



Ellington Residential Mortgage REIT (EARN)

Updated January 31st, 2022 by Quinn Mohammed

Key Metrics

Current Price:	\$10.48	5 Year CAGR Estimate:	10.6%	Market Cap:	\$136 M
Fair Value Price:	\$10.80	5 Year Growth Estimate:	1.0%	Ex-Dividend Date:	02/30/2022
% Fair Value:	97%	5 Year Valuation Multiple Estimate:	0.6%	Dividend Payment Date:	03/25/2022
Dividend Yield:	11.5%	5 Year Price Target	\$11.30	Years Of Dividend Growth:	1
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	7.1%

Overview & Current Events

Ellington Residential Mortgage REIT acquires, invests in, and manages residential mortgage and real estate-related assets. Ellington focuses primarily on residential mortgage-backed securities, specifically those backed by a U.S. Government agency or U.S. government-sponsored enterprise. The corporation trades on the NYSE under the ticker symbol EARN. EARN is headquartered in Old Greenwich, Connecticut and is a small-cap company with a market capitalization of \$136 million. Ellington Residential Mortgage REIT is externally managed by Ellington Residential Mortgage Management LLC.

The mortgage REIT has an agency residential mortgage-backed securities (RMBS) portfolio of \$1.2 billion and a non-agency RMBS portfolio of \$9.1 million. Agency MBS are created and backed by government agencies or enterprises, while non-agency MBS are not guaranteed by the government.

In the second quarter of 2021, Ellington increased the quarterly dividend by 7.1%, from \$0.28 per share to \$0.30 per share. In October 2021, the corporation chose to modify the dividend payment schedule from quarterly to monthly.

On November 2nd, 2021, Ellington Residential reported its Q3 results for the period ending September 30th, 2021. Net income came in at \$0.86 million, an improvement over the -\$4.5 million loss in the prior quarter. On a per share basis, net income of \$0.07 outpaced the -\$0.36 loss in the prior quarter. Core earnings of \$4.0 million this quarter led to core EPS of \$0.31 per share, which covered the dividend payment. EARN achieved a net interest margin of 1.88% in Q3.

At quarter end, Ellington had \$61.2 million of cash and cash equivalents, and \$31.7 million of other unencumbered assets. The debt-to-equity ratio was 6.7x. The company also had a book value of \$12.28 per share.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Core EPS	---	---	\$2.09	\$3.04	\$2.41	\$1.71	\$1.91	\$1.34	\$0.91	\$1.26	\$1.27	\$1.33
DPS	---	---	\$1.14	\$2.20	\$2.00	\$1.65	\$1.57	\$1.45	\$1.18	\$1.12	\$1.20	\$1.20
Shares¹	---	---	6.6	9.1	9.1	9.1	11.6	12.8	12.5	12.4	12.9	14.0

Ellington has seen its core earnings per share shrink rather than grow for the most part. Since 2015, the compound annual growth rate has been -12.2%. In its first few years, the company held their share count consistent, but following 2016, the number of shares outstanding has grown, which can be another barrier to growing earnings on a per share basis. The corporation has a few avenues of growth, which all revolve around optimizing their MBS portfolio. Capitalizing on opportunities driven by market volatility, particularly around Fed tapering, could yield results. The looming rise of interest rates will also benefit the corporation. Additionally, Ellington will protect their book value through interest rate hedges and liquidity management. Despite this, the company has a poor track record of earnings, leading us to anticipate very minor growth of 1.0%. The dividend has been cut every single year (results from 2013 only account for half the year) in its history with an increase in 2021, followed by the dividend schedule being modified to monthly over quarterly, which some shareholders may appreciate.

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	---	---	7.8	5.6	6.1	7.4	7.4	8.3	12.2	8.3	8.3	8.5
Avg. Yld.	---	---	7.0%	12.4%	15.0%	14.5%	11.4%	13.7%	12.2%	11.5%	11.5%	10.6%

Ellington's P/E ratio has hovered around 7.9 times core earnings since 2013. The average P/E ratio has grown slightly recently, with the 5-year average P/E of 8.7. Today, EARN is trading at 8.3 times earnings, just about in the middle of its historical valuation. We believe the company earns a fair value of 8.5 times earnings, so we anticipate a minor valuation tailwind to total annual returns. The current 11.5% yield is slightly lower than its historic average of 12.2%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

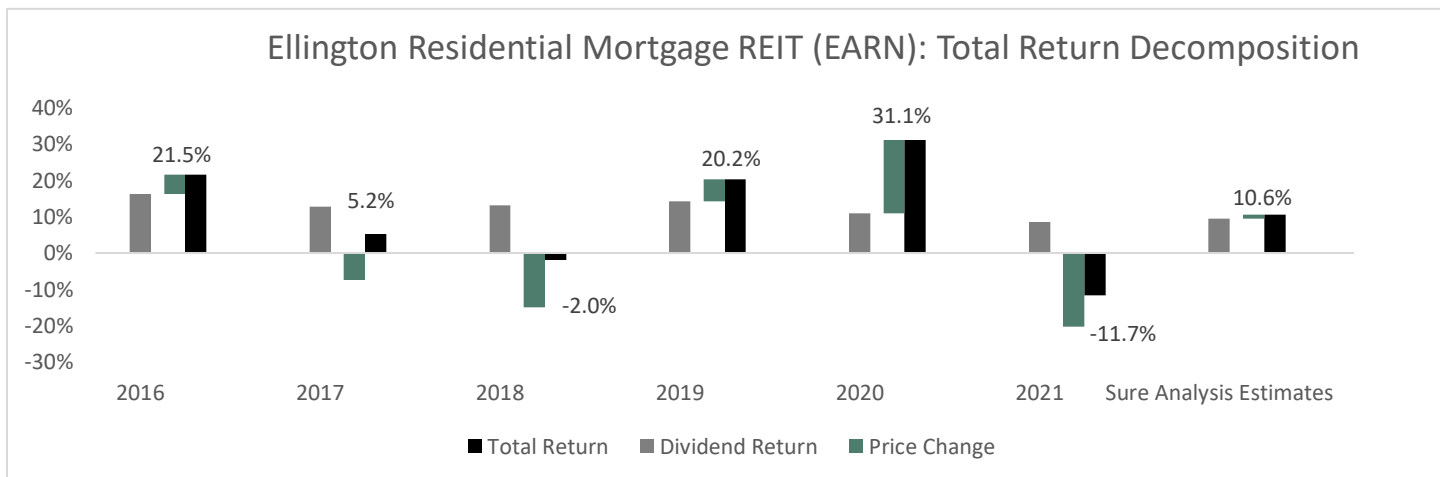
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	---	---	55%	72%	83%	96%	82%	108%	130%	89%	94%	90%

EARN's dividend is far from trustworthy given the corporation has a trail of cuts in the rearview. In at least three years over the last seven full calendar years in operation, the company's payout ratio was near or above 100%. Currently, the dividend appears to be stretched, but so far it is covered for the year. Ellington claims that their portfolio managers are among the most experienced in the MBS sector and their analytics have been developed over the company's 26-year history. The company possesses advanced proprietary models for prepayments and credit analysis. Also, roughly 25% of the company's employees are focused on research and information technology. While the company's details were not public in the 2008 real estate crash, a recession of that magnitude would most definitely affect EARN. It's focus on government-sponsored MBS provide some safety, but a prolonged recession in the future would likely affect EARN's bottom line, and result in further dividend reductions.

Final Thoughts & Recommendation

Ellington Residential has a poor historical track record, both in core earnings per share and in the dividend. In fact, EARN slashed the dividend for six years in a row leading up to 2021. Despite these constant cuts, the yield remains very high, as share price has also cratered over the long-term. Results are volatile, and thus, quite risky. We forecast annualized returns of 10.6% in the medium term, driven almost entirely by the stock's 11.5% yield. We also assume a minor 1% annual core earnings growth rate and a 0.6% bump due to valuation expansion. While total returns are strong, we rate EARN a hold rather than a buy, due to its unreliable dividend and minimal margin of safety.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	---	2	22	5	17	16	(6)	28	26
SG&A Exp.	---	2	3	3	3	4	3	3	3
Net Profit	---	(2)	16	0	12	11	(11)	22	20
Net Margin	---	-79.4%	73.8%	0.6%	70.4%	65.4%	195%	80.8%	77.5%
Free Cash Flow	---	26	21	25	20	34	29	18	24

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	32	1,511	1,521	1,557	1,429	1,887	1,676	1,489	1,195
Cash & Equivalents	18	50	45	40	34	56	19	35	58
Accounts Receivable	0	5	5	4	5	6	6	5	4
Total Liabilities	1	1,344	1,358	1,412	1,287	1,694	1,522	1,328	1,028
Accounts Payable	---	24	1	2	3	4	6	4	2
Shareholder's Equity	31	167	163	145	142	193	154	161	166

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	---	---	1.1%	0.0%	0.8%	0.7%	-0.6%	1.4%	1.5%
Return on Equity	---	-1.9%	9.8%	0.0%	8.3%	6.5%	-6.5%	14.1%	12.3%
ROIC	---	---	9.8%	0.0%	8.3%	6.5%	-6.5%	14.1%	12.3%
Shares Out.	---	6.6	9.1	9.1	9.1	11.6	12.8	12.5	12.4
Revenue/Share	---	0.37	2.40	0.57	1.85	1.42	(0.45)	2.21	2.10
FCF/Share	---	3.88	2.33	2.71	2.18	2.97	2.25	1.41	1.97

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

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