



Ellington Residential Mortgage REIT (EARN)

Updated November 11th, 2022 by Quinn Mohammed

Key Metrics

Current Price:	\$7.13	5 Year CAGR Estimate:	12.1%	Market Cap:	\$90 M
Fair Value Price:	\$7.43	5 Year Growth Estimate:	1.0%	Ex-Dividend Date:	11/29/2022
% Fair Value:	96%	5 Year Valuation Multiple Estimate:	0.8%	Dividend Payment Date:	12/27/2022
Dividend Yield:	13.5%	5 Year Price Target	\$7.80	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Hold

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 \$90 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 \$909 million and a non-agency RMBS portfolio of \$7.7 million. Agency MBS are created and backed by government agencies or enterprises, while non-agency MBS are not guaranteed by the government.

On August 4th, 2022, Ellington reduced its dividend to \$0.08 monthly, a 20% decrease compared to the \$0.10 paid monthly from October 2021 to May 2022.

On November 9th, 2022, Ellington Residential reported its Q3 results for the period ending September 30th, 2022. The company booked a \$(1.04) net loss per share for Q3. The company renamed what was previously called core earnings to adjusted distributable earnings starting in the last quarter. Ellington achieved adjusted distributable earnings of \$3.0 million in the quarter, leading to adjusted EPS of \$0.23 per share, which does not cover the dividend paid in the period. EARN achieved a net interest margin of 1.28% in Q3. At quarter end, Ellington had \$25.4 million of cash and cash equivalents, and \$2.6 million of other unencumbered assets. The debt-to-equity ratio was 9.1x. Book value per share declined from the prior quarter to \$7.78, a 14% decrease.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Adj. EPS	-	\$2.09	\$3.04	\$2.41	\$1.71	\$1.91	\$1.34	\$0.91	\$1.26	\$1.27	\$0.99	\$1.04
DPS	-	\$1.14	\$2.20	\$2.00	\$1.65	\$1.57	\$1.45	\$1.18	\$1.12	\$1.18	\$0.96	\$0.96
Shares¹	-	6.6	9.1	9.1	9.1	11.6	12.8	12.5	12.4	12.7	13.1	15.0

Ellington has seen its adjusted distributable earnings (referred to as core earnings prior to Q2 2022) 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

¹ Share count is in millions.

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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%.

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	7.2	8.0
Avg. Yld.	-	7.0%	12.4%	15.0%	14.5%	11.4%	13.7%	12.2%	11.5%	11.5%	13.5%	11.5%

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 trades at 7.2 times earnings, below its historical valuation. We believe the company earns a fair value of 7.5 times earnings; thus, we estimate a small valuation tailwind to total annual returns. The current 13.5% yield is in excess of its historic average of 12.2%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

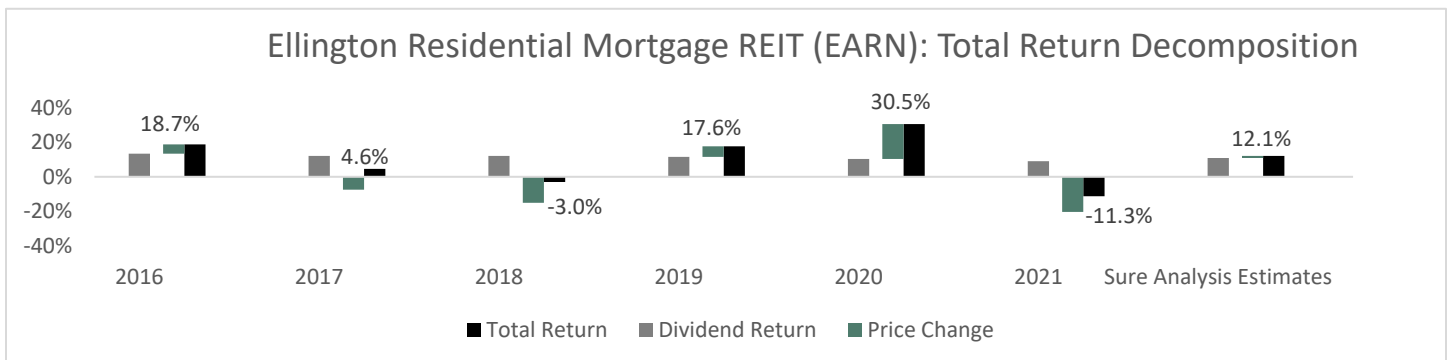
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	-	55%	72%	83%	96%	82%	108%	130%	89%	93%	97%	92%

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 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 and then again in 2022. 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 12.1% in the intermediate term, driven almost entirely by the stock's 13.5% yield. We also assume a minor 1% annual adjusted distributable earnings growth rate and a potential for a small valuation tailwind. Still, Ellington Residential receives a hold rating due to its abysmal dividend history and the fact its dividend is still not on solid footing, leaving it open to even further potential dividend cuts.

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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