



# Ellington Residential Mortgage REIT (EARN)

Updated May 10<sup>th</sup>, 2022 by Quinn Mohammed

## Key Metrics

<b>Current Price:</b>	\$8.13	<b>5 Year CAGR Estimate:</b>	13.1%	<b>Market Cap:</b>	\$112 M
<b>Fair Value Price:</b>	\$9.76	<b>5 Year Growth Estimate:</b>	1.0%	<b>Ex-Dividend Date:</b>	05/30/2022
<b>% Fair Value:</b>	83%	<b>5 Year Valuation Multiple Estimate:</b>	3.7%	<b>Dividend Payment Date:</b>	06/27/2022
<b>Dividend Yield:</b>	11.8%	<b>5 Year Price Target</b>	\$10.26	<b>Years Of Dividend Growth:</b>	1
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	B	<b>Rating:</b>	Buy

## 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 \$112 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 \$1.1 billion and a non-agency RMBS portfolio of \$8.7 million. Agency MBS are created and backed by government agencies or enterprises, while non-agency MBS are not guaranteed by the government.

On May 2<sup>nd</sup>, 2022, Ellington announced a monthly dividend of \$0.08 per share to be paid on June 27<sup>th</sup>, 2022. This \$0.08 monthly dividend is a 20% decrease compared to the \$0.10 paid in the prior month. The company paid a \$0.10 monthly dividend since October 2021, when they began paying monthly dividends.

On May 2<sup>nd</sup>, 2022, Ellington Residential reported its Q1 results for the period ending March 31<sup>st</sup>, 2022. The company booked a \$(1.33) net loss per share for Q1. Core earnings of \$3.9 million this quarter led to core EPS of \$0.30 per share, which covers the dividend paid in the period. EARN achieved a net interest margin of 1.76% in Q1. At quarter end, Ellington had \$29.9 of cash, cash equivalents, and other liquidity, and \$11.3 million of other unencumbered assets. The debt-to-equity ratio was 9.1x. Book value per share declined from the prior quarter to \$10.14, a 14% decrease.

## Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
<b>Core EPS</b>	-	\$2.09	\$3.04	\$2.41	\$1.71	\$1.91	\$1.34	\$0.91	\$1.26	\$1.27	<b>\$1.22</b>	<b>\$1.28</b>
<b>DPS</b>	-	\$1.14	\$2.20	\$2.00	\$1.65	\$1.57	\$1.45	\$1.18	\$1.12	\$1.18	<b>\$0.96</b>	<b>\$0.96</b>
<b>Shares<sup>1</sup></b>	-	6.6	9.1	9.1	9.1	11.6	12.8	12.5	12.4	12.7	<b>13.5</b>	<b>15.0</b>

Ellington has seen its core earnings per share shrink rather than grow for the most part. Since 2016, the compound annual growth rate has been -5.8%. 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 the rate hiking cycle and quantitative tightening, could yield results. Additionally, Ellington will protect their book value and manage volatility through interest rate hedges and liquidity management, which they have ramped up at the start of 2022. 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. And in May 2022, the dividend was cut yet again, by 20%.

<sup>1</sup> 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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	-	7.8	5.6	6.1	7.4	7.4	8.3	12.2	8.3	9.3	6.7	8.0
Avg. Yld.	-	7.0%	12.4%	15.0%	14.5%	11.4%	13.7%	12.2%	11.5%	11.5%	11.8%	9.4%

Ellington's P/E ratio has hovered around 8.0 times core earnings since 2013. The average P/E ratio has grown slightly recently, with the 5-year average P/E of 9.1. Today, EARN is trading at 6.7 times earnings, below its historical valuation. We believe the company earns a fair value of 8.0 times earnings, so we estimate a valuation tailwind to total annual returns. The current 11.8% yield is slightly lower than its historic average of 12.2%.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

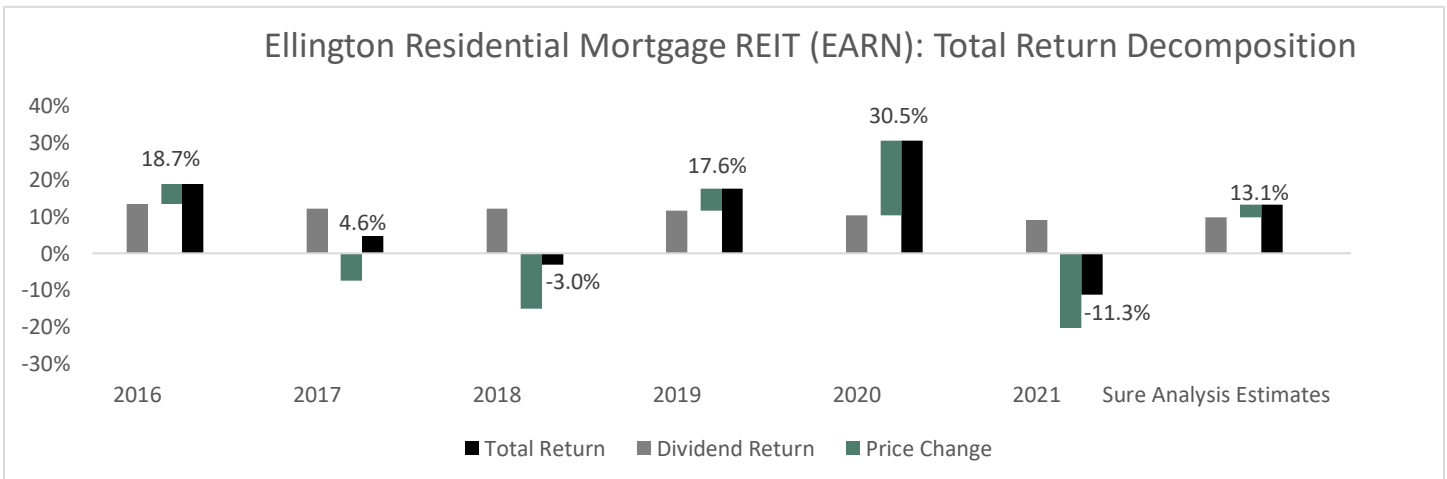
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	-	55%	72%	83%	96%	82%	108%	130%	89%	93%	79%	75%

EARN's dividend is far from trustworthy given the corporation has a trail of cuts in the rearview. In at least three years of the last eight full calendar years in operation, the company's payout ratio was near or above 100%. Currently, the dividend appears to be no longer be under pressure, as they just slashed it again. 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 27-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 13.1% in the intermediate term, driven almost entirely by the stock's 11.8% yield. We also assume a minor 1% annual core earnings growth rate and the potential for a valuation tailwind. Given that total returns are strong, we rate EARN a speculative Buy due to its attractive total return potential alongside an unreliable dividend.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	---	2	22	5	17	16	(6)	28	26	(1)
SG&A Exp.	---	2	3	3	3	4	3	3	3	4
Net Profit	---	(2)	16	0	12	11	(11)	22	20	(6)
Net Margin	---	-79.4%	73.8%	0.6%	70.4%	65.4%	195%	80.8%	77.5%	1132%
Free Cash Flow	---	26	21	25	20	34	29	18	24	28

## Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	32	1,511	1,521	1,557	1,429	1,887	1,676	1,489	1,195	1,598
Cash & Equivalents	18	50	45	40	34	56	19	35	58	69
Accounts Receivable	0	5	5	4	5	6	6	5	4	5
Total Liabilities	1	1,344	1,358	1,412	1,287	1,694	1,522	1,328	1,028	1,444
Accounts Payable	---	24	1	2	3	4	6	4	2	3
Shareholder's Equity	31	167	163	145	142	193	154	161	166	154

## Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	---	---	1.1%	0.0%	0.8%	0.7%	-0.6%	1.4%	1.5%	-0.5%
Return on Equity	---	-1.9%	9.8%	0.0%	8.3%	6.5%	-6.5%	14.1%	12.3%	-3.9%
ROIC	---	---	9.8%	0.0%	8.3%	6.5%	-6.5%	14.1%	12.3%	-3.9%
Shares Out.	---	6.6	9.1	9.1	9.1	11.6	12.8	12.5	12.4	12.7
Revenue/Share	---	0.37	2.40	0.57	1.85	1.42	(0.45)	2.21	2.10	-0.04
FCF/Share	---	3.88	2.33	2.71	2.18	2.97	2.25	1.41	1.97	2.20

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

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