



Ellington Financial Inc. (EFC)

Updated August 10th, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	\$18.14	5 Year CAGR Estimate:	9.5%	Market Cap:	\$903M
Fair Value Price:	\$18.30	5 Year Growth Estimate:	1.0%	Ex-Dividend Date:	08/30/2021
% Fair Value:	99%	5 Year Valuation Multiple Estimate:	0.2%	Dividend Payment Date:	09/27/2021
Dividend Yield:	9.9%	5 Year Price Target	\$19.23	Years Of Dividend Growth:	1
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	7.1% ¹

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 \$903 million and is headquartered in Old Greenwich, Connecticut.

On August 5th, 2021, Ellington Financial reported its Q2 results for the quarter ended June 30th, 2021. Due to the company's business model, Ellington doesn't report any revenues. Instead, it records only income. Interest income came in at \$36.5 million, a 6.7% increase quarter-over-quarter, while core earnings per share came in at \$0.51, 18.6% higher vs. Q1-2021 due to an expanded, accretive loan portfolio and higher core income, respectively. The company leveraged its strong balance sheet to drive growth in its high-yielding loan portfolios and opportunistically rotate its capital allocations towards more promising securities. Its total long credit portfolio expanded by 5% QoQ, driven by an increase in non-QM (non-qualified mortgage loans), small-balance commercial mortgage, and residential transition loan acquisitions. Ellington's book value per share increased from \$18.16 to \$18.47 during the last three months, with its earnings exceeding the underlying dividend. The company cut its monthly dividend from \$0.15 to \$0.08 in Q1 2020 due to the effects of COVID-19, but management has increased it several times, reaching its previous levels at \$0.15. We forecast FY2021 EPS at \$1.83, reflecting the company's asset rotation to better-performing assets.

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	\$1.83	\$1.92
DPS	\$1.60	\$2.87	\$3.08	\$2.96	\$2.30	\$1.90	\$1.72	1.64	\$1.40	\$1.26	\$1.80	\$1.89
Shares²	16.5	17.9	23.6	28.0	33.4	32.8	32.1	30.3	32.8	44.1	44.6	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, 72% of its RMBS exposure is allocated to 30-year fixed mortgages. Additionally, while around 52% of its credit portfolio is invested in residential mortgages, that 52% is split among many different securities types (non-QM, Reverse mortgages, Real-estate-owned loans 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 \$2.1 million in losses (i.e., - 0.23% of equity), while a 50bp increase in rates would result in losses of \$4.8 million (0.53% of equity).

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. To be prudent and price-in the issue, we are forecasting EPS growth of 1% per year in the

¹ The last intra-year increase was of 7.1%. On a year-over-year basis, the monthly DPS grew by 66% due to last year's dividend slash.

² Share count is in millions.

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medium term in hopes that its higher-yielding assets will slightly boost profitability over time. We are also forecasting a DPS growth of 1% during this period. Since 2019, the company has switched to monthly dividend payments.

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	9.9	10.0
Avg. Yld.	7.2%	14.6%	13.4%	13.6%	9.7%	10.6%	10.1%	10.1%	9.2%	7.0%	9.9%	9.8%

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. Despite the lower DPS during the first quarter of 2021, the resumption of the monthly rate to \$0.15 points to a yield of 9.9%. In terms of its valuation, considering the company's latest book value of \$18.47/share, at its current price of \$18.14, the stock is trading very close to its fair value. On a P/E basis, we believe shares are also more or less fairly valued.

Safety, Quality, Competitive Advantage, & Recession Resiliency

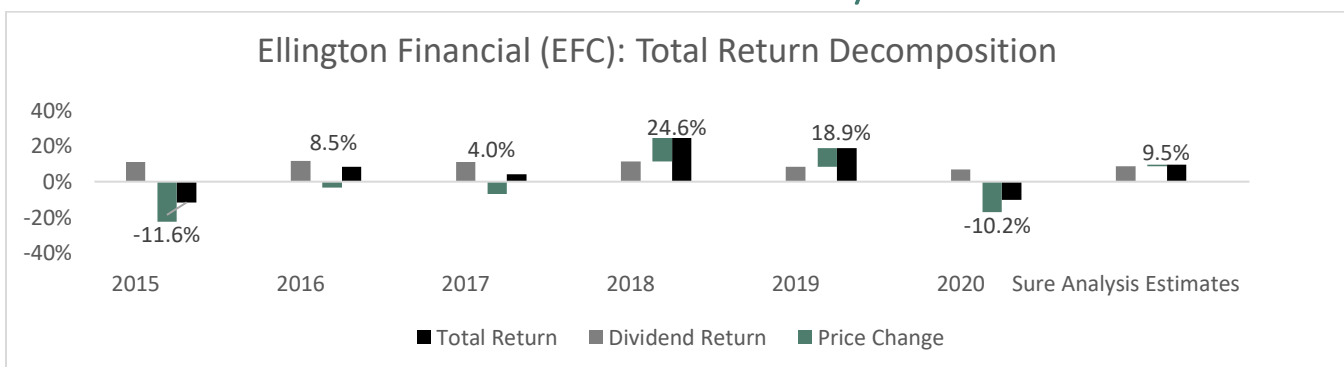
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	262%	54%	94%	142%	204%	-396%	165%	108%	80%	77%	98%	98%

The company's DPS should be seen as safe, considering that management has already resumed 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 remaining at 3.2 during Q2. 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 1.48X 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. Our prudent future EPS and DPS projections point to annualized returns of around 9.5% in the medium term. Investors should be aware of the fact that mortgage REITs have riskier credit profiles than traditional REITs. We rate shares a hold at this point, though investors should remain cautious due to the risks of Ellington's business model.

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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