



Ellington Financial Inc. (EFC)

Updated February 23rd, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	\$16	5 Year CAGR Estimate:	5.8%	Market Cap:	\$689M
Fair Value Price:	\$15.80	5 Year Growth Estimate:	-1.0%	Ex-Dividend Date:	02/25/2021
% Fair Value:	101%	5 Year Valuation Multiple Estimate:	-0.3%	Dividend Payment Date:	03/25/2021
Dividend Yield:	7.5%	5 Year Price Target	\$15.0	Years Of Dividend Growth:	N/A
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 company has a market cap of 689 million and is headquartered in Old Greenwich, Connecticut.

On February 18th, 2021, the company reported its Q4 results for the quarter ended December 31st, 2020. Due to the company's business model, Ellington doesn't report any revenues. Instead, it records only income. Interest income came in at \$34 million, a 9.8% decline quarter-over-quarter, while core earnings per share came was \$0.37, a -9.7% decline vs. Q3-2020. While the company was able to grow its CLO, CMB, and loan portfolio by approximately 2%, lower interest rates and additional share issuance to fund this expansion caused lower per-share results. Consequently, book value per share declined to \$17.59, compared to Q4-2019 book value of \$18.48, but slightly higher than the previous quarter's \$16.45, due to the company's dividend cut reducing cash outflows.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$0.61	\$5.31	\$3.27	\$2.09	\$1.13	(\$0.48)	\$1.04	\$1.52	\$1.76	\$1.63	\$1.66	\$1.58
DPS	\$1.60	\$2.87	\$3.08	\$2.96	\$2.30	\$1.90	\$1.72	1.64	\$1.40	\$1.26	\$1.20	\$1.26
Shares¹	16.5	17.9	23.6	28.0	33.4	32.8	32.1	30.3	32.8	44.1	47.0	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, 71% of its RMBS exposure is allocated to 30-year fixed mortgages. Additionally, while around 50% of its credit portfolio is invested in residential mortgages, that 50% 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 \$1.6 million in gains, while a 50bp increase in rates would result in losses \$2.7 million, suggesting that the company has hedged against the declining interest rates. 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. However, with rate spreads consistently dropping and the stock's expensive financing due to its high dividend should continue pressuring EPS generation. To be prudent and price-in the issue, we are forecasting an EPS 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. We believe that the dividend has once again space to grow, but at a cautious rate of 1%.

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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	36.6	3.7	9.7	13.1	8.4	---	9.7	9.4	9.9	7.9	9.6	9.5
Avg. Yld.	7.2%	14.6%	13.4%	13.6%	9.7%	10.6%	10.1%	10.1%	9.2%	7.0%	7.5%	8.4%

The reason investors find mortgage REITs attractive is generally because they pay very high dividend yields to shareholders as they are required by law to distribute the majority of their income. Hence, the company features a dividend yield average of around 10.6% over the last decade. That figure has been slashed to 7.5% post the company's dividend cut. In terms valuation, considering the company's latest book value of \$17.59/share, at its current price of \$15.70, 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

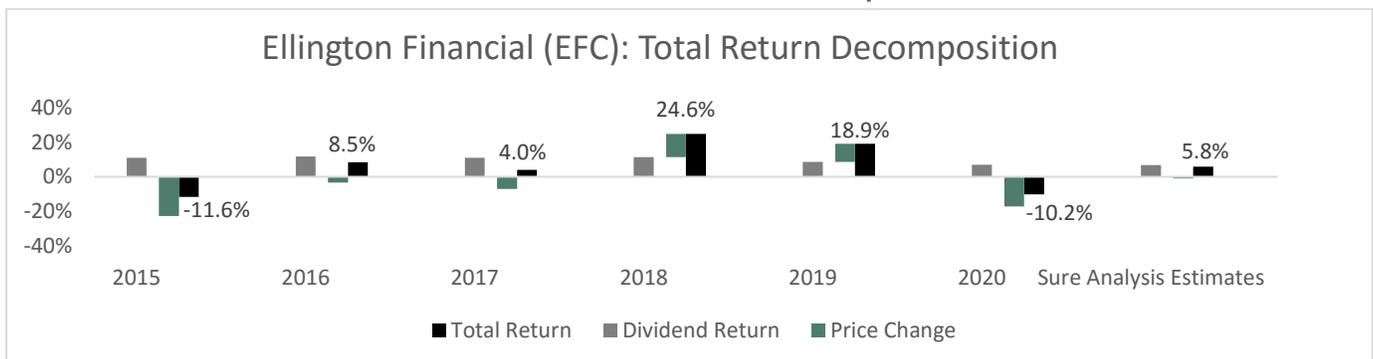
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	262%	54%	94%	142%	204%	-396%	165%	108%	80%	77%	72%	80%

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 2.6x, with its overall leverage being 2.6x. 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 5.8% in the medium term. Investors should be aware of the fact that mortgage REITs have riskier credit profiles than traditional REITs. Hence, we rate shares a Sell at their current levels amid a lack of attractive returns prospects against the underlying risks.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	16	103	87	73	53	2	53	75	82	31
SG&A Exp.	4	4	6	12	10	12	10	15	15	17
Net Profit	10	97	79	59	38	(16)	34	47	58	25
Net Margin	64.5%	94.4%	90.5%	81.4%	72.1%	-822.1%	64.7%	62.4%	71.0%	80.6%
Free Cash Flow	(47)	(51)	(244)	(604)	654	70	(463)	(494)	79	---

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	1,968	2,152	2,975	3,945	2,992	2,413	2,993	3,971	4,338	3,414
Cash & Equivalents	63	59	183	114	184	123	47	45	72	112
Total Liabilities	1,597	1,646	2,349	3,157	2,253	1,768	2,372	3,376	3,470	2,492
Accounts Payable	130	60	196	104	171	92	209	496	80	14
Long-Term Debt	---	1	1	1	---	24	268	497	830	892
Shareholder's Equity	371	506	620	782	732	638	600	564	718	774
D/E Ratio	---	0.00	0.00	0.00	---	0.04	0.45	0.88	1.00	1.01

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	0.5%	4.7%	3.1%	1.7%	1.1%	-0.6%	1.3%	1.3%	1.4%	0.7%
Return on Equity	2.7%	22.1%	13.9%	8.4%	5.0%	-2.3%	5.5%	8.0%	9.0%	3.4%
ROIC	2.7%	22.1%	13.8%	8.4%	5.0%	-2.3%	4.4%	4.7%	4.2%	1.4%
Shares Out.	16.5	17.9	23.6	28	33.4	32.8	32.1	30.3	32.8	43.5
Revenue/Share	0.97	5.75	3.68	2.60	1.58	0.06	1.64	2.47	2.55	0.72
FCF/Share	(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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