



Ellington Financial Inc. (EFC)

Updated December 8th, 2020 by Nikolaos Sismanis

Key Metrics

Current Price:	\$15	5 Year CAGR Estimate:	6.9%	Market Cap:	\$648 M
Fair Value Price:	\$15	5 Year Growth Estimate:	-1.0%	Ex-Dividend Date:	12/27/2020
% Fair Value:	100%	5 Year Valuation Multiple Estimate:	-0.1%	Dividend Payment Date:	01/25/2021
Dividend Yield:	9.3%	5 Year Price Target	\$14	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	N/A

Overview & Current Events

Ellington Financial Inc. acquires and manages mortgage, consumer, corporate, and other related financial assets in the United States. The company acquires and manages residential mortgage-backed securities (RMBS) backed by prime jumbo, Alt-A, manufactured housing, and subprime residential mortgage loans. Additionally, it manages RMBS, for which the U.S. government guarantees the principal and interest payments. It also provides collateralized loan obligations, mortgage-related and non-mortgage-related derivatives, equity investments in mortgage originators and other strategic investments. The \$650 million market capitalization company is headquartered in Old Greenwich, Connecticut.

On November 5th, 2020, the company reported its Q3 results for the quarter ending September 30th, 2020. Due to the company's business model, Ellington doesn't report any revenues. Instead, it records only income. Interest income came in at \$37.7M, a 21% increase year-over-year, while core earnings per share came was \$0.41, a -12.7% decline vs. Q3-2019. While the company was able to grow its CLO, CMB, and loan portfolio, lower interest rates and additional share issuance to fund this expansion caused lower per-share results. Consequently, book value per share declined to \$16.45 from \$18.81 over the comparable period last year.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$3.04	\$0.61	\$5.31	\$3.27	\$2.09	\$1.13	-\$0.48	\$1.04	\$1.52	\$1.76	\$1.66	\$1.58
DPS	\$2.51	\$1.60	\$2.87	\$3.08	\$2.96	\$2.30	\$1.90	\$1.72	1.64	\$1.40	\$1.39	\$1.32
Shares¹	13	16.5	17.9	23.6	28	33.4	32.8	32.1	30.3	32.8	41.5	60.0

Ellington's EPS generation has been quite inconsistent over the past decade, as rates have mostly been decreasing. As a result, DPS has also mostly been falling since 2015. However, the company has done its best to diversify its portfolio and reduce its performance variance. For example, 74% of its RMBS exposure is allocated to 30-year fixed mortgages. Additionally, while around 40% of its credit portfolio is invested in residential mortgages, 40% is split among many different securities types (Non-QM, Reverse mortgages, REOs, etc.). The point is that Ellington has taken great care as of late not to concentrate its risk in too few areas, which improves economic return volatility.

At Ellington's current portfolio construction, a 50bp decline in interest rates would result in just a \$104k change in fair value attributable to the common stock, while a 50bp increase would be just \$10k. While it's quite complex to generate those values, what matters is that Ellington has designed its portfolio in such a way that these inevitable movements in rates over time won't have a major impact on its overall portfolio value over time. However, this doesn't mean that the company's funding cost will always be low enough to generate constant returns, as we saw by the recent results showing losses in its book value.

To be prudent and price-in the potential for Ellington's spreads to keep on declining, we are forecasting an EPS and DPS decline of -1% per year in the medium term. Since 2019, the company has switched to monthly dividend payments. While the company cut its monthly dividend from \$0.15 to \$0.08 during March to remain cautious, the rate has been slowly increasing to \$0.10 as of now, displaying active and thoughtful management in Ellington's outflows.

¹ Share count is in millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	7.3	32.1	4.3	9.7	13.1	8.4	---	9.7	9.4	9.9	9.0	9.0
Avg. Yld.	11.3%	8.2%	12.5%	14.1%	12.5%	12.9%	11.2%	10.6%	10.7%	7.8%	9.3%	9.3%

The reason investors like mortgage REITs is generally because they pay very high dividend yields to shareholders, distributing the majority of their income. Hence, the company is currently yielding a hefty 9.3%, despite temporarily slashing its DPS. In terms of its valuation, considering the company's latest book value of \$16.45/share, at its current price of \$15.0, the stock is trading at a discount. On the other hand, on a P/E basis we believe shares are more or less fairly valued.

Safety, Quality, Competitive Advantage, & Recession Resiliency

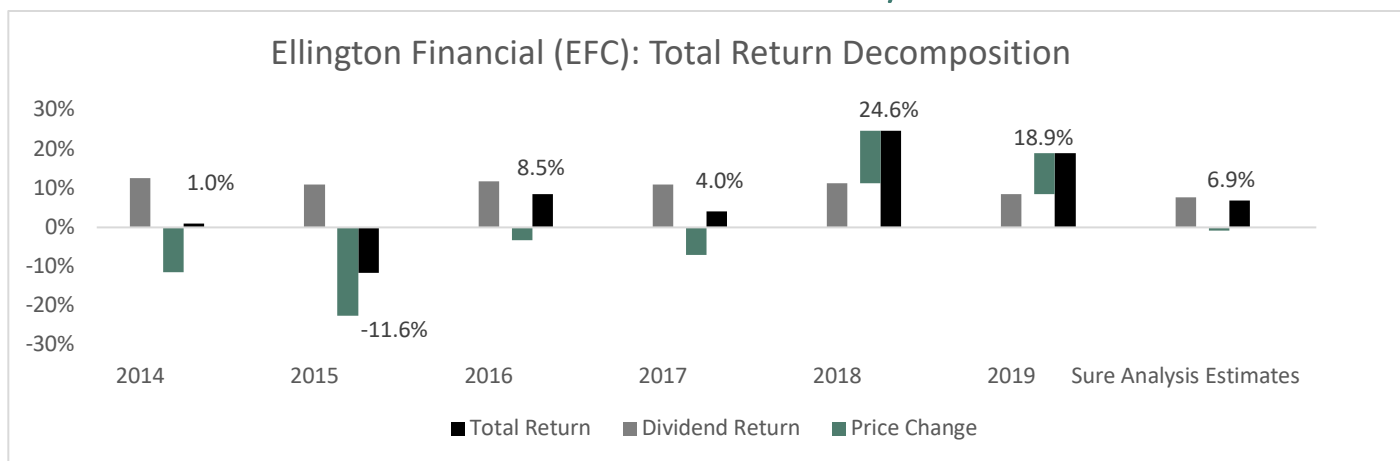
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	83%	262%	54%	94%	142%	204%	---	165%	108%	80%	84%	84%

The company's DPS should be seen as safe, considering that management has already started resuming its monthly rate since its initial cut. However, based on DPS' downward historical trajectory, slight decreases going forward are possible due to the risks of mortgages defaulting amid the ongoing pandemic and the overall decrease in interest rates. Still, the balance sheet remains of high quality, with Ellington's debt-to-equity ratio in its credit portfolio being just 2.3x, with its overall leverage being 3.5x. If we include unsettled transactions, that ratio falls to 3.1x. The days of mortgage REITs employing 8x or 9x leverage have come and gone, but Ellington is still embodying low leverage for a mortgage REIT, which should improve safety and reduce volatility during both good and bad times.

Final Thoughts & Recommendation

Ellington Financial is a decent income-oriented stock, which, despite management's thoughtful portfolio construction, has suffered as of lately due to the challenges all mortgage REITs have been facing. However, since its IPO, the company has paid cumulative dividends in excess of \$27/share, which is almost double the value of its current share price. Hence, it has delivered a fruitful income stream to its shareholders over the past decade that has adequately compensated for the losses in share capital. Amid our prudent future EPS and DPS projections, we expect annualized returns of around 6.9% in the medium term. In any case, investors should be aware of the fact that mortgage REITs have a riskier credit profiles than traditional REITs. Shares earn a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	46	16	103	87	73	53	2	53	75	82
SG&A Exp.	5	4	4	6	12	10	12	10	15	15
Net Profit	41	10	97	79	59	38	(16)	34	47	58
Net Margin	87.7%	64.5%	94.4%	90.5%	81.4%	72.1%	-822.1%	64.7%	62.4%	71.0%
Free Cash Flow	(348)	(47)	(51)	(244)	(604)	654	70	(463)	(494)	79

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	2,334	1,968	2,152	2,975	3,945	2,992	2,413	2,993	3,971	4,338
Cash & Equivalents	56	63	59	183	114	184	123	47	45	72
Total Liabilities	1,931	1,597	1,646	2,349	3,157	2,253	1,768	2,372	3,376	3,470
Accounts Payable	167	130	60	196	104	171	92	209	496	80
Long-Term Debt	---	---	1	1	1	---	24	268	497	830
Shareholder's Equity	404	371	506	620	782	732	638	600	564	718
D/E Ratio	---	---	0.00	0.00	0.00	---	0.04	0.45	0.88	1.00

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.1%	0.5%	4.7%	3.1%	1.7%	1.1%	-0.6%	1.3%	1.3%	1.4%
Return on Equity	11.5%	2.7%	22.1%	13.9%	8.4%	5.0%	-2.3%	5.5%	8.0%	9.0%
ROIC	11.5%	2.7%	22.1%	13.8%	8.4%	5.0%	-2.3%	4.4%	4.7%	4.2%
Shares Out.	13	16.5	17.9	23.6	28	33.4	32.8	32.1	30.3	32.8
Revenue/Share	3.57	0.97	5.75	3.68	2.60	1.58	0.06	1.64	2.47	2.55
FCF/Share	(26.82)	(2.88)	(2.87)	(10.36)	(21.61)	19.58	2.13	(14.44)	(16.31)	2.47

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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