



# Orchid Island Capital, Inc. (ORC)

Updated May 3<sup>rd</sup>, 2022 by Samuel Smith

## Key Metrics

|                             |       |  |       |                                  |                       |
|-----------------------------|-------|--|-------|----------------------------------|-----------------------|
| <b>Current Price:</b>       | \$2.9 | <b>5 Year CAGR Estimate:</b>               | 15.9% | <b>Market Cap:</b>               | \$490 M               |
| <b>Fair Value Price:</b>    | \$3.2 | <b>5 Year Growth Estimate:</b>             | 0.3%  | <b>Ex-Dividend Date:</b>         | 05/28/22 <sup>1</sup> |
| <b>% Fair Value:</b>        | 90%   | <b>5 Year Valuation Multiple Estimate:</b> | 2.1%  | <b>Dividend Payment Date:</b>    | 06/27/22 <sup>2</sup> |
| <b>Dividend Yield:</b>      | 19.3% | <b>5 Year Price Target</b>                 | \$3.3 | <b>Years Of Dividend Growth:</b> | 0                     |
| <b>Dividend Risk Score:</b> | F     | <b>Retirement Suitability Score:</b>       | B     | <b>Rating:</b>                   | Buy                   |

## Overview & Current Events

Orchid Island Capital, Inc. is a Real Estate Investment Trust, or REIT, operating in the mortgage industry. Mortgage REITs differ from most other REITs. For example, traditional REITs typically own a portfolio of physical real estate, which they lease to tenants to collect rental income. Mortgage REITs are purely financial entities, and Orchid Island does not own any physical properties. Instead, it is an externally managed REIT (by Bimini Advisors LLC) that invests in residential mortgage-backed securities (RMBS), either pass-through or structured agency RMBSs, which are financial instruments that collect cash flow based on residential loans such as mortgages, including subprime, and home-equity loans. The \$490 million market capitalization trust is based in Vero Beach, FL.

On April 28th, 2022 Orchid Island Capital reported Q1 results. The company reported a Q1 net loss of \$148.7 million. Net interest income increased to \$39.2 million from \$24.9 million year-over-year. Total expenses stood at \$4.7 million. Moreover, net realized and unrealized losses stood at \$183.2 million on RMBS and derivative instruments, including net interest expense on interest rate swaps.

Meanwhile, Q1 total return stood at (19.5%) while book value per common share stood at \$3.34. The company also reported net portfolio loss of \$144.03 million compared to \$25.88 million net portfolio loss in the year-ago period. Finally, Orchid Island Capital had \$0.155 per common share of total dividends declared and paid in Q1.

## Growth on a Per-Share Basis

| Year                      | 2012 | 2013    | 2014    | 2015    | 2016    | 2017   | 2018   | 2019   | 2020   | 2021   | 2022          | 2027          |
|---------------------------|------|---------|---------|---------|---------|--------|--------|--------|--------|--------|---------------|---------------|
| <b>BPS</b>                | ---  | \$13.40 | \$13.06 | \$11.64 | \$10.10 | \$8.71 | \$6.84 | \$6.27 | \$5.46 | \$4.77 | <b>\$3.45</b> | <b>\$3.50</b> |
| <b>EPS</b>                | ---  | \$2.13  | \$2.46  | \$2.50  | \$2.59  | \$2.27 | \$1.38 | \$0.86 | \$1.20 | \$0.93 | <b>\$0.69</b> | <b>\$0.70</b> |
| <b>DPS</b>                | ---  | \$1.395 | \$2.16  | \$1.92  | \$1.68  | \$1.68 | \$1.07 | \$0.96 | \$0.79 | \$0.78 | <b>\$0.56</b> | <b>\$0.56</b> |
| <b>Shares<sup>3</sup></b> | ---  | 8.6     | 16.7    | 21.8    | 33.0    | 53.1   | 48.7   | 65.1   | 85.1   | 177.0  | <b>177.1</b>  | <b>215.0</b>  |

Orchid Island has experienced extreme earnings volatility over the past several years, with a net loss in 2013 and 2018, along with multiple years in which the trust barely generated a profit. As a result, we are using book value per share as an alternate metric to earnings-per-share. The growth outlook for mortgage REITs is challenged. Mortgage REITs make money by borrowing at short-term rates and lending at longer-term rates, then pocketing the difference. This is referred to as the spread, which is how Orchid Capital generates its cash flow. When the spread between short-term rates and long-term rates compresses, profitability erodes at a rapid pace. This is why mortgage REITs can be dangerous if the yield curve flattens.

In addition, while the dividend yield is sky high, the payout record has been inconsistent. After bumping the dividend to \$0.18 per month in late 2013, Orchid Island paid this dividend rate for 19 months before dropping it to \$0.14 per month in 2015 (paid for 30 months), then down to \$0.11 in 2018 (paid two months), down to \$0.09 (paid 5 months) and then

<sup>1</sup> Estimate

<sup>2</sup> Estimate

<sup>3</sup> In thousands

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dropping it a few more times to \$0.045, but today the dividend payout has slightly recovered to a \$0.56 annualized payout.

## Valuation Analysis

| Year      | 2012 | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  | 2021  | Now          | 2027         |
|-----------|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------------|--------------|
| Avg. P/B  | ---  | 0.93  | 1.01  | 0.98  | 1.02  | 1.17  | 0.93  | 0.91  | 1.02  | 0.94  | <b>0.84</b>  | <b>0.93</b>  |
| Avg. Yld. | ---  | 11.2% | 16.4% | 16.8% | 16.3% | 16.5% | 16.8% | 16.8% | 14.2% | 17.4% | <b>19.3%</b> | <b>17.2%</b> |

Since we are using book value instead of earnings-per-share, we will also use the price-to-book ratio for valuation instead of the price-to-earnings ratio. The stock presently has a price-to-book ratio of 0.84, compared with our fair value estimate of 0.93 which accounts for uncertainties and risks facing the business. In turn, investors could experience a valuation tailwind over the next five years.

Some investors may be enticed by the extremely high dividend yield for the stock, which drives the investment thesis. However, we offer two cautionary notes. First, the dividend has already been cut on four separate occasions since 2015. Second, and just as important, is that despite an exceptionally high starting yield, total returns can be dampened significantly by the erosion in the share price as time goes on. This idea is underscored by the virtually nil total returns since the security's inception, despite carrying a double-digit dividend yield throughout this period.

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

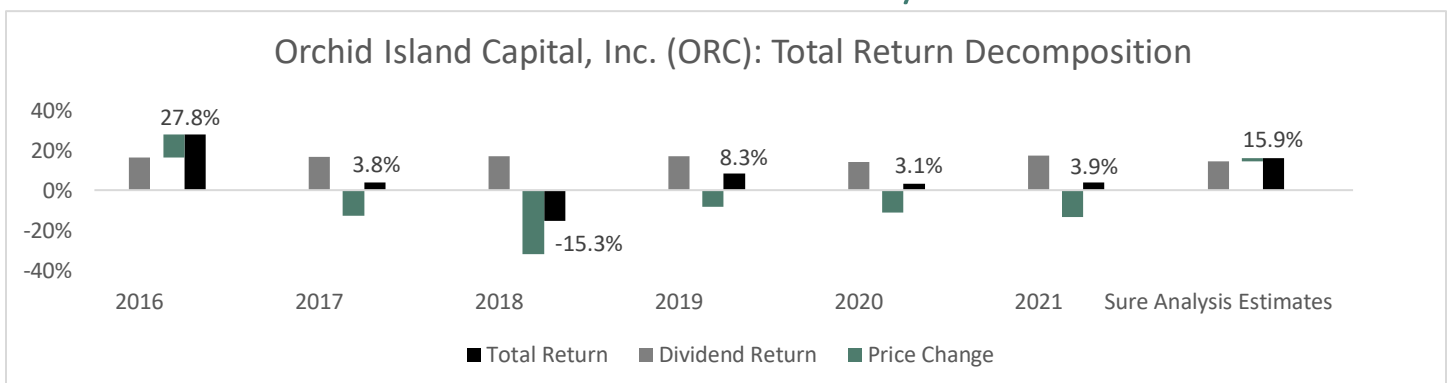
| Year   | 2012 | 2013 | 2014 | 2015   | 2016   | 2017   | 2018 | 2019 | 2020 | 2021 | 2022       | 2027       |
|--------|------|------|------|--------|--------|--------|------|------|------|------|------------|------------|
| Payout | ---  | ---  | 87%  | 3,740% | 2,000% | 3,260% | ---  | ---  | 66%  | 84%  | <b>81%</b> | <b>80%</b> |

Orchid Island is not a safe stock. The above payout ratios are extreme due to low or non-existent earnings. Mortgage REITs are exposed to a number of risks, including interest rate risk, as well as credit risk. These risks pertain to the direction of interest rates, as well as the ability of borrowers to repay the mortgage loans. Moreover, mortgage REITs do not possess many competitive advantages. Since mortgage REITs do not provide differentiated products and services, traditional competitive advantages such as brand power or manufacturing efficiencies do not apply. In addition, Orchid Island is not a recession-resistant trust. A recession generally leads to higher mortgage defaults.

## Final Thoughts & Recommendation

Orchid Island Capital offers an extremely attractive dividend yield and annualized total return potential of 15.9%. That said, it is an extremely risky stock due to its track record of consistently destroying shareholder capital and slashing its dividend repeatedly. That said, given that immense total return potential after the latest dramatic sell-off in the stock price, we rate it a speculative Buy.

## Total Return Breakdown by Year



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## Income Statement Metrics

| Year           | 2012  | 2013   | 2014  | 2015  | 2016  | 2017  | 2018 | 2019  | 2020  | 2021   |
|----------------|-------|--------|-------|-------|-------|-------|------|-------|-------|--------|
| Revenue        | 1     | 1      | 29    | 9     | 11    | 13    | (32) | 35    | 13    | (50)   |
| SG&A Exp.      | 0     | 1      | 4     | 7     | 8     | 9     | 9    | 8     | 8     | 13     |
| Net Profit     | 1     | (1)    | 25    | 1     | 2     | 2     | (44) | 24    | 2     | (65)   |
| Net Margin     | 42.1% | -72.0% | 84.5% | 11.9% | 17.9% | 15.2% | 137% | 70.0% | 16.8% | 130.8% |
| Free Cash Flow | 2     | 10     | 12    | 31    | 47    | 85    | 94   | 48    | 55    | 96     |

## Balance Sheet Metrics

| Year                 | 2012 | 2013 | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  | 2021  |
|----------------------|------|------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total Assets         | 119  | 364  | 1,658 | 2,242 | 3,139 | 4,023 | 3,396 | 3,882 | 4,058 | 7,069 |
| Cash & Equivalents   | 3    | 8    | 93    | 57    | 73    | 214   | 108   | 194   | 220   | 385   |
| Accounts Receivable  | 0    | 2    | 6     | 8     | 12    | 14    | 13    | 12    | 10    | 19    |
| Total Liabilities    | 104  | 319  | 1,440 | 1,989 | 2,806 | 3,561 | 3,060 | 3,487 | 3,643 | 6,301 |
| Accounts Payable     | 0    | 0    | 1     | 1     | 2     | 7     | 6     | 11    | 1     | 1     |
| Long-Term Debt       | -    | -    | -     | 188   | -     | -     | -     | -     | -     | -     |
| Shareholder's Equity | 15   | 45   | 218   | 253   | 333   | 462   | 336   | 396   | 415   | 768   |

## Profitability & Per Share Metrics

| Year             | 2012 | 2013  | 2014  | 2015 | 2016 | 2017 | 2018   | 2019 | 2020 | 2021   |
|------------------|------|-------|-------|------|------|------|--------|------|------|--------|
| Return on Assets | 0.6% | -0.3% | 2.4%  | 0.1% | 0.1% | 0.1% | -1.2%  | 0.7% | 0.1% | -1.2%  |
| Return on Equity | 3.7% | -2.3% | 18.7% | 0.5% | 0.7% | 0.5% | -11.1% | 6.6% | 0.5% | -10.9% |
| ROIC             | 3.7% | -2.3% | 18.7% | 0.3% | 0.5% | 0.5% | -11.1% | 6.6% | 0.5% | -10.9% |
| Shares Out.      | ---  | 8.6   | 16.7  | 21.8 | 33.0 | 53.1 | 48.7   | 65.1 | 85.1 | 177.0  |
| Revenue/Share    | 0.38 | 0.32  | 2.93  | 0.44 | 0.46 | 0.32 | (0.62) | 0.62 | 0.19 | (0.41) |
| FCF/Share        | 0.56 | 3.35  | 1.18  | 1.52 | 1.95 | 2.07 | 1.80   | 0.86 | 0.82 | 0.80   |

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

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