 when there is reliance on at least one significant unobservable input in the valuation models.

	Fair value as at January 1, 2022 \$	Investments \$	Unrealized gains recorded in income \$	Payment and amortization \$	Fair value as at September 30, 2022 \$
<b>Financial assets</b>					
Mortgage and loan investments	192,340	349,259	(580)	(353,157)	187,862

	Fair value as at January 1, 2021 \$	Investments \$	Unrealized gains recorded in income \$	Payment and amortization \$	Fair value as at September 30, 2021 \$
<b>Financial assets</b>					
Mortgage and loan investments	213,301	507,893	(593)	(484,466)	236,135

#### 13. Capital management

The Company's objective is to maintain a capital base so as to maintain investor, creditor and market confidence and sustain future development of the business. Management defines capital as the Company's common share capital and retained earnings. FNFLP has a minimum capital requirement as stipulated by its bank credit facility. The agreement limits the debt under bank indebtedness together with the unsecured notes to four times FNFLP's equity. As at September 30, 2022, the ratio was 1.93:1 [December 31, 2021 – 2.21:1]. The Company was in compliance with the bank covenant throughout the period.

## First National Financial Corporation

### Notes to interim condensed consolidated financial statements

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

September 30, 2022

#### 14. Earnings by business segment

The Company operates principally in two business segments, Residential and Commercial. These segments are organized by mortgage type and contain revenue and expenses related to origination, underwriting, securitization and servicing activities. Identifiable assets are those used in the operations of the segments.

	Three months ended September 30, 2022			Nine months ended September 30, 2022		
	Residential \$	Commercial \$	Total \$	Residential \$	Commercial \$	Total \$
<b>Revenue</b>						
Interest revenue – securitized mortgages	155,917	82,148	238,065	408,837	224,055	632,892
Interest expense – securitized mortgages	(127,546)	(67,259)	(194,805)	(325,895)	(183,673)	(509,568)
Net interest – securitized mortgages	28,371	14,889	43,260	82,942	40,382	123,324
Placement and servicing Mortgage investment income	95,969	22,511	118,480	320,466	73,876	394,342
Realized and unrealized gains (losses) on financial instruments	6,426	(580)	5,846	61,543	(580)	60,963
	149,544	48,064	197,608	508,731	141,209	649,940
<b>Expenses</b>						
Amortization	3,873	567	4,440	11,620	1,700	13,320
Interest	30,063	8,634	38,697	67,259	26,521	93,780
Other operating	85,512	14,314	99,826	280,597	51,430	332,027
	119,448	23,515	142,963	359,476	79,651	439,127
<b>Income before income taxes</b>	30,096	24,549	54,645	149,255	61,558	210,813
Identifiable assets	28,222,553	14,139,896	42,362,449	28,222,553	14,139,896	42,362,449
Goodwill	—	—	29,776	—	—	29,776
<b>Total assets</b>	28,222,553	14,139,896	42,392,225	28,222,553	14,139,896	42,392,225
<b>Capital expenditures</b>	3,486	1,496	4,982	7,026	3,011	10,037

## First National Financial Corporation

### Notes to interim condensed consolidated financial statements

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

September 30, 2022

	Three months ended September 30, 2021			Nine months ended September 30, 2021		
	Residential \$	Commercial \$	Total \$	Residential \$	Commercial \$	Total \$
<b>Revenue</b>						
Interest revenue – securitized mortgages	133,735	64,283	198,018	411,233	186,803	598,036
Interest expense – securitized mortgages	(105,703)	(52,169)	(157,872)	(326,968)	(152,712)	(479,680)
Net interest – securitized mortgages	28,032	12,114	40,146	84,265	34,091	118,356
Placement and servicing Mortgage investment income	117,895	21,976	139,871	337,954	67,469	405,423
Realized and unrealized gains (losses) on financial instruments	267	(650)	(383)	6,460	(574)	5,886
	157,401	38,431	195,832	458,650	116,984	575,634
<b>Expenses</b>						
Amortization	2,528	247	2,775	7,586	738	8,324
Interest	12,506	5,642	18,148	35,180	13,245	48,425
Other operating	92,474	17,301	109,775	263,502	48,673	312,175
	107,508	23,190	130,698	306,268	62,656	368,924
<b>Income before income taxes</b>	49,893	15,241	65,134	152,382	54,328	206,710
Identifiable assets	28,848,811	11,884,582	40,733,393	28,848,811	11,884,582	40,733,393
Goodwill	—	—	29,776	—	—	29,776
<b>Total assets</b>	28,848,811	11,884,582	40,763,169	28,848,811	11,884,582	40,763,169
<b>Capital expenditures</b>	5,962	2,555	8,517	15,485	6,636	22,121

## First National Financial Corporation

### Notes to interim condensed consolidated financial statements

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

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#### 15. Related party and other transactions

The Company has servicing contracts in connection with commercial mezzanine mortgages originated by the Company and subsequently sold to various entities controlled by a senior executive and shareholder of the Company. The Company services these mortgages during their terms at market commercial servicing rates. During the quarter, the Company originated \$73,485 of new mortgages for the related parties. The related parties also funded several progress draws totaling \$13,179 on existing mortgages originated by the Company. All such mortgages, which are administered by the Company, have a balance of \$293,285 as at September 30, 2022 [December 31, 2021 – \$213,648]. As at September 30, 2022, two of the mortgages are secured by real estate in which the Company is also a subordinate mortgage lender.

A senior executive and shareholder of the Company has a significant investment in a mortgage default insurance company. In the ordinary course of business, the insurance company provides insurance policies to the Company's borrowers at market rates. In addition, the insurance company has also provided the Company with portfolio insurance at market premiums. The total bulk insurance premium paid by the Company during the three months ended September 30, 2022 was \$462 [2021 – \$616], net of third-party investor reimbursement.

A senior executive and shareholder of the Company has a significant investment in a Canadian bank. In the first quarter of 2021, the Company entered into an agreement to originate and adjudicate applications for secured credit cards for the bank. These applications are originated from the Company's mortgage broker relationships. The Company receives a fee for successfully adjudicating such credit.

# **First National Financial Corporation**

## **Shareholder Information**

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### **TSX Symbols**

FN, FN.PR.A, FN.PR.B

### **Investor Relations**

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